

RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES
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Major developments and trends

June proved to be a month, when there were presented numerous liberal initiatives. At the International Economic Forum, I. Shuvalov, First Vice Prime Minister, advocated a limitation of excessive state interference in the economy and protection of private property, whereas A. Kudrin, the RF Finance Minister, supported a reduction of budget expenditures and made a statement against the transfer of substantial assets to the state owned corporation "Rostekhnologii," whereas P. Krasheninnikov, the head of the Duma Committee on legislation presented the initiative to reduce the terms of deprivation of freedom via an increased offset of the time spent in confinement in pre-trial detention centers, and M. Shaimiyev, the President of the Tatarstan, provoked a heated discussion within the ruling party by proposing to restore the elections of Governors. Igor Yurgens, the head of the Institute of Contemporary Development, made a statement warning President D. Medvedev that "... in the case D. Medvedev fails to create his coalition in this struggle, he will loose similarly to some past reformists in the course of Russian history." However, until the liberal demands of even a part of the ruling elite are not supported by the new head of the state, what begins to increase the doubts about his intentions.

In the 1st quarter of 2008, the amount of GDP increased by 8.5 per cent. The growth in the industrial output observed in January through May of 2008 was at the level of 6.7 per cent, whereas the manufacturing industries increased by 110.3 per cent. The growth in investments in fixed assets made 18.9 per cent. The rates of increase in the amount of retail trade accelerated and were registered at the level of 115.6 per cent as they were supported by the high dynamics of the real household incomes (113.9 per cent). In the structure of financing of investments in fixed assets there was registered a significant growth in the share of credits provided by Russian banks (an increase by 1.2 p. p.), whereas the share of financial resources of the RF subjects declined by 2.0 p. p.

In the situation of extremely high oil prices, in Russia, for the first time in the recent years, there is observed a decline in the extraction of oil. In January through May of 2008, the annual rate of decrease in the production of oil made 0.5 per cent. For the purposes of stabilization of and growth in the extraction of oil, the RF Government has developed a package of measures aimed at the reduction of the tax burden on the oil sector, including the introduction of tax related incentives for more intensive exploitation of the developed oil fields and the development of new oil reserves.

As at the end of May, the CPI value in the RF again made 1.4 per cent (this value was at 0.6 per cent in the respective period of the preceding year). Therefore, the increase in the consumer prices made 7.7 per cent over the period from January till June and exceeded the value of this indicator registered last year by 3 p. p. At the background of a rapid inflow of foreign exchange in the country the real effective Ruble exchange rate grew by 0.4 per cent, whereas the amount of gold and foreign exchange reserves of the RF Central Bank increased by 2.4 per cent. In order to slow down the rates of growth in money supply and inflation rates, the Bank of Russia has increased by 0.25 percentage points the interest rates on credits and deposits of the RF Central Bank. Since June 10 of 2008, there has been applied the new refinancing rate, which makes 10.75 per cent.

RF President D. A. Medvedev stated in his Budget Statement that it was necessary to reduce the rate of growth in public expenditures, as well as the tax burden on the economy and to work out new parameters of development of the pension system in the Russian Federation. The RF Government has approved the main parameters of the federal budget for years 2009 through 2011. At this point of time, the plans envisage a reduction of the tax burden, but not a reduction of the level of expenditures. The current level of budget expenditures has declined after the completion of the political cycle and is at the moment at the level close to the values of the respective indicators observed over the last three years.

In June, in general on the Russian financial markets there was observed not very favorable market situation as a result of the flow of investors from financial to commodity markets caused by the constant growth in oil prices observed throughout the month (in the second half of the month, there was reached a new record of oil prices, which made more than US \$ 141 per barrel). This fact, as well as the deterioration of the values of financial indicators of a number of international financial companies observed in the 1st quarter of 2008, influenced the Russian market leading to a decline in the values of its major stock indices by 3 per cent to 5 per cent in comparison with the figures registered during the past month. The activity of investors on the Russian stock market dropped by more than 20 per cent.

In April of 2008, the monthly amount of the Russian external trade turnover reached its maximum value registered in the last 17 years. This development was caused by a significant growth in both export and im-

port transactions. The export balance of trade also demonstrated high rates of increase; however, the number of countries with respect to which Russia had an adverse balance of trade was growing. In Geneva, there was discussed the new version of the draft report of the working group on the Russia's accession to the WTO. The next round of negotiations was planned to be held in July.

In the 1st quarter of 2008, the amount of foreign investments flowing in the non-financial sector of the Russian economy was by 29.9 per cent below the figures registered in the respective period of the past year. The most significant decline was observed in the segment of foreign direct investments (a 42.8 per cent decrease). At the same time, as at the end of March of 2008 the amount of accumulated foreign investments made in the economy of Russia made US \$ 221.0 billion (a 45.9 per cent growth over the year).

In June of 2008, at the meetings held by the Presidium of the RF Government there were discussed the principle guidelines of the tax policy to be pursued in 2009 and in the period of years 2010 and 2011, as well as the draft laws aimed at the implementation of these guidelines; amendments made to the laws on the federal budget for years 2008 through 2010 and extra-budgetary funds; the results of the execution of the federal budget in the 1st quarter of 2008 and some other documents. By its Resolution, the RF Government approved the new methods of distribution of the federal subsidies for regional budgets, whereas the RF Finance Ministry adopted the procedure governing the planning of budget assignments from the federal budget for year 2009 and the period of years 2010 and 2011. Since January 1, 2009, the minimum wage (MROT) should amount to Rub. 4330 a month.

The Central Bank of Russia approved a new procedure governing the assessment of the economic standing of banks.

The political and economic situation in June of 2008

S. Zhavoronkov

June proved to be a month, when there were presented numerous liberal initiatives. At the International Economic Forum, I. Shuvalov, First Vice Prime Minister, advocated a limitation of excessive state interference in the economy and protection of private property, whereas A. Kudrin, the RF Finance Minister, supported a reduction of budget expenditures and made a statement against the transfer of substantial assets to the state owned corporation "Rostekhnologii," whereas P. Krashennnikov, the head of the Duma Committee on legislation presented the initiative to reduce the terms of deprivation of freedom via an increased offset of the time spent in confinement in pre-trial detention centers (in the case such an amendment is approved, M. Khodorkovsky could be released already in 2009), and M. Shaimiyev, the President of the Tatarstan, provoked a heated discussion within the ruling party by proposing to restore the elections of Governors. At the same time, it should be noted that nothing is known about the reaction of Dmitry Medvedev with respect to any of these statements. Until the liberal demands of even a part of the ruling elite are not supported by the new head of the state, what begins to increase the doubts about his intentions.

In contradistinction to May, when there were made numerous appointments, June has become a month of predominantly ideological discussions.

At the International Economic Forum held in St. Petersburg, many awaited program statements on the part of the leaders of the country. These expectations came true; however, a certain brief outline of the economic program was presented by I. Shuvalov, First Vice Prime Minister, rather than D. Medvedev. "Today, an important aspect is the limitation of the excessive interference of the state in the economy. ...In the recent years many a one has again begin to believe that the state is able to remove all market failures forgetting about its ability to generate its own failures... The state reacts to crises much more slowly than an economic object under the influence of market signals," Mr. Shuvalov said. However, the solution offered by him, which envisaged a rotation of management "in all the companies, which are in the 100 per cent ownership of the state" and replacement of "bureaucrats with professionals"¹ in such companies, looked rather strange. Besides, I. Shuvalov announced that protection of ownership rights is the priority of the Russian state and in the course of the further discussion concretized that he meant private property. In his statement, Mr. Shu-

¹ First, the wording chosen by I. Shuvalov sharply shrinks the area, where his idea could be implemented, leaving out, for instance, Gazprom and Rosneft. Second, the hypothetical removal of officials from the management bodies of state owned companies (for instance, their Boards of Directors) in no way affects the motivation of the management of such companies.

valov also mentioned the “catch up psychology,” “energy trap” and even the unhealthy way of life of Russian citizens.

A few days after that V. Putin in a rather hard wording charged I. Shuvalov with the settlement of the problem of a growth in the price of milk, what made some experts to arrive to the conclusion about a certain discussion underway within the RF Government. It is hardly the case. The statement made by I. Shuvalov repeats numerous speeches of V. Putin and the documents issued by the RF Government, which stated the necessity to reduce the excessive state interference in the economy. However, the problem is that over the recent years the economic statements made by the authorities have almost stopped to reflect both the real policy pursued by these authorities and the real discussion taking place within the public administration. The fact that the Russian authorities do not openly mention nationalization does not put the end to the continuing capture of private businesses on the part of the state. Besides, if one wishes, it is possible to make some other selection of citations of the same leaders (including I. Shuvalov himself, who just recently has discussed the necessity to organize “show trials” with respect to businesspersons).

During the Forum, D. Medvedev said little about the Russian economy and focused a significant part of his speech on the criticism of the American economy. “No matter how large the American market is and no matter how reliable its financial system is, it cannot serve as a substitute for global commodity and financial markets... This has shown how illusory it is to suppose that a single country, even if it is the most powerful, can assume the role of global government... There is a kind of institutional vacuum at the level of international governmental agencies responsible for solving the specific problems that are today the most acute.” Among the concrete problems the RF President indicated the financial crisis, rising prices for natural resources and food, as well as a number of global catastrophes. President D. Medvedev stated that Russia “recognizes its responsibility for the destiny of the world and we want to participate in shaping the new rules of the game...”, adding that “Russia today is a global player.” Having presented an important issue (indeed, for many years already there have been voiced doubts in the efficiency of the existing in the world supranational financial, political and military institutions), D. Medvedev offered no new ideas permitting to solve the current collisions, either institutional, or even topical (with the exception of briefly speaking on the problem of the fuel and energy complex, where the RF President promised to pursue the policy of liberalization of the market of natural gas and of reduction of the tax burden on the oil sector in to counter the “wrong” production of the bio fuels).

In June of 2008, D. Medvedev signed his first Budget Statement. In their comments presented even prior to the publication of the statement A. Dvorkovich, Aide of the President, and A. Kudrin, the RF Finance Minister, who made a more clear statement, noted that the return to the prior inflation parameters meant the necessity to curb the rates of growth in budgetary expenditures until they approximately correspond to the rates of increase in GDP and that it was necessary to abandon the practice of constant introduction of changes in the budget aimed at the increase in the budgetary expenditures (including those of not social nature), that in general it was necessary to introduce tighter financial discipline in the situation of changing world market situation. However, in the text of the Statement it was said nothing about any limitation of budgetary expenditures, on the contrary, there were mentioned the past achievements concerning the increase of such expenditures and stated that they should be raised in the future. The “restrictive” items of the Statement appear to be rather indirect hints (for instance, mentions of the stability of financial policy). It is not surprising, since in June the Presidium of the RF Government increased the expenditures borne by the budget by more than Rub. 285 billion as it was proposed by V. Putin. Therefore, it is impossible to note any clear course also in the sphere of budgetary policy.

As yet, the promise given by D. Medvedev to present the measures aimed at the fight against corruption and implementation of the reform of the judicial system within a month has remained unfulfilled. The discussion on the radical changes (for instance, real irrevocability of judges or analysis of regulatory acts with respect to their propensity for corruption) are turning into the discussions on the tightening of control of the incomes of officials and their relatives, which will remain inefficient until the oversight agencies are free of corruption themselves. At this background there was resumed the discussion on the “thaw.” The tone of this discussion was set by I. Yurgens, the head of the Institute of Contemporary Development, the first Vice President of the investment bank “Renaissance Capital.” Dmitry Medvedev is the head of the Board of Trustees of the Institute of Contemporary Development established this March. The management of the Institute has announced that it is a think tank close to the present leadership of the country.

In an interview I. Yurgens has given to the Reuters agency, he noted that D. Medvedev was immersed in a fight against hostile Kremlin groupings and for an opportunity to fulfill his program statements concerning the introduction of the rule of law, implementation of measures against corruption and expansion of political liberties. Moreover, from the point of view of I. Yurgens, “...in the case Medvedev fails to create his coali-

tion in this struggle, he will loose similarly to some past reformists in the course of Russian history.” According to I. Yurgens, D. Medvedev’s opponents are the people “who will always attempt to control assets, promote their own people and hold top posts in the economy, since they do not trust the market, do not trust liberals and do not trust the West.” At the same time, I. Yurgens is sure that without V. Putin “...Medvedev just can not take any resolute step, can not create a coalition.”

It is apparently a contradiction – as it turns out V. Putin should give permission to create a coalition, which is openly aimed against himself and his group, against their absolute power and unrestricted management of assets. It should be noted that a significant part of the arguments presented by the head of the Institute of Contemporary Development are justified, the very fact that he made his comments public appears to be rather strange. In the case D. Medvedev is ready or will be soon ready to create a coalition with the supporters of the right wing course, it looks strange that this readiness is made public by I. Yurgens, since the Russian tradition is that a signal should be given by a top official, otherwise there is a risk that it may be seen just as a wish of the commentator. If it is a warning for D. Medvedev, its public nature looks no less strange. It seems that the management of the Institute of Contemporary Development has in a general form expressed its doubts in the feasibility of the objectives, which as the minimum it sets for itself and as the maximum are set for himself by D. Medvedev. These objectives can not fail to spark a conflict with the bureaucratic feudal lords and V. Putin, who is the chief architect of the present Russian realities. It is highly probable that for D. Medvedev his main task will be not the “contemporary development” but the execution of the instructions given to him by V. Putin. At least, it may be noted that the two first months of his nominal leadership in the country have not been marked by any actions, which observers could characterize as pro-liberal and pro-right measures. All liberal initiatives are presented by various persons, including some functionaries of the ruling regime, but not by D. Medvedev himself.

This month, there were advanced two important initiatives of this kind. The head of the RF State Duma Committee on civil, criminal and procedural legislation P. Krasheninnikov submitted for the discussion in the Russian Parliament the amendments to the RF Criminal Code. In the case these amendments are approved, not only several tens of thousands of convicts, but also M. Khodorkovsky, the former owner of the YUKOS and a number of his colleagues may be released already in 2009. The new version of article 72 of the RF Criminal Code should count one day spent in confinement in pre-trial detention centers for 1.5 days in the case the citizen was sentenced to a term in a standard regime penal colony or a juvenile correctional facility and for 2 days in case the citizen was sentenced to a term in a prison settlement; it should be noted that these amendments should have retroactive effect and extend to those, who had been convicted earlier. It should be reminded that P. Krasheninnikov has been the head of the community liaison office of D. Medvedev at the time he was a Presidential nominee. The story of discussion of this amendment is rather interesting taking into account the fact that after D. Medvedev assumed the office of the RF President the topic of release of M. Khodorkovsky (via a grant of pardon being within the competence of the RF President, amnesty, or other amendments to the legislation currently in force) has been often discussed on the international arena, so often that even V. Putin had to comment on this issue. From our point of view, it is most probable that the discussion of this problem will be delayed for an indefinite time.

President of Tatarstan M. Shaimiyev made a statement calling for return to the practice of popular elections of the heads of regions. It should be noted that M. Shaimiyev himself has no “liberal” background. He has been the President of Tatarstan since 1991, and it should be reminded that the elections held in this republic have always given rise to doubts as concerns the ballot box stuffing. In 2005, after the elections of the heads of regions were abolished, M. Shaimiyev put the question of confidence to V. Putin and could retain his office. President Shaimiyev stated that “we will return” to the elections of the heads of regions. Besides, he said that he believed that the provision of the law in accordance with which the RF President had the right to dissolve local legislatures in the case they fail to approve the candidate head of the region nominated by the RF President within the certain term was improper. This statement made by M. Shaimiyev was unexpected by the ruling political party “United Russia” and at first it even was commented in a neutral or well disposed tone (for instance, by V. Pligin, the head of the RF State Duma Committee on the Constitutional legislation and state building); however, later this statement was denounced by B. Gryzlov, the head of the RF Parliament and the political party “United Russia.”

It is of course apparent that the term of M. Shaimiyev in office comes to an end; it is probable that he is not sure that this term will be prolonged or that a “right” successor will be approved, whereas the elections, especially in their current form, provide him a real chance to retain his post. However, on the other hand, the statement made by M. Shaimiyev may be viewed as a certain demand for creation in Russia of some additional elements of a law governed state, where the fate of its regional leaders depends not only on the will of V. Putin or D. Medvedev.

In June the conflict concerning the expansion of the authorized capital of the state owned corporation “Rostekhnologii” headed by S. Chemezov, one of the most close friends of V. Putin, came into the public sphere. Alexey Kudrin, a Vice Prime Minister and the Minister of Finance accused the “Rostekhnologii” company of an attempt to carry out “concealed privatization” of the federal assets transferred to this corporation and demanded to exclude from the list of transferred assets enterprises belonging to civil industries, shares of the RF in foreign joint ventures, as well as the large defense industry holding OAO OPK “Oboronprom.” The approval of this issue has been delayed (there is necessary to obtain a draft Presidential Decree approved by the RF Prime Minister), and now it seems that minority blocks of shares owned by the state will not be transferred to the corporation Rostekhnologii, although most probably it will retain “Oboronprom.”

In June it was announced that Gazprom and the Siberian energy company SUEK made an official statement that they abandoned the plans of creation of a joint venture accumulating energy related assets of these two companies. Initially, it was planned that Gazprom would receive the controlling block of shares in the new company; however, the parties failed to agree about the price. From the standpoint of cessation of the expansion of state owned companies this development seems to be a favorable news for the economy.

There continued a deep rooted conflict as A. Khinshtein, a RF State Duma deputy close to B. Gryzlov, proposed to return the right to initiate criminal cases and carry out investigations with respect to judges, prosecutors, investigators and lawyers to the RF Prosecutor General Office, whereas D. Dovgy, a former chief investigator of the Investigative Committee at the RF Prosecutor General Office, who fell out with the head of the RF Investigative Committee A. Bastrykin, stated that he had initiated the two most high profile corruption related cases of the recent time – against S. Storchak, a Deputy Minister of Finance and A. Bulbov, a general of the RF State Committee for control of the circulation of narcotics and psychotropic substances – without proper justification carrying out an order by A. Bastrykin. Taking into account the loyalty of Yu. Chaika to D. Medvedev, the fate of the RF Investigative Committee created specifically for the undermining of the position of the RF Prosecutor General Office and removal of the respective function from the terms of reference of this institution, these developments are also important for an assessment of the balance of power within the top echelon of the Russia’s leaders.

The RF Prosecutor General Office appealed the sentence of acquittal passed by the Moscow Regional Court with respect to the case concerning the assassination attempt against A. Chubais, the head of the RAO UES company. According to the verdict passed by the jury, three persons on trial – V. Kvachkov, A. Naidenov and R. Yashin – were acquitted of this crime and fully rehabilitated. From the very start, this case seemed to be dubious as it was built on the testimony given by one of the friends of the persons on trial, who later withdrew it and stated that he was forced to testify. No any material evidence or other witnesses were registered in this case. It should be noted that A. Chubais himself refused to appeal the sentence of acquittal saying that it was “better to acquit a guilty person than to condemn an innocent.”

In June Yu. Baluyevsky², the First Deputy Defense Minister, the Chief of the RF General Staff, resigned his office; the probability of this resignation had been discussed for a long time. This office was taken by N. Makarov, a Deputy Defense Minister, an appointee of A. Serdyukov, the RF Defense Minister. The conflict between Yu. Baluyevsky and A. Serdyukov was mostly of personal nature; however, it was aggravated by property disputes. Anyway, the resignation of a person, who liked to discuss the strategy and tactics of a nuclear war against the USA from the post of the RF Chief of Staff seems to be a positive development.

A change of the leader was observed in the Yabloko, one of the oldest political parties of Russia. At the report and election congress of the party held in June, G. Yavlinsky, who had been at the head of the party for the last 15 years, unexpectedly resigned. Nevertheless, it should be noted that before the congress the party had experienced a six months long period of internal struggle. After the second in a row utter defeat of the party at the parliamentary elections in December of 2007, a number of party activists headed by the leader of the Yabloko St. Petersburg organization M. Reznik made a slashing criticism of G. Yavlinsky and demanded a serious reform of the party: renewal of the party leadership via the introduction of the posts of co-chairpersons; abandonment of the isolationist strategy and criticism of other democratic organizations; a clear statement of the party position as an organization belonging to the opposition. In order to counter these attacks, G. Yavlinsky held a meeting with V. Putin and started to hint about his possible appointment as a member of the RF Government; however, he failed to obtain such an appointment. Moreover, the long, sometimes continuing for many months in a row, absence of G. Yavlinsky in the public sphere, which had become traditional in the recent years, did not bring any additional advantages either to him, or the party. As a result, within the Yabloko there was carried out the “succession operation” – yet on the first day of the

² As a consolation, Yu. Baluyevsky was appointed as a Deputy Secretary of the RF Security Council.

Congress S. Mitrokhin, the leader of the Moscow Yabloko organization, a deputy of the Moscow City Duma, was nominated as the official candidate for the post of the party leader. In the end, he was elected to this office obtaining 60 per cent of the total vote as he ran against M. Reznik and entrepreneur V. Popov, the head of the Karelia party organization. However, G. Yavlinsky was appointed as a rank and file member of the political committee of the Yabloko.

The new leader of the party Yabloko personifies the eclectic nature of this structure; for instance, taking part in various protest actions against the policy pursued by the Moscow authorities he voted for the retaining of Yu. Luzhkov as the Mayor of Moscow and being elected to the capital city legislature in the framework of an election bloc with SPS he makes a slashing criticism of this party, etc. However, the appearance of a new person in the office of the Yabloko Chairman is, although an insufficient, but necessary minimum condition for the political survival of this structure.

Real Economy Sector: Trends and Factors

O. Izryadnova

The volume of the GDP over the 1st quarter 2008 was RUR 8838.1 bln in current prices and had increased by 8.5% as compared with the 1st quarter 2007. Over January-May 2008 the increase in production in the industry was at the level of 6.7%, processing industry growing by 110.3%. Increase in investments in fixed assets reached 18.9% and secured the increase in workload in construction by 25.4%.

As compared with January-May 2007 retail trade turnover growth rates accelerated up to 115.6%. Sales growth was sustained by the high dynamics of real population's incomes and real wages – 109.4% and 113.9% as compared with January-May 2007, correspondingly.

Inflation index over January-May was equal to 107.7% and exceeded the figure of the previous year by 3 p.p.

Federal State Statistics Service made the first estimation of the GDP of the current year. It was the intensive growth of construction, processing industries, wholesale and retail trade and financial services that had positive effect on the dynamics of the GDP produced. The share of construction in the GDP produced in the 1st quarter 2008 increased up to 5.1% compared with 4.7% in the corresponding period of the previous year, the share of processing industries growing by 1.2 p.p. and being equal to 10.6%, while the proportion of processing industries remained practically unchanged at the level of 18.5%.

Table 1

Growth Rates of Volumes of GDP Produced by Quarters 2006-2008, as percentage to the corresponding period of the previous year

	2006				2007				2008
	I	II	III	IV	I	II	III	IV	I
Gross domestic product	106.3	107.4	107.5	108.0	107.4	108.1	107.3	109.5	108.5
Agriculture, hunting and forestry	101.8	101.5	102.6	108.4	102.4	102.8	102.6	104.6	103.2
Minerals extraction	100.1	103.9	103.7	98.4	102.4	97.4	98.7	103.0	101.5
Processing industries	102.0	104.5	101.7	103.3	108.5	107.4	106.8	107.2	107.6
Electricity, gas and water production and distribution	106.3	105.9	104.7	102.2	90.1	99.6	101.4	103.4	105.3
Construction	98.3	108.6	112.7	120.8	128.1	119.6	111.4	113.0	128.3
Wholesale and retail trade, motor-vehicles and motorcycles servicing, household appliances and items of private use repair	115.5	113.3	115.2	114.3	111.1	113.2	113.2	114.0	111.9
Transportation and communication	107.8	110.1	111.1	109.2	108.7	108.4	107.1	106.6	109.8
Net production taxes	108.6	108.4	108.8	108.0	106.7	110.3	107.8	113.0	110.5

Source: Federal State Statistics Service

Macroeconomic situation at the beginning of 2008 was formed under the influence of dynamic expansion of the internal market due to aggregated effect of domestic business activity factors and growth of population's pecuniary incomes. Increase in industrial production over January-May 2008 was equal to 6.7%, workload in construction – to 19.6%, retail trade turnover – to 15.6%. High investment activity is maintained in 2008. Increase in investments in fixed assets reached 18.9% in January-May. In the environment of investment demand acceleration it is the positions of machine-building and construction materials production that look quite auspicious in near-term prospect. As compared with January-May 2007 machinery and equipment production increased by 24.8%, and construction materials production – by 9.9%.

The dynamics of the external demand was significantly influenced by the existing situation at the world markets for fuel and raw materials resources, on the one hand, and increased demand at the internal market for hydrocarbons and material and technical resources, on the other. Against the background of high world prices and growth of supplies volumes to the external market, the total volume of Russian export in terms of value increased by 51.8% in January-April 2008 against 8.3% over the corresponding period of the previous year.

When analyzing internal demand dynamics and structure the strengthening of trend for import is observed. High import elasticity towards internal demand demonstrates that while economy earnings and population's incomes increasing and competitive ability of domestically produced goods decreasing, the shift of consumers' preferences towards import goods is becoming more and more visible. Over January-April 2008 import growth was equal to 42.8%, exceeding by 2.0 p.p. the level of the corresponding period of the previous year. The share of import supplies in the volume of trading resources of the retail trade was equal to 46%, including 37% for foodstuffs and 56% - for non-food goods.

The increase in import pressure on the internal market was restricted by the trend for accelerating growth of processing industries. Though the ratio between growth rates of different kinds of economic activity suffered quite radical changes, on the whole it illustrates gradual shift from the growth based on traditional factors of raw materials exploitation, oriented mainly to the external market, to the formation of the resources for internal development.

In January-May 2008 the growth of processing industries was 110.2%, of extraction industries – 100.5% against the background of electricity, gas and water production and distribution increase by 4.1%.

Increase in machinery and equipment production in January-May 2008 was equal to 124.3%. It was reached mainly due to the increase in mechanical equipment production by 166.1%, hydraulic turbines production growing by 2.2 times and steam turbines – by 3.3 times.

Construction scales expanding, demand for construction equipment also went up, supported by target allotment of budget funds to roads and objects of utilities construction and repair works. As compared with January-May 2007, tower crane construction increased by 36.7%, caterpillar tractors – by 110.0%, excavators – by 41.25, bulldozers – by 22.8%, lifts – by 30.2%, motor graders – by 29.1%. Starting with 2006 the output of machine-building industries productions has been increasing to fulfill priority national project “Agriculture production complex development”: in January-May 2008 machinery and equipment production for agriculture and forestry increased by 19.8% against 4.7% in the corresponding period of the previous year.

Increase in machine-tools production by 8.9% in January-May 2008 was in many respects due to demand expansion from timber-processing production.

Electric, electronic and optic equipment production reduced by 7% in January-May 2008, compared with the growth by 15% in the corresponding period of the previous year. It should be noted that drop in production is observed for nearly all kinds of activity.

Electric machines and equipment production reduced by 11.0% as compared with January-May 2007, equipment for radio, television and communication production – by 12.4% and production of medicinal equipment, measuring instruments, optic instruments and equipment, watches – by 2.8%.

In January-May 2008 transport vehicles and equipment production was 117.3% as compared with January-May 2007. It was motor vehicles, trailers and semi-trailer production that increased by anticipating growth rates (119.8%), passenger cars growing by 118.8%, transport for municipal services – by 114.4%. Growth in production is in many respects due to intensive development of passenger cars assemblage plants, increase in orders for machine-building production within the framework of national projects realization as well as increase in export supplies of some kinds of machine-building equipment. Vessels, air- and space-crafts as well as other transport vehicles production went up by 15.9% as compared with January-May 2007.

Increase in transport machine-building industry production is mainly accounted for by the growth of demand from joint-stock company Russian Railways and independent carriers for rolling-stock for the network of railways as a result of increase in capacity of internal market for passenger and freight transportation, as well as for expansion of purchase to update equipment because of critical deterioration of the domestic fleet of railway machinery. In January-May 2008 increase in mainline electric locomotives production was 169.1%, in diesel locomotive shunters and industrial diesel locomotives for broad gauge – by 120.5%, for freight cars – by 116.7%.

The dynamics of intermediate demand goods production also remained in the field of positive values. Nature of metallurgy, chemistry, wood-processing industry was defined by the level of internal and external demand. Metallurgy production and finished metal goods production was 110.9% in January-May 2008 as compared with the corresponding period of 2007, metallurgy production being 101.6% and finished metal goods production – 148.8%.

In January-May 2008 increase in chemistry production was 103.8 against 109.3% in the corresponding period of the previous year, and of rubber and plastic goods production – to 134.2% against 123.8%.

Internal market's capacity for chemistry production being high, the main factors, restricting functioning of chemistry industry complex are high wear and tear extent of equipment and outdated technologies; anticipating growth rates of prices and tariffs for natural monopolies production; problems with provision with raw materials, especially hydrocarbons, and scantiness of investment resources.

Macroeconomic situation at the beginning of 2008 is defined by sustention of high inflation background. Consumer inflation index since the beginning of the year was 107.7%, growth of prices for foodstuffs being 10.2% and for non-food goods – 3.7%. Change in structure of prices of industrial goods was defined by anticipating growth of prices of processing industry (112.2% in May 2008 on December 2007) and electricity, gas and water production and distribution (117.6%) as compared to the dynamics of prices in fossil fuels extraction (107.1%). This year the highest growth of prices in processing industries in activities with high level of power- and electricity consumption, for instance it is in metallurgy (by 22.1%) and in chemistry industry (22.3%), where prices grew the highest.

In May growth of prices for crude oil and casing-head gas by 7.7%, for coal, brown coal and peat – by 2.6% gave additional incentives for growth in process for oil processing products, which will undoubtedly influence the prices dynamics in short-term prospect, taking into account traditionally high increase in demand in the middle of the year.

Investments in Real Economy Sector

O. Izryadnova

The trend for anticipating growth of investments in fixed assets as compared with the dynamics of goods and services production sustains in the economy. The increase in the investments over January-May 2007 was equal to 18.9%.

At the beginning of 2008 considerable changes occurred in the structure of investments by sources of financing. The structure of borrowed funds was defined by the increase of Russian banks share in investment process crediting up to 10.4% against 9.2% in 1st quarter 2007. After considerable changes were made to the procedure for budget investments execution in the objects of capital construction, the share of funds of subjects of the Russian Federation in the total volume of investment financing lowered by 2.0 p.p.

The trend for anticipating growth of investments in fixed assets as compared with the GDP dynamics has been observed since 1999. In 1st quarter 2008 the increase in investments in fixed assets was equal to 20.2% and in GDP – to 8.5%. As a result of 1st quarter 2008 the share of investments in fixed assets was at the level of 14.7% of the GDP against 13.6% of the GDP in the corresponding period of 2007 and 11.2% in 2006. Over January-May 2008 the volume of investments in fixed assets was RUR 2483.1 bln and by 18.9% exceeded the level of the corresponding period of the previous year.

Steady positive dynamics of production changed the situation in the investment sector. Expansion of investment demand is proceeding against the background of favorable changes in price situation at the world market of hydrocarbons and raw mineral materials on the one hand and of active investments strategy of Russian business at the internal market on the other. Aggregated effect of internal factors regulating the level of business activity accounted for intensive growth of investments in fixed assets as well as special structure characteristics of fixed assets renewal.

Financial indices of enterprises and organization improving, the change in the structure of investments in fixed assets by sources of financing was due to the continuous action of the trend for increase in the share of borrowed funds in 1st quarter 2008. At the beginning of 2008 the positive moment was sustention of the trend for expansion of banking sector participation in investment process crediting. The share of Russian banks in the structure of investments in fixed assets financing was equal to 8.8% and credits of foreign banks – to 1.6%. The share of foreign investments in the total volume of investments in fixed assets in the Russian economy was 5.3%, exceeding the level of the previous year.

**Structure of Investments in Fixed Assets by Sources of Financing,
in 1st quarters of 2006-2008, as percentage to the total**

	2006	2007	2008
Investments in fixed assets	100.0	100.0	100
of which			
1. <i>Own funds</i>	48.9	46.7	46.2
including			
Profit	21.4	20.2	20.5
2. <i>Borrowed funds</i>	51.1	53.3	53.8
including			
Budget funds	12.3	13.4	11.8
Of which from:			
Federal budget	2.6	2.3	2.8
Budgets of subjects of the Russian Federation	8.9	10.3	8.3
Bank credits	9.3	9.2	10.4
Of which foreign banks credits	2.7	0.7	1.6
Borrowed funds	8.1	7.2	6.9
Off-budget funds means	0.5	0.4	0.3
Other	20.9	23.1	24.4
Foreign investments in the total investments in fixed assets	8.1	5.1	5.3

Source: Federal State Statistics Service

It was reduction of budget funds share in the structure of investment financing by 1.6 p.p. that was the characteristic feature of the 1st quarter 2008. The share of budget funds used for investments in fixed assets was equal to 1.1% of the GDP in 1st quarter 2008 and was 0.2 p.p. below the figure of the previous year in the corresponding period. This is accounted for by making substantial changes into procedure of budget investments in the objects of capital construction. Starting with 2008 financing of objects that belong to the property of the Russian Federation was excluded from the Federal Targeted Investment Program (FTIP). This resulted in the reduction in the number of construction sights and objects planned for financing to 2173 in 2008, 959 of which are scheduled to be put into commission this year. It should be noted that change in the procedure for financing was not made up by expansion of budget funds from subjects of the Russian Federation participation.

In order to increase investment attractiveness of regions and to sustain the level of business activity a decision was made to make changes to the rules of budget allotments of the Investment Fund of the Russian Federation formation and use (Decree of the Government from 23 June 2008 No 468). In 2008 the Ministry for Regional Development of the Russian Federation directed budget allotments of the Investment Fund of the Russian Federation at the rate of RUR 80 bln to financing of investments projects of regional and inter-regional importance. Projects worth no less than RUR 500 mln on condition that participation of private investors is 50% will get government support – earlier only projects worth no less than RUR 5 bln were subject to financing from the Investment Fund. Regional investment projects are to be chosen on the basis of financial, budgetary and economic efficiency indices in concordance with the methods for indices calculation and application of efficiency criteria for regional investment projects.

In 2008 the limit of government investments within FTIP will be equal to RUR 483.8 bln or 1.47% of the GDP against 1.55% in 2007. Funds at the sum of RUR 327.1 bln are envisaged for FTIP program part, and at the sum of RUR 156.7 bln – for non-program measures financing. RUR 100.6 bln or 19.4% of the total limit was allocated for financing of budget investments within the framework of government defense order, including program and non-program part – RUR 50.1 and 50.5 bln, correspondingly.

According to the Federal State Statistics Service data, in January-April 2008 the level of financing for FTIP construction sights and objects (not taking into account construction sights and objects included in government defense order) was RUR 72.4 bln or 22.5% of the annual limit for government investments financing, in January-May 2008 – RUR 110.4 bln or 34.3% of the annual limit against 20.2% in January-May 2007.

Year limit for government investments within the framework of transport complex is financed at be far higher extent than on the whole for construction sights and objects. The level of agriculture social complex financing is a bit lower than on average across Russia, and the level of special complex financing is by far lower. In January-May 2008 government customers used RUR 23.1 bln of capital investments at the expense of all financing sources or 6.7% of the limit of funds, envisaged for construction.

Table 2

**FTIP Funds Financing and Use Broken By Complexes
in January-April 2008, as RUR bln**

	Government investments limit for 2008		Financing at the expense of gov- ernment investments		Use of funds at the expense of all the sources of financing
	Total	Of which from the federal budget	Total	As percentage of the federal budget funds	
Total	344.7	321.3	72.4	22.5	23.1
Transportation complex	131.6	129.3	45.2	35.0	8.7
Agriculture complex	8.9	7.0	1.5	21.4	0.5
Social complex	114.4	112.6	22.8	20.3	10.1
Special complex	75.8	61.9	0.1	0.2	2.9
Other objects	14.0	10.6	2.8	26.4	0.9

Source: Federal State Statistics Service

Over the last four years changes in the structure of investments in fixed assets have been defined by gradual decrease of investments in industrial productions against the background of infrastructure and services growing more and more important. Besides, starting in 2006 there has been an increase of investment activity in agriculture observed, which was initiated by inclusion of this kind of activity in priority projects. In 1st quarter 2008 growth of investments in fixed assets in agriculture was equal to 8.6%.

Against the background of steady growing demand for trade services, redistribution of investments among kinds of activities is proceeding while material and technical base for motor-vehicles trade is expanding, increase in investments in which was 136.9% to the level of 1st quarter 2007. In 2008 the trend for investments in fixed assets in transportation increasing (112.5% on the 1st quarter 2007) sustained, as well as in kinds of activities, oriented towards social services rendering – education (120.9% on the 1st quarter 2007), health service (112.3%). In 1st quarter 2008 characteristic features of investment process in transportation was dynamic growth of investments in railway transportation development (120.4% on 1st quarter 2007), investment rates in pipeline transportation being moderate (107.8%).

Table 3

**Structure of Investments by Kinds of Economic Activities
in 1st Quarter 2006-2008, as percentage to the total**

	2006	2007	2008
Industry	48.0	46.7	47.0
including			
Minerals extraction	20.5	23.1	21.6
Of which:			
Fossil fuels extraction	18.9	21.1	19.9
Processing industry	21.4	17.9	18.6
Electricity, gas and water production and distribution	6.1	5.7	6.8
Agriculture	2.9	3.8	3.6
Transportation	20.5	20.0	19.1
Communication	5.2	4.6	4.5
Construction	3.4	2.6	3.4
Trade	2.3	2.6	2.5

Source: Federal State Statistics Service

Intensive growth of investments in fossil fuels extraction in 2007 aimed at overcoming the consequences of sharp drop in investment activity in 2004-2006 did not continue at the beginning of this year. Investments in fixed assets increasing by 18.9% on the whole over the economy in the 1st quarter 2008, in minerals extraction the growth of this figure was 0.6% against 31.1% in the corresponding period of the previous year, including in fossil fuels extraction – 1.8% against 29.8%. However as a result of the 1st quarter 2008 there were still the extractive industries which had a prevailing part of investments in industry (46.0%).

In processing industries increase in investments was 15.7% and in electricity, gas and water production and distribution - 35.3%.

In the 1st quarter 2008 the share of investments in processing industries was 39.6% of the total amount of investments in industry and by 0.7% exceeded the corresponding figure of the previous year. In comparison with 2007 the highest investment growth rates were observed for goods groups, defining development of capital goods and construction materials markets: machinery and equipment production (141.4%), transport vehicles production (148.4%), non-metal mineral goods production (136.6%), timber processing and wooden

goods production (159.4%). It was stagnation in investment activity in foodstuffs production (99.9%) that was a worrying moment at the beginning of 2008.

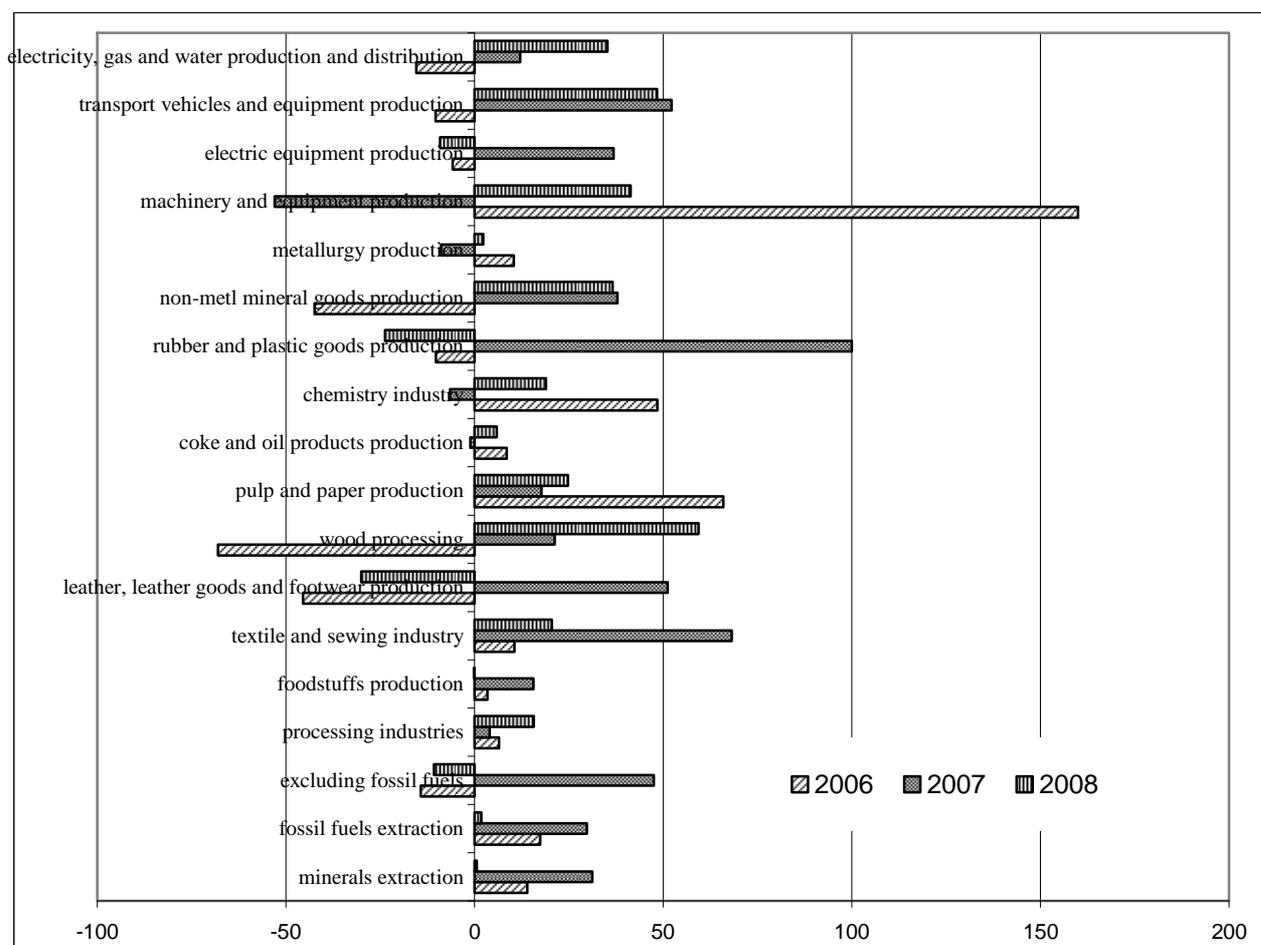


Fig. 1 Change of Investments in Fixed Assets Growth Rates in Industry in 1st Quarters 2006-2008, as compared with the corresponding quarter of the previous year, as percentage

The share of machinery and equipment in the structure of investments by kinds of fixed assets was equal to 36.5%. Production of domestic machine-building, however, does not correspond to increasing investment demand either in volumes, or in the structure of capital goods offer. In 1st quarter 2008 investments in import equipment purchase were RUR 57.5 bln or 19.5% of the total volume of investments in machinery, equipment and transport vehicles as compared with 17.6% in the 1st quarter 2007. Under existing structure of domestic production of investment goods import remains one of the main sources for renewal of fixed assets, production reconstruction and modernization.

Foreign Trade

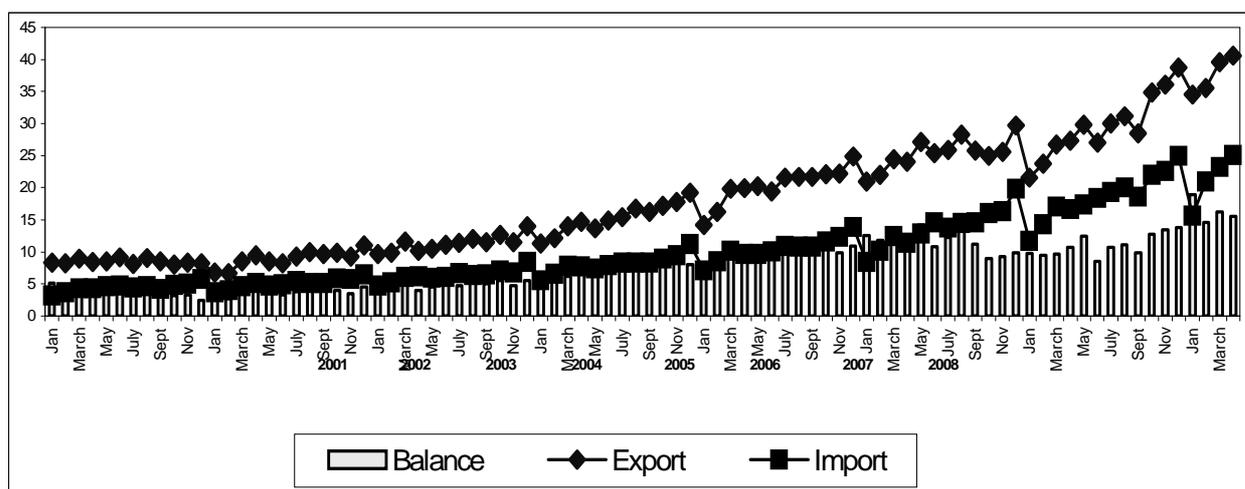
N. Volovik

In April 2008 Russian foreign trade turnover reached a record over the last seventeen years level. This was due to a considerable growth of both export and import supplies. Export growth is connected with a significant increase in prices for energy commodities, physical volumes of export growing but little. Import growth was – the same as earlier – stimulated by internal demand expansion and ruble appreciation. Trade balance also demonstrates high growth rates, but the number of countries with which Russia has negative trade balance is rising.

A reading of a new version of Working Group report on Russia’s accession to the WTO was held in Geneva. Next negotiation round is scheduled for July.

According to the forecasts of the IMF, in 2008 the world trade will be characterized by sustention of relatively low import growth rates from developed countries, consuming a substantial part of raw materials, stuff and industrial production. At the same time for the countries with developing market economy favorable dynamics for trading goods is predicted in 2008 – especially for countries exporting energy commodities: they will get additional advantages from improving of trading conditions thanks to anticipating growth of prices for export goods as compared to increase in prices for import ones.

In April 2008 the main indices of Russian foreign trade reached new record level over the whole period of monitoring. Foreign trade turnover calculated on the basis of balance-of-payments methodology was equal to USD 65.7 bln, exceeding the corresponding figure of the previous year by 49.7%. It should be noted that both export and import supplies grew at high rates.



Источник: ЦБ РФ.

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

The volume of monthly import of goods in the Russian Federation has for the first time exceeded USD 25 bln (USD 25.1 bln), while export – also for the first time over the last seventeen years – USD 40 bln (USD 40.5 bln). One more record was set by import growth rates: in April 2008 they exceeded the level of 150% (being equal to 150.2%) on April of the previous year.

Positive trade balance went up to USD 15.49 bln as compared with USD 10.68 bln in April 2007, that is increased by 45% as to corresponding month of the previous year. However the number of countries with which Russia's trade is characterized by negative balance is increasing continuously. Whereas in January-April 2007 their number was 22, and share of goods turnover with these countries was 20.2%, in January-April 2008 their number went up to 24 and their share in goods turnover was 22.7%.

Export growth acceleration is primarily connected with a considerable growth in prices for energy commodities against the background of little change in physical volumes over the last year.

During April a stable growth of oil prices was observed at world markets. The main reasons for this are US dollar depreciation against leading world currencies, oil import growth in China, tough policy of OPEC countries, regarding oil production increase as well as tense geopolitical and unfavorable climate conditions.

As compared with March 2008 in April 2008 average price for oil grade Brent went up by 5.8%, being equal to USD 108.26 per barrel. In comparison with April 2007 the price increased by 58.4%. Average price for oil grade Urals was USD 105.3 per barrel and rose by 5.6% in comparison with March 2008 or by 1.7 times when compared with April 2007.

World prices for oil products in April 2008 were also considerably above those in April 2007. Growth of prices was primarily caused by oil prices for oil growth and increase in demand for oil products. In April 2008 petrol was 8% more expensive than in March 2008 and by 35.4% more expensive than in April 2007. Average monthly price for natural gas increased by 6.8% on the previous month.

In April 2008 average monthly price for aluminum remained at the same level as in March 2008. As compared with April 2007 the price rose by 5.1%.

Prices for copper went up by 3.2% as compared with March 2008 and by 11.8% as compared with April 2007. On 10 April a new historical record was set, which was equal to USD 8884.5 per ton. The main cause of increase in copper prices was the reduction of stocks at London Metal Exchange.

**Average Monthly World Prices in April
of the Corresponding Year**

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Oil (Brent), USD/bbl	17.22	13.92	15.72	22.97	26.26	25.81	24.79	33.5	50.6	68	68.32	108.26
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	10.32
Petrol, USD/gallon	0.455	0.378	0.391	0.808	0.999	0.814	0.855	1.152	1.603	2.016	2.13	2.884
Copper, USD/ton	2369.7	1775.3	1539.9	1710.1	1689.4	1620.8	1598.5	2950	3395	6370	7766.5	8684.9
Aluminum, USD/ton	1554.0	1413.5	1318.0	1448.0	1493.7	1370.3	1332.8	1734	1894	2620	2814.8	2959.3
Nickel, USD/ton	7312.4	5352.5	5239.5	9657.1	6303.1	6940.6	7915.3	12872	16142	17935	50267	28763.2

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

Demand for nickel from the main consumers is decreasing. Nickel stocks at LME went up to maximum over the last 9 years volumes. As a result of these factors action, prices for nickel are falling. In April 2008 average price for nickel as compared with the preceding month reduced by 7.3% and as compared with April 2007 – by 42%.

There were still fuel and energy commodities that formed the basis of Russian export in January-April 2008, which comprised 69.2% of the total Russian export as compared with 63.3% a year ago. Such a considerable increase in the biggest export group is due to contract prices growth by 1.7 times, for oil products – by 1.6 times, for natural gas – by 1.3 times.

Machinery and equipment export increased by 41.8% in January-April 2008 as compared with the corresponding period of the previous year. The growth of this figure was primarily defined by the increase in value volumes of air- and spacecrafts, nuclear reactors and electric equipment.

Export value volume of foodstuffs and agriculture raw materials (excluding textile) went up as compared with the corresponding period of the previous year by 3.6%. Such a small export growth on the whole over the commodities group is connected with a considerable decrease in grains export – by 44%, which was the result of prohibitive duty rate for wheat, rye and wheat mix and barley.

Increase in metals and goods thereof export by 19.3% was connected with ferrous metals export growth – by 30.5% (mainly due to contract prices growth) and aluminum by 1.5 times as a result of physical volumes growth.

Export of chemistry industry goods and rubber export growth by 46.3% (in terms of value) was primarily influenced by prices for fertilizers increase by 1.7 times. The growth of this goods group was also affected by increase in ammonia and synthetic rubber export by 1.7 and 1.5 times, correspondingly because of prices growth.

Wood and pulp and paper goods export went up by 11.7% due to the growth of prices for the main goods of this group – unprocessed timber, pulp and plied wood.

The same as earlier, import growth was stimulated by expansion of internal demand and ruble appreciation. The dynamics of real disposable incomes of the population sped up a bit in January-April 2007 as compared with January-April 2007 despite inflation acceleration – the corresponding increase was equal to 11.8% (10.0% in January-April 2007). Besides, the market of consumer crediting is developing actively. According to the data of the Central Bank of the Russian Federation, as compared with January-April of last year ruble against dollar appreciated by 12.5%, against euro – by 3.5%, against the basket of trade partners currencies – by 4.7%.

Machinery, equipment and transport vehicles import in crease by 63.8% in terms of value. Import of land transport vehicles rose by 1.7 times. Physical volumes of passenger cars import supplies went up by 53.7% of trucks – by 34.1%.

Import value volumes of the main kinds of foodstuffs and agriculture raw materials (excluding textile) increased by 27.1% due to growth of prices, physical volumes decreasing.

Despite the decrease in chemistry production and rubber share in import structure from 14.2% in January-April 2007 to 13.6% in January-April 2008, its import value volume growing by 43.9% physical volumes and average contract prices increasing by 25.4% and 13.7%, correspondingly.

On 3 June 2008 in Riyadh Russia and Saudi Arabia signed the protocol on conclusion of bilateral negotiations on Russia's accession to the World Trade Organization. The negotiations with Saudi Arabia concerned conditions on traditional export of the country – oil and oil products, cable production, aluminum, glass, cement, dates and carpets. The parties also agreed on accession of architecture, construction, accounting, leasing and tourist services to the market.

On signing the agreement with Saudi Arabia, the Russian Federation has formally finished all the bilateral negotiations concerning accession to the WTO. But before conclusion of negotiation process talks can be started anew by any country that is a member of Working Group on Russia's accession to the WTO.

Georgia, which wants to make Russia abolish measures taken concerning Abkhazia and South Osetia, has not renewed negotiations yet not having presented proof that these measures are against the WTO standards.

Ukraine, which joined the Working Group on Russia's accession to the WTO in May 2008, has not started the bilateral talks yet. Ukraine's official representatives have repeatedly announced that there will be no delays in Russia's accession to the WTO because of the Ukrainian party.

In Geneva from 16 to 21 June within the framework of the Working Group on Russia's accession to the WTO the new reading of Working Group's Report project, which was distributed by the WTO secretariat on 30 April 2008, was held. Questions of WTO members, asked in the course of negotiations, were mainly of technical nature, which testifies the fact that the majority of problems at negotiations is successfully solved. The most difficult situation is that in the field of sanitary and veterinary regulations, as well as in the field of technical regulations, where completion of the negotiations is complicated by new measures of meat import regulations, already introduced or planned for introduction in Russia.

There are three disputable sections that have not been included in the report – export duties, government trading enterprises and the volume for agriculture support. These issues will be discussed separately.

The final version of agriculture section of the general report of the Working Group on Russia's accession to the WTO is likely to be finished for the next round of negotiations in July. Russia still insists on the level of support for agriculture of USD 9 bln annually at least for 5 years after accession to the WTO. This financial support will allow Russia to achieve the corresponding level of agriculture production. During negotiations the question of possible decrease of support for Russian agriculture starting with 2013 for the following five years, agriculture policy being generally liberalized in the world. Such a concession, however, is possible only if developed countries, mainly EU members, will adopt the same measures.

Members of Cairnes group, which consolidates 20 countries that are the biggest foodstuffs exporters, insist on the decrease of agriculture support down to USD 3 bln, but Russia has ambitious plans concerning agriculture producing complex development and the government of the Russian Federation is not going to deviate from the sum declared. Besides, the USA, as well as EU countries has by far higher level of similar support for agriculture producers.

One of the main barriers for Russia's accession to the WTO is the question on export duties for unprocessed timber introduced in Russia. Increase in export duties for wood, in the opinion of the EU, infringe upon interests of Scandinavian, especially Finnish, pulp and paper producers, who buy a substantial amount of raw materials in Russia. It should be remembered that according to the decree of the Russian Government on 5 February 2007, export duties are increased step by step. On 1 April 2008 export duties for unprocessed timber were raised from 20 to 25%. By 2011 duty rates for a number of positions are to grow up to 80% of the customs value but no less than Euro 50 for 1 cu. m.

Finland insists that Russia does not need to introduce prohibitive duties for timber export to stimulate its processing industry. Russian party, in its turn, holds that only the increase of export duty rates will stimulate investors to finance expensive projects of pulp and paper factories in the territory of Russia.

The project of Working Group's report concerning government trading enterprises is not included in the new version of the report, since the project of Russia's liabilities regarding government trading enterprises operation has not been agreed upon with the interested members of the WTO yet. The problem is that there is a legislative act in the USA according to which commercial consideration apply not only to the government companies, operating in the field of trade, but also for government companies, rendering services. This law suggests that all countries joining the WTO should observe this principle. Many countries including China, Saudi Arabia, Vietnam took such liabilities on accession. In Russia there are some companies operating in the field of services (Aeroflot, Russian Railways, for instance) that are controlled by the government and have some monopoly rights, full or partial, for which the principle of commercial considerations cannot be applied.

Oil and Gas Sector

Yu. Bobylev

Against the background of exceptionally high world prices for oil, there is a decrease of oil production observed in Russia - for the first time over the last years: in January-May 2008 it reduced by 0.5% as compared with the corresponding period of the previous year. In order to stabilize and increase oil production the government has developed a number of measures to reduce tax load on oil and gas sector of the economy and to stimulate by taxation deeper exploitation of oil fields currently in operation and development of new oil fields in regions undeveloped regions and on continental shelf.

In recent months world prices for oil remain at an exceptionally high level (*table 1*). In May 2008 they reached historical record not only in nominal terms but also in real, exceeding the threshold of USD 120 per barrel. The main factors for prices growth were increased demand for oil, especiall from China, India and other Asian countries, conservative policy of the OPEC regarding oil production increase, low oil production growth in countries that are not OPEC members, as well as a considerable inflow of capitals to the oil exchange market. Over the first three weeks of June price for oil grade Brent was on average equal to USD 131.4 per barrel and for Russian oil grade Urals – USD 126.1 per barrel.

Table 1

World Prices for Oil in 2006-2008, as USD per barrel

	2006	2007 1 quarter	2007 2 quarter	2007 3 quarter	2007 4 quarter	2008 1 quarter	2008 April	2008 May
Price for oil grade Brent, the UK	65.16	57.75	68.76	74.87	88.69	96.9	109.0	122.7
Price for oil grade Urals, Russia	61.24	54.30	65.16	72.19	85.91	93.3	105.7	118.8
Price for oil basket of OPEC member countries	61.08	54.65	64.97	71.59	85.18	92.7	105.2	119.4

Source: OECD/IEA, OPEC.

Despite exceptionally high prices for oil and considerable growth of profits in oil sector, oil production in Russia has demonstrated negative dynamics – for the first time since 1999. Whereas in 2002-2004 increase in oil production reached 8.9-11% a year, in 2005–2007 - 2.1-2.2%, in January-May 2008 oil production decreased by 0.5% as compared with the corresponding period of the previous year (*Table 2*). This testifies that the reserves for the rapid growth of oil production owing to the exploitation intensification of oil fields in operation are exhausted and it is necessary to develop new oil fields more actively.

Table 2

Oil Production in Russia in 2001-2008, as percentage to the previous year

	2001	2002	2003	2004	2005	2006	2007	2008 January- May
Oil, gas condensate included	107.7	109.0	111.0	108.9	102.2	102.1	102.1	99.5

Source: Federal State Statistics Service

The majority of new oil fields in Russia are characterized by worse mining, geological and geographical conditions, their exploitation requiring increase in capital, operating and transportation costs. At the same time existing taxation system does not provide necessary decrease of tax burden while exploiting new oil fields with high costs that limits investments in new projects. Start of such oil fields development, especially in undeveloped regions with underdeveloped or absent infrastructure requires improvement of the existing system of oil sector taxation, pursuing of special tax policy, which provides necessary incentives for investments in oil production.

System of oil industry taxation, which was introduced in 2002, is based on severance tax, which is levied on flat specific rate and did not take into account existing differences in oil production conditions because of mining and geological characteristics of oil field, their location, as well as the stage of exploitation. As a result, oil production economy at oil fields with higher costs has been worsening, selective choice of the most effective reserves and pre-term cessation of exhausted fields has been encouraged. At the same time putting new fields with higher costs in operation has been becoming more complicated.

Imperfections of severance tax flat rate provoked the search of variants for differentiation of tax rate, taking into account real mining and geological, geographical differences in oil production conditions. In 2007 the system of oil production taxation was supplemented with new elements:

1. Step-down coefficient C_e to severance tax rate has been introduced for oil fields with exhaust of reserves of more than 80%. This coefficient is calculated according to some general formula and lies in the range from 1 (level of exhaust is 0.8) to 0.3 (level of exhaust is 1 or more).

2. Tax vacations from severance tax are introduced for oil fields in East-Siberian oil and gas province in the Republic Sakha (Yakutia), Irkutsk oblast, Krasnoyarsk krai. The oil fields situated in the regions will be subject to zero severance tax rates till 25 mln tons of accumulated oil production volume on the subsoil area is achieved or when period of exploitation is less than 10 years, or for 10 years for the license to use subsoil with the aim of exploration and for 15 years in case of the license for simultaneous geological exploration and oil production from the moment of the state registration of the license.

The severance zero rate for the period before reaching of 25 million tons of accumulated oil production volume on the subsoil area or the period of exploitation of less than 10 years, calculated from 1 January 2007, is also applied to all oil fields of these region in the process of development, if the extent of exhaust does not exceed 0.05.

3. Zero severance tax rate is established for superviscous oil fields.

These amendments are aimed at the stimulation of the development of exhausted and new oil fields. Severance rate differentiation with regard to reserves exhaust enables to prolong exhausted fields development periods and increase oil extraction extent. The extension of exhausted fields exploitation provides extra inpayments of severance (collected with the lowered rate) as well as other taxes (profit tax, export duties etc.). Severance rate reduction for new oil fields makes it possible to stimulate the development of East Siberia oil and gas province, create the basis for future income of the state budget.

Passed amendments envisage that severance preferences for new and exhausted oil fields can only be received when applying a direct method of oil production quantity control at the subsoil area. As applied to exhausted oil fields, this regulation limits substantially the sphere of tax remissions application, for the majority of exhausted oil fields (licensed lots) have not got a direct control of oil production quantity.

Taking technical steps to secure direct control over oil production at such oil fields is economically ineffective in the majority of cases – the fact that prevents them from using the established severance privilege, leading to pre-term cessation of their exploitation and loss of oil in subsoil areas. Application of this privilege is rather limited, that is the task of stimulation and prolongation of exhausted fields exploitation is solved only partially and in limited scope.

The changes made did not solve also the task to stimulate by taxation new oil fields with higher costs development that are not a part of East-Siberian oil and gas province, that is located in other regions and on continental shelf. Higher capital, exploitation and transport costs lead to inefficiency of fulfillment of these oil fields development projects under general tax regime.

In April-June 2008 the Government of the Russian Federation prepared and submitted to the State Duma additional amendments to the Tax Code of the Russian Federation aimed at the reduction of tax burden on oil sector of the economy, stimulation of new and exhausted oil fields development. The amendments in question are to be adopted in July 2008 and come into effect on 1 January 2009. The most important among them are the following:

1. In the formula used for calculation of C_p coefficient, which characterizes the world oil prices dynamics and applied to the severance tax basic rate, the price minimum not levied with the tax was increased from USD 9 to USD 15 per barrel, the formula now being:

2.

$$C_p = (P - 15) \times E / 261 ,$$

where P is average level of oil grade Urals price in USD per barrel, E – average exchange rate of Us dollar against ruble, established by the Central Bank of the Russian Federation.

As it is shown by calculations, change in C_p calculation formula as well as dollar exchange rate decrease and inflation will lead to considerable decrease in the applied rate of severance tax on oil production. Owing to these factors, under forecast conditions for 2008 (according to the Ministry for Trade and Economic Development: price for Urals grade USD 78 per barrel, dollar exchange rate – 24.9 RUR/USD, average annual inflation in 2008 – 12.9%, in 2009 – 8.4%) severance tax rate in real terms will decrease by 27% on 2007 (table 3).

**Influence of Change in Cp Calculation Formula and Other Factors
on Severance Tax Rate on Oil Production**

	Price for Urals grade, USD/bbl								
	30	40	50	60	70	78	80	90	100
Severance rate with the existing formula for Cp calculation under 2007 condition, RUR/ton	862	1273	1683	2094	2504	2832	2914	3325	3735
Severance rate with the new formula for Cp calculation under 2009 condition, RUR/ton	600	999	1399	1799	2199	2518	2598	2998	3398
Severance rate with the new formula for Cp calculation under 2009 condition with 2007 prices, RUR/ton	490	817	1143	1470	1796	2058	2123	2450	2776
Decrease in severance rate in 2009 (in 20076 prices) as compared with 2007, %	43.2	35.8	32.1	29.8	28.3	27.3	27.2	26.3	25.7

Source: IET calculations

Such a decrease in severance tax rate will reduce tax burden on oil sector, allow oil companies to have additional financial resources to use, increase investments profitability, will stimulate deeper exploitation of exhausted oil fields.

At the same time, as it is shown by microeconomic calculations, an additional decrease of severance rate is necessary for a number of cases. Such a reduction, however, should be differentiated, it should apply only to some regions and some categories of oil fields that are characterized by higher development costs.

2. The requirement for application a direct method of oil production quantity control at the subsoil area for the established severance tax privileges to be used at oil fields with high level of exhaustion and at oil fields in East-Siberian oil and gas province (in the territory of the Republic Sakha (Yakutia), Irkutsk oblast and Krasnoyarsk krai) is abolished.

Application of severance tax privileges on the basis of the system of oil production control currently in use at some subsoil plots will allow application of privileges at all exhausted oil fields, which will secure the prolongation of the period of their exploitation, additional oil production and extra tax earnings.

This will also allow application of severance tax privilege (tax vacations) at new small oil fields of East-Siberian oil and gas province, whose development if there are no severance tax privileges is ineffective.

3. For oil fields on the continental shelf of the Russian Federation, situated to the north of the Arctic circle zero severance tax rate is established up to achievement of oil production of 35 mln of tons or for the period of 10 years for licenses for subsoil exploitation for exploration or for 15 years for licenses for subsoil exploitation to simultaneous exploration and minerals extraction from the date of government registration of the corresponding license. For subsoil plots situated in these areas licenses for which are given before 1 January 2009 and the level of whose exhaust does not exceed 0.05 zero severance tax rate is in effect till 35 mln tons of oil production is reached or during 10 years, starting with 1 January 2009.

4. For oil fields situated in Azov and Caspian seas zero severance tax rate is established for the period until accumulated volume of oil production of 10 mln tons is reached at a subsoil plot or for 7 or 12 years from the date of government registration of the license depending on the kind of license for subsoil exploitation. For subsoil plots situated in these areas licenses for which are given before 1 January 2009 and the level of whose exhaust does not exceed 0.05 zero severance tax rate is in effect till 10 mln tons of accumulated volume of oil production is reached or during 7 years, starting with 1 January 2009.

5. For oil fields situated in the territory of Nenets autonomous okrug (the north of Timano-Pechor oil and gas province) and on the Yamal peninsula in Yamalo-Nenets autonomous okrug zero severance tax rate is established for the period until accumulated volume of oil production of 15 mln tons is reached at a subsoil plot or for 7 or 12 years from the date of government registration of the license depending on the kind of license for subsoil exploitation. For subsoil plots situated in these areas licenses for which are given before 1 January 2009 and the level of whose exhaust does not exceed 0.05 zero severance tax rate is in effect till 15 mln tons of accumulated volume of oil production is reached or during 7 years, starting with 1 January 2009.

6. Accelerated amortization is introduced for licenses for subsoil exploitation purchase: according to the new procedure the expenses mentioned will be regarded as costs for two years and not for the all period of license validity.

Decrease in severance tax rate for oil production because of the change in the calculation formula, expansion of the established privileges application and first of all of step-down coefficient to severance tax rate for exhausted oil fields and envisaged expansion for tax vacation practice enables decreasing tax burden on the

oil sector, stimulate deeper exploitation of oil fields currently in operation and start of new oil fields exploitation.

It should be expected that maintenance of high world prices for oil (according to IET forecast price for oil grade Brent will be in the range 125-144 USD per barrel – see Bulletin for model calculations and short term forecasts for social and economic indices of the Russian Federation June 2008. IET) and fulfillment of envisaged measures for stimulation by taxation will have a positive effect on the development of the sector and the dynamics of oil production in the country.

Inflation and monetary policy

P. Trunin

As at the end of May, the CPI value in the RF again made 1.4 per cent (this value was at 0.6 per cent in the respective period of the preceding year). Therefore, the increase in the consumer prices made 7.7 per cent over the period from January till June. At the background of a rapid inflow of foreign exchange in the country the real effective Ruble exchange rate grew by 0.4 per cent, whereas the amount of gold and foreign exchange reserves of the RF Central Bank increased by 2.4 per cent. In order to slow down the rates of growth in money supply and inflation rates, the Bank of Russia has increased by 0.25 percentage points the interest rates on credits and deposits of the RF Central Bank.

In May of this year, the value of the consumer price index made 1.4 per cent (0.5 in May of 2007, see Fig. 1). The increase in the prices of food products made the most significant contribution in the general growth of prices observed in May, similarly to the situation observed in February through April (+ 2.1 per cent). Therefore, the prices of basic food products continued to grow at a rapid rate. The most considerable increase in prices of food products was caused by the growing prices of white sugar (+ 6.8 per cent), sunflower oil (+ 5.9 per cent), cereals and legumes (+ 5 per cent), paste goods (+ 4.7 per cent), and fruit and vegetables (+ 6.4 per cent). However, by the end of May there was registered a decline in the price of eggs by 7.4 per cent.

In May, there also continued the growth in prices of paid consumer services, which made 1 per cent by the end of the month. The most significant increase in prices was registered with respect to the services related to foreign tourism (+ 4.3 per cent), those provided by passenger transport organizations (+ 2.9 per cent), preschool educational organizations (+ 1.7 per cent), and by sanatoriums and health centers (+ 1.5 per cent). However, in May there was registered a decline in the prices of communications services by 0.2 per cent.

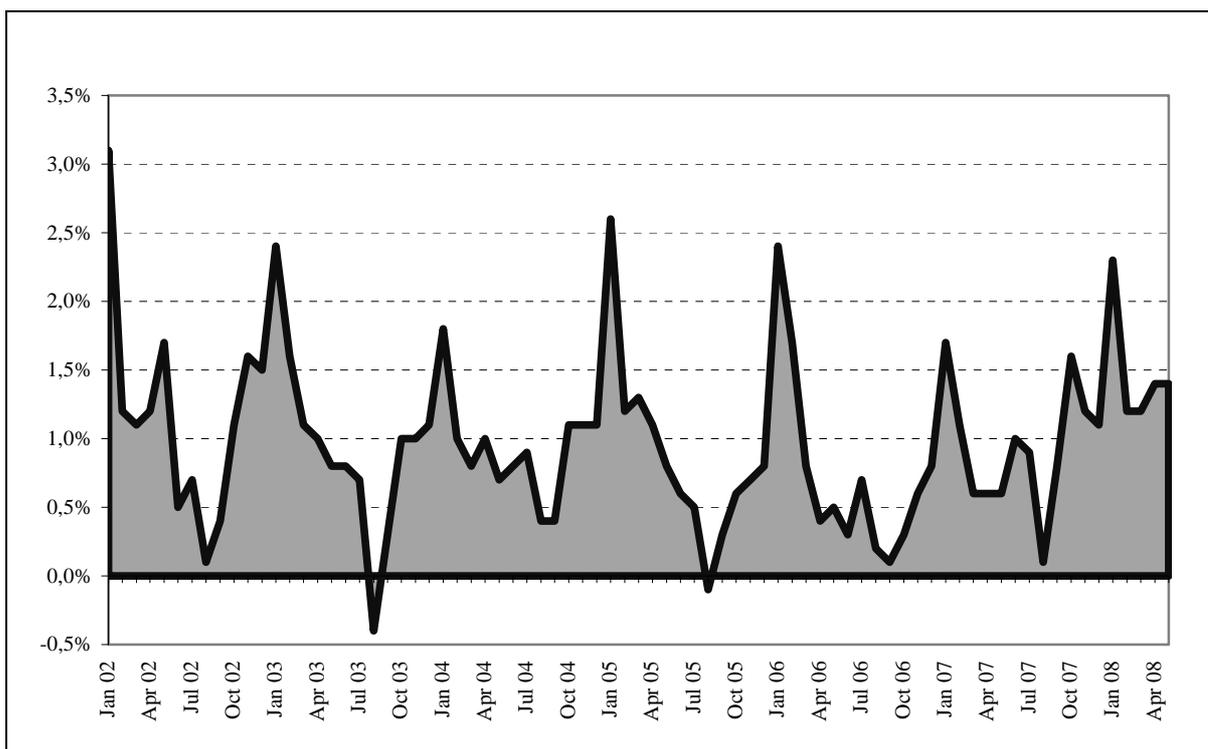
That month there was also observed a growth in the prices of non-food goods; on the average, the prices of such goods grew by 0.8 per cent across the country. The most rapid rate of increase in prices was registered with respect to motor petrol (+ 3.4 per cent), detergents and cleaning agents (+ 2 per cent), construction materials (+ 1.5 per cent), and medicines (+ 1 per cent). At the same time, the prices of TV and radio sets declined by 0.1 per cent.

Therefore, as of May results, consumer price index was same as in April, making 15.1 per cent in annual terms, what has further aggravated the inflation upsurge and deepened the gap between the level of the current year prices growth rates and the level, registered in the respective period of 2007. As we have mentioned in earlier surveys, a sharp increase in budget expenditures at the end of 2007 is contributing to inflation in April and May of the current year. It should be noted that some decline in the money supply growth rate observed at the beginning of current year (in the period from January till April of this year the monetary base M_2 has increased only by 0.6 per cent as compared with 11.2 per cent observed in the respective period of 2007), as well as growing supply of agricultural produce might restrain the inflation in summer. At the same time, the inflation inertia stays rather explicit, what provides serious grounds for expectations that in 2008 the value of CPI will exceed its level registered at the end of the preceding year.

In May of 2008, the growth in the base consumer price index³ was at 1.1 per cent (as compared with 0.3 per cent registered in the respective period of the preceding year). Therefore, in accordance with our estimates in June the value of CPI made from 1 per cent to 1.2 per cent, whereas by the end of the year the CPI value may reach from 13 per cent to 14 per cent. In June, representatives of the RF Government and the RF

³ The Base Consumer Price Index (BCPI) is an indicator reflecting the inflation rate on the consumer market. It leaves out of account the seasonal (prices of fruits and vegetables) and administrative (tariffs on regulated types of services etc.) factors, calculated by the Statistics Service of the RF.

Central Bank recognized that it would be impossible to ensure the official cap on inflation rates for 2008 set at 10.5 per cent.



Source: RF Statistics Service.

Figure 1. The Growth Rate of the CPI in 2002 - 2008 (% per month).

In The Growth Rate of the CPI in 2002 - 2008 (% per month). May of 2008, the monetary base of the Russian Federation (in the broad definition⁴) increased by RUR 157.4 billion and made RUR 5129.5 billion (+ 3.2 per cent). As on May 1, 2008, the amount of the monetary base of the Russian Federation (in the broad definition) was at RUR 4972.1 billion. Below, the dynamics of the monetary base (in the broad definition) will be analyzed across its components.

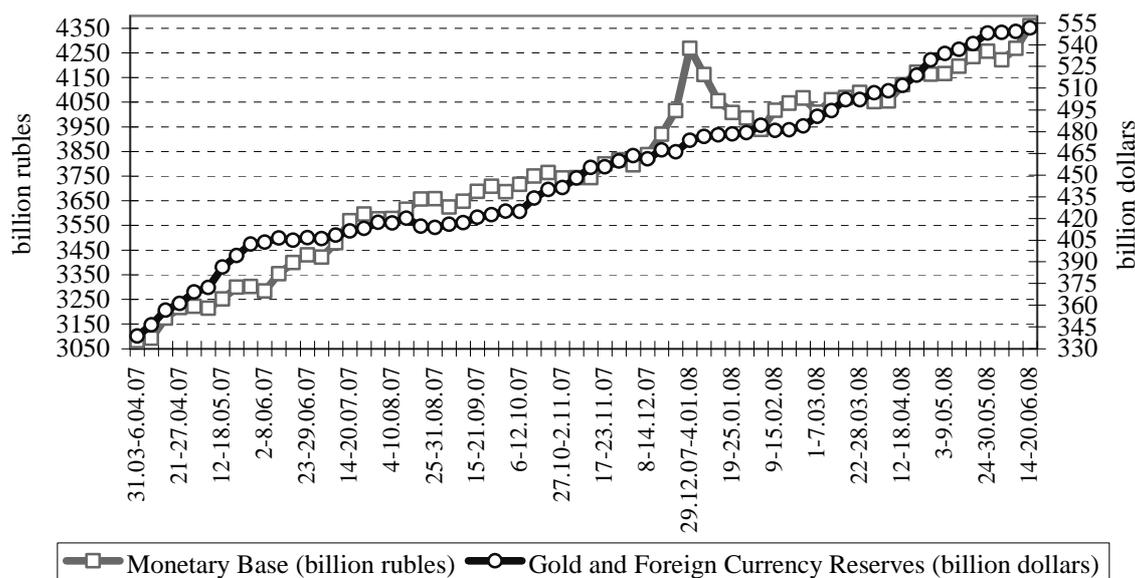
The Growth Rate of the CPI in 2002 - 2008 (% per month). The amount of cash in circulation (as adjusted for cash balances of crediting organizations) made RUR 3.98 trillion as on June 1 (a 1.2 per cent growth in comparison with the figures registered as on May 1). On the same date, the amount of accounts of crediting organizations with the Central Bank of Russia made RUR 543.9 billion (- 10.4 per cent), the amount of mandatory reserves was at RUR 350.4 billion (+ 1.4 per cent), the amount of banks' deposits in the Bank of Russia made RUR 235.7 billion (this amount has grown by 2.4 times), the value of the Bank of Russia bonds held by crediting organizations made RUR 19.8 billion (+ 5.9 per cent). Therefore, in May the increase in the excess reserves of commercial banks made more than RUR 100 billion; it should be noted that the highest rates of growth were demonstrated by bank's deposits in the RF Central Bank, what to a certain degree may be explained by the increase of respective rates at the end of April. Besides, the growth in the amount of reserves was facilitated by a significant inflow of foreign exchange in the country.

Therefore, the situation regarding the bank liquidity is rather stable at this point of time, the evidence of which is low interest rates on the market of inter-bank credits, small amounts of REPO transactions between commercial banks and the RF Central Bank, as well as low demand for federal budget funds placed by the RF Ministry of Finance on the auction basis on the deposits with commercial banks.

In May, there was registered an increase in the amount of cash in circulation by 1.2 per cent, which was observed simultaneously with the growth in the amount of mandatory reserves by 1.4 per cent, resulted in

⁴ The RF Monetary Base in broad definition includes, alongside with cash in circulation issued by the Bank of Russia and the Ruble denominated balances of mandatory reserves relating to the borrowings made by credit organizations deposited with the Bank of Russia, also the funds in credit organizations' correspondent accounts and banks' deposits with the Bank of Russia.

the increase in the monetary base in the narrow definition (cash plus mandatory reserves)⁵ by 1.4 per cent (see Fig. 2). At the same time, in May there was observed a growth in the amount of gold and foreign exchange reserves of the RF Central Bank by 2.4; as a result, the amount of these reserves made US \$ 547.4 billion as on June 1, 2008. In the first three weeks of June, the amount of gold and foreign exchange reserves increased by another 2.1 per cent and reached the amount of US \$ 558.7 billion. At the same time, the sterilization of liquidity entering the country at the accounts of the RF Government with the RF Central Bank persisted: the amount of deposits of the RF public authorities increased in April by 1.4 per cent and made RUR 7.33 trillion.



Source: RF CB.

Figure 2. Changes in the Monetary Base and in the Gold and Foreign Currency Reserves in 2007 - 2008

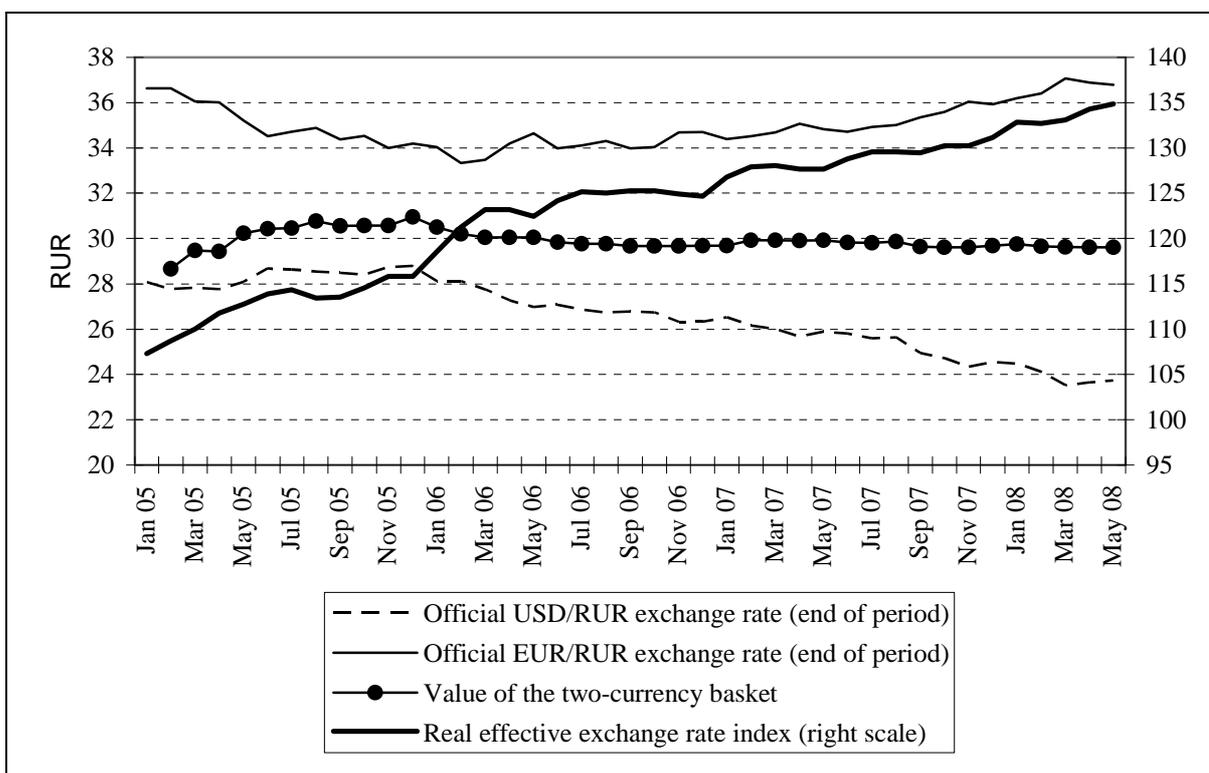
In May, the prices of energy resources remained at a rather high level, what resulted in the persistence of RUR appreciation in real terms. For instance, the real effective RUR exchange rate grew by 0.4 per cent by the end of May (as compared with 0 per cent registered in the respective period of the preceding year): the index of the RUR real effective exchange rate made 134.8⁶ (see Figure 3). As a result, in January through May the RUR appreciation in real terms against the basket of currencies made 2.9 per cent in comparison with 2.4 per cent registered in the period from January through May of 2007. According to our estimates, in 2008 the value of this indicator will reach 6.6 per cent.

In May, the exchange rate of the US dollar on the world forex market practically did not change, whereas its official exchange rate against RUR grew: by the end of the month the US dollar exchange rate made RUR 23.74 per US \$ as compared with RUR 23.65 per US \$ registered as on May 1. In spite of the fact that the US dollar appreciated against the ruble, in April the value of the two-currency basket⁷ did not change. As a result, the EURO / Ruble exchange rate dropped and made RUR 36.78 by the end of April.

⁵ It should be reminded that the monetary base in broad definition is not a monetary aggregate, but characterizes the liabilities of the Bank of Russia denominated in the national currency. The narrow defined monetary base is a monetary aggregate (one of the characteristics of the amount of money supply) fully controlled by the RF Central Bank.

⁶ The level registered in January of 2002 is indexed as 100.

⁷ The two-currency basket is the RF Central Bank operational indicator in its foreign exchange policy. Currently the share of EURO in the currency basket makes 45 per cent, US \$ – 55 per cent.



Source: RF CB, author's calculations.

Figure 3. Indicators of Ruble's Exchange Rate Dynamics

On June 9, the Bank of Russia took the decision to change its official bank rate, as well as interest rates on credit and deposit operations carried out by the Bank of Russia. In particular, the official bank rate was raised by 0.25 percentage points and made 10.75 per cent per annum. Since the official bank rate is the base interest rate for all credit operations of the Bank of Russia, its change resulted in the similar change of other interest rates of the RF Central Bank.

Type of credit	Interest rate (% per annum)	
	Before change	After change
Intraday	0	0
Overnight	10,5	10,75
Lombard	7,5% – for terms making 7 calendar days; 8,5% – for terms making 1 calendar day	7,75% – for terms making 7 calendar days; 8,75% – for terms making 1 calendar day
Mortgage and guaranteed credits	9,5	9,75
Credits secured with assets	9,5	9,75
Borrowings against bill pledging, assignment of rights and claims under loan agreements of organizations or guarantees of crediting organizations	7,5 – up to 90 calendar days; 8,5 – from 91 to 180 calendar days	7,75 – up to 90 calendar days; 8,75 – from 91 to 180 calendar days

Moreover, the interest rate for “cross-currency swap” transactions has also been raised from 8.5 per cent to 8.75 per cent, while interest rates on direct REPO transactions increased by 0.25 p.p. (from 7.5 per cent to 7.75 per cent per annum for 1 day term and from 8.5 per cent to 8.75 per cent per annum for the period of 7 days).

This measure was taken by the Bank of Russia due to the continuing acceleration of increase in inflation rates observed in 2008. It should be noted that as we have mentioned above at present Russian banks experience no problems related to liquidity. In order to sterilize excessive money supply the bank has increased interest rates on deposit operations under standard conditions: "tom-next", "spot-next" and "on demand" from 3.25 per cent to 3.5 per cent per annum, "1 week" and "spot-week" from 3.75 per cent to 4 per cent per annum. This measure was taken by the Bank of Russia with the aim of making deposits more attractive for credit organizations, and therefore, of sterilizing excessive liquidity.

Thus, the RF Central Bank has taken measures aimed at the tightening of the monetary policy. It should be reminded that this year it was the third case of raising of interest rates: earlier, the RF Central Bank had already raised the refinancing rate by 0.25 p. p. on February 4 and April 29. From our point of view, in the situation of a significant inflation acceleration these measures are well justified. However, it should be kept in mind that due to an insignificant role played by the interest rates set by the RF Central Bank on the national financial market the measures undertaken by the Bank of Russia are rather psychological in nature and designed to demonstrate the CB high motivation for curbing inflation. Besides, the raise of the interest rates carried out in three stages is rather unsubstantial. It should be noted that such a small increment of increase in the interest rates seems to be rather strange in the current situation in Russia, where it has no such significance as in developed countries. Besides, it should be reminded that some time ago the Bank of Russia carried out the reduction of interest rates at a much faster pace.

Budgetary and Tax Policy

O. Kirillov

In June of 2008, D. A. Medvedev, the President of Russia, stated in his Budget Statement that it was necessary to reduce the rate of growth in public expenditures, as well as the tax burden on the economy and to work out new parameters of development of the pension system in the Russian Federation. The RF Government has approved the main parameters of the federal budget for years 2009 through 2011. At this point of time, the plans envisage a reduction of the tax burden, but not a reduction of the level of expenditures. The current level of budget expenditures has declined after the completion of the political cycle and is at the moment at the level close to the values of the respective indicators observed over the last three years. In January through May of 2008 the aggregate amount of financial resources accumulated in the RF Reserve Fund and the RF National Welfare Fund declined by 3.3 per cent of GDP.

In May of 2008, there were registered no significant changes in the administration of the RF federal budget. Over the three last months of the year, the dynamics of the revenues of the state budget were rather stable (see *Figure 1*) similarly to the situation observed in the sphere the expenditures after the completion of the political cycle in the beginning of 2008, and are at the moment at the level close to the values of the respective indicators observed over the last three years (see *Figure 2*).

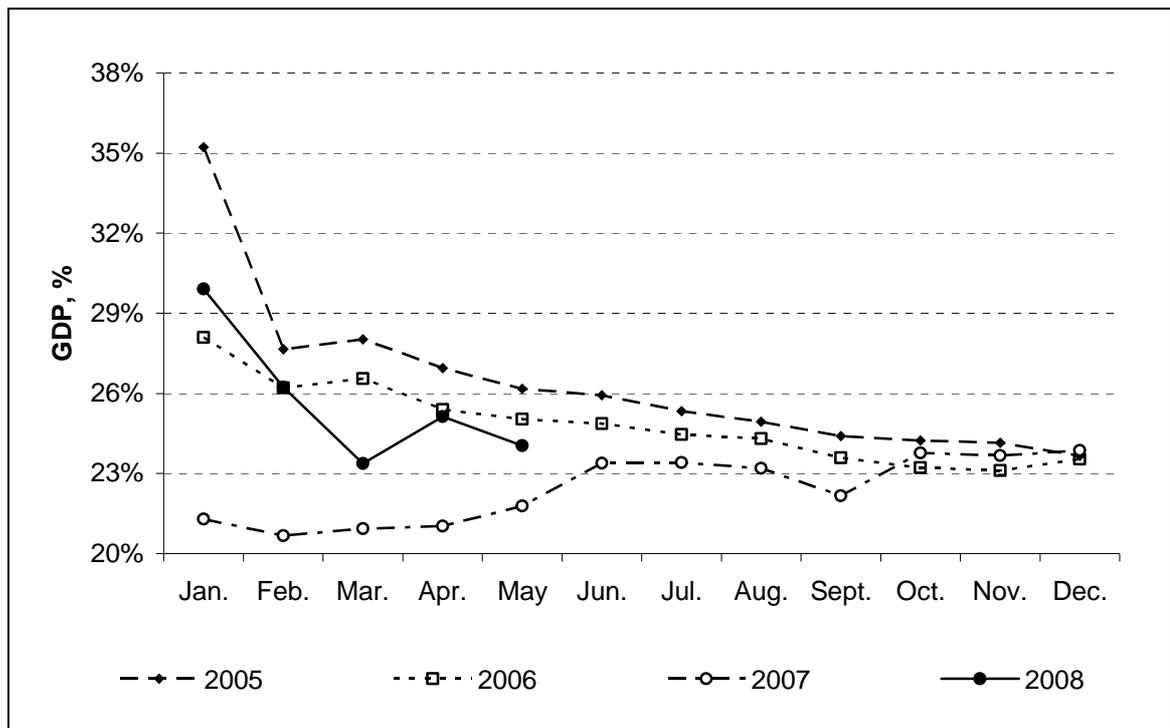


Fig. 1. RF Federal Budget Revenues in 2005-2008, in % in GDP

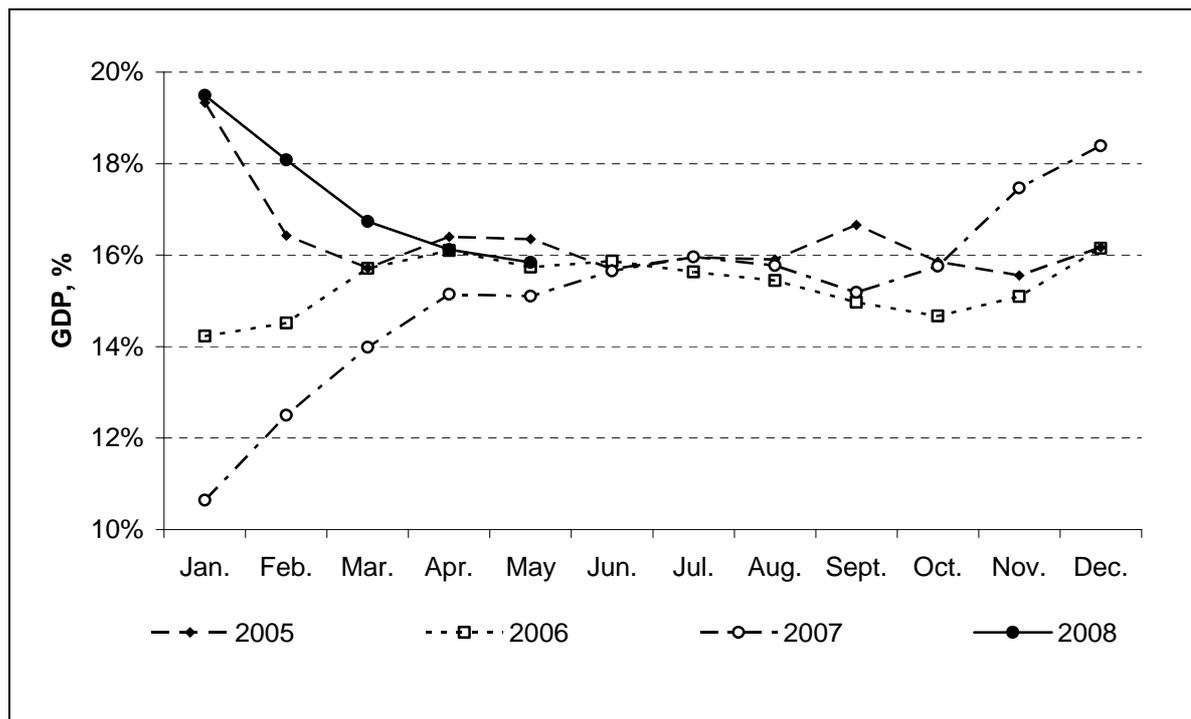


Fig. 2. RF Federal Budget Expenditures in 2005-2008, in % in GDP

Dmitry Medvedev, the President of the Russian Federation, in his Budget Statement for years 2009 through 2011 has set the task to reduce the rate of growth in public expenditures. Alexey Kudrin, Vice Prime Minister and the Minister of Finance, explained that in order to avoid negative macroeconomic consequences and to restrain inflation rates the expenditures of the federal budget should not grow at the current rates. In 2009 through 2011, the average rate of increment in budget expenditures will decline and correspond to the rates of the economic growth. The Minister of Finance has also noted that budget resources should be to a greater degree concentrated in the key avenues of expenditures, such as healthcare, education, research and development, and transport infrastructure.

According to the estimates presented by the RF Finance Ministry the increase in the budget expenditures will make about 25 per cent by the end of 2008, whereas by the end of 2007 the respective figure amounted to 37 per cent. At the same time, the IET assessment demonstrate that in the period from January through May the nominal growth in GDP made 33.4 per cent in comparison with the value of this indicator registered in January through May of 2007, whereas the budget expenditures over the same period made 39.9 per cent in the nominal terms. Therefore, in order to avoid negative macroeconomic consequences the necessity to reduce the level of expenditures of the federal budget appears to be very convincingly.

In his Budget Statement, Dmitry Medvedev has also taken notice of the necessity to reduce the tax burden and to reform the tax system in the Russian Federation, from what it follows that the decision on the reduction of the VAT rate may be adopted sooner. The RF Government was instructed to elaborate concrete decisions concerning these issues by August of this year. Besides, the RF Government was given the task of accelerate the working out of new parameters of the pension system in the Russian Federation to be used for a long term. It is planned to settle both the problem of an increase in the average amount of pensions and its financial support.

The RF Government has approved the main parameters of the federal budget (FB) for years 2009 through 2011. Thus, in 2009 the revenues of the federal budget are planned in the amount of Rub. 9.518 trillion, or 19.58 per cent of GDP, expenditures should make Rub. 8.811 trillion, or 18.1 per cent of GDP. In 2009, the budget surplus will amount to Rub. 707 billion, or 1.5 per cent of GDP. In 2010, it is envisaged that the revenues of the federal budget should amount to 18.68 per cent of GDP, expenditures should make 17.6 per cent of GDP, whereas the surplus will be at 1.1 per cent of GDP. It should be noted that the planned for years 2009 through 2011 amounts of revenues of the federal budget in terms of GDP shares are below the respective values observed in 2005 through 2008, whereas the size of the expenditures planned for the same period on the contrary exceeds the values of the respective indicators registered in 2005 through 2008. It means that at this point of time the plans envisage a reduction of the tax burden, but not a reduction of the level of expenditures.

According to the statement made by T. Nesterenko, a Deputy Finance Minister, on July 4 of 2008 the RF Ministry of Finance should inform other Ministries and government agencies about the caps on expenditures, whereas after July 16 the RF Finance Ministry and the Budget Commission should discuss with the Ministries and other government agencies all the respective problems causing disputes. Later, on August 11, 2008, the draft law on the federal budget of the Russian Federation for years 2009 through 2011 should be submitted for review on the part of the RF Government.

As it has become known from the statement made by V. Putin, the Prime Minister of the RF, in the new federal budget it is envisaged that for the purposes of remuneration of labor of employees of federal institutions financed from the RF budget, i. e. universities, medical centers, institutes and sector specific Ministries, there should be spent by Rub. 130 billion more than at present.

The dynamics of the main parameters of the federal budget of the RF in 2006 through 2008 are presented in *Table 1*. In January through May of 2008, the revenues of the federal budget were by 2.27 p. p. above the figures registered in the respective period of 2007, whereas the expenditures were by 0.74 p. p. and the surplus was by 1.52 p. p. above the respective values of these indicators.

Table 1

Main parameters of the RF federal budget in 2006 through 2008 (in % of GDP)

	2006	May of 2007	2007	May of 2008
Revenues	23,5	21,78	23,87	24,05
Expenditures	16,2	15,10	18,39	15,84
Deficit (-) / Surplus (+)	7,4	6,68	5,48	8,20

Source: RF Finance Ministry, IET calculations.

In 2008, the level of revenues of the federal budget (see *Figure 1*) was close to the respective values registered in 2006; it should be noted that as earlier, the graph of 2008 is significantly above the graph of 2007 in spite of the fact that in May of 2008 the revenues of the federal budget declined and made only 20.2 per cent of GDP⁸.

Below, there will be discussed the revenues of the federal budget across the major tax administrators (see *Table 2*). The revenues generated by the taxes administrated by the Federal Customs Service increased in

⁸ In April of 2008, the revenues of the federal budget made 33.7 per cent of GDP, what is the maximum value registered this year.

January through May of 2008 by 1.52 p. p. of GDP in comparison with the figures registered in the respective period of 2007. The amounts of revenues of the federal budget administered by other federal agencies grew by 0.47 p. p. of GDP. The revenues generated by taxes and payments administered by the Federal Tax Service increased by 0.27 p. p. of GDP. The revenues administered by the Federal Agency for Management of Federal Property persisted at the level observed in May of 2007. No complaints may be made with respect to the cash execution of the federal budget, whereas a certain decline in the revenues administered by the Federal Agency for Management of Federal Property was, most probably, caused by the seasonal nature of the respective payments and the decrease should be compensated by the end of the year. It should be noted that the share of the Federal Agency for Management of Federal Property in the total amount of tax generated and other revenues of the RF makes about 0.5 per cent.

Table 2

Amounts of revenues of the RF federal budget in 2006 through 2008 (in % of GDP)

	2006	May of 2007	2007	May of 2008	% of the cash execution of the FB as in 2008
Taxes and other payments administered by the Federal Tax Service	11,27	10,80	11,50	11,07	45,8
Taxes and other payments administered by the Federal Customs Service	10,76	9,97	9,98	11,49	44,0
Revenues administered by the Federal Agency for Management of Federal Property	0,26	0,13	0,25	0,13	30,9
Revenues of the federal budget administered by other federal agencies	1,25	0,89	2,14	1,36	82,2
Total revenues	23,54	21,78	23,87	24,05	45,9

Source: RF Finance Ministry, IET calculations.

According to the statement made by Alexey Kudrin, the RF Minister of Finance, recently the dynamics of world oil prices have become even more volatile and Russia should be equally ready to face both a growth and a sharp decline in oil prices. The rates of world economic growth have recently decreased; nevertheless, at the same time the prices of oil continued to grow, what was an apparent deviation from the traditional correlations. Earlier, as a rule the oil prices had declined in accordance with the decreases in the rates of growth in the world GDP.

In *Figure 3* there is presented the monthly dynamics of the oil and natural gas generated revenues and the oil and natural gas generated deficit of the federal budget. The oil and natural gas revenues are formed at the expense of the following sources: the tax on extraction of mineral resources in the form of hydrocarbon raw materials, export duties on crude oil, natural gas and oil products. The oil and natural gas is the difference between the aggregate expenditures of the budget and its revenues generated by oil and natural gas. The oil and natural gas deficit is one of the key indicators used for the evaluation of the stability of public finances from the standpoint of external economic risks. As it is seen from the graphs presented below (see *Figure 3*), at the backdrop of a significant growth in the world prices of energy resources, on the average in 2005 through 2008 the share of revenues of the federal budget generated by oil and natural gas in terms of the percentage of GDP was close to the level of 10 per cent; however, there were registered some fluctuations at the beginning and the end of each year over the period under observation. In its turn, the RF Ministry of Finance forecasts a decline in the oil and natural gas generated revenues of the federal budget from 10.06 per cent of GDP in 2008 to 7.49 per cent of GDP in 2009, 6.52 per cent of GDP in 2010 and 5.8 per cent of GDP in 2011.

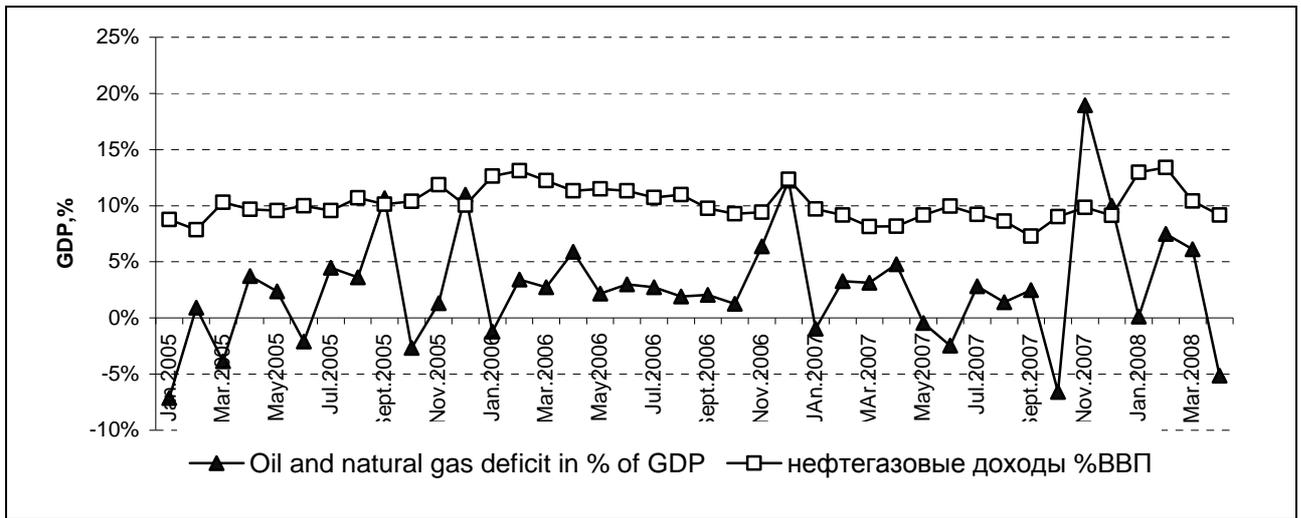


Fig. 3. Oil and natural gas generated revenues and the oil and natural gas generated deficit of the federal budget in 2005 through 2008 (in % of GDP)

Over the period under observation, the balance of the federal budget with the exclusion of oil and natural gas was predominantly within the limits from (-1) to (+5) per cent of GDP with specific peaks registered at the end of each year. This is evidence that there persist serious risks for the stability of the system of public finances and requires the prevention of undue softening of the budgetary policy. The lack of adequate policies aimed at the accumulation of oil generated revenues in the situation of high world oil prices can negatively affect the exchange rate of the Russian national currency.

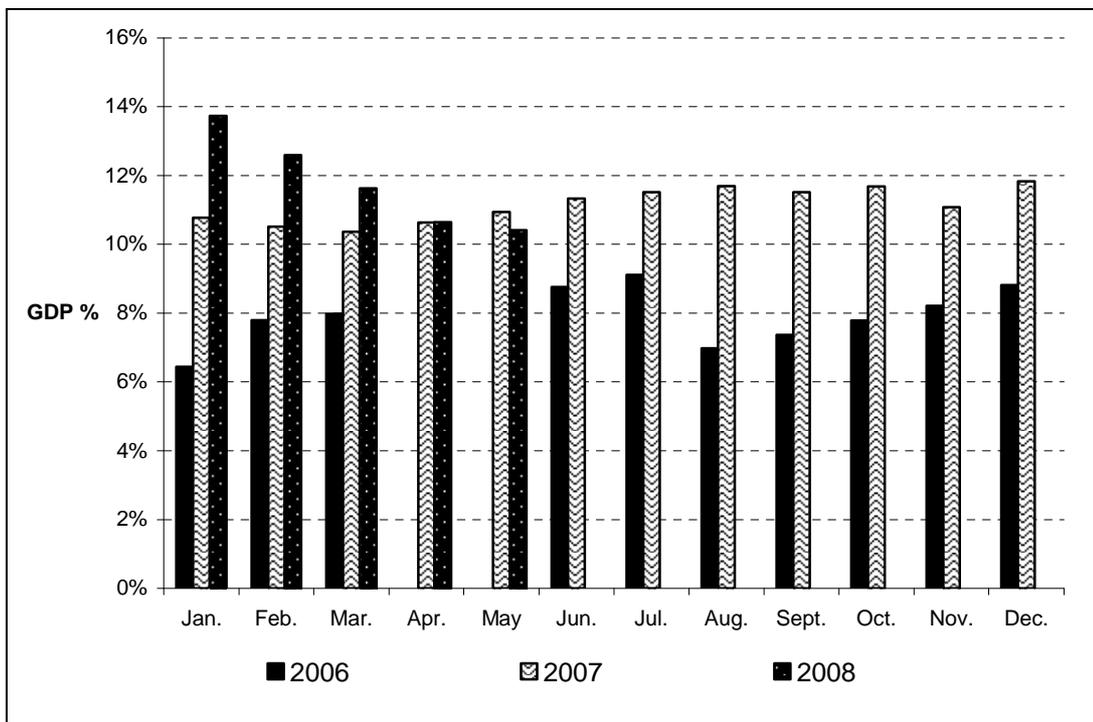


Fig. 4. The aggregate amount of financial resources of the RF Reserve Fund and the RF National Welfare Fund in 2006 through 2008, in % of GDP

As on July 1, 2008, the aggregate amount of financial resources of the RF Reserve Fund denominated in Rubles made 3 069.94 billion, or 8.3 per cent of GDP, whereas the amount of financial resources of the RF National Welfare Fund was registered at Rub. 773.93 billion, or 2.1 per cent of GDP. Therefore, the total amount of financial resources accumulated by these two funds in terms of shares in GDP continues to de-

crease; in January through May of this year it diminished by 3.33 per cent of GDP. This negative dynamics of revenues of the funds is caused by the fact that the oil and natural gas generated revenues are first accumulated in the federal budget until they make the amount of the annual oil and natural gas transfer and only after that begin to be entered in the RF Reserve Fund and the RF National Welfare Fund.

Financial Markets⁹

N. Burkova

In June, in general on the Russian financial markets there was observed not very favorable market situation as a result of the flow of investors from financial to commodity markets caused by the constant growth in oil prices observed throughout the month. This fact, as well as some negative corporate news about certain international financial companies influenced the Russian market leading to a decline in the values of its major stock indices by 3 per cent to 5 per cent in comparison with the figures registered during the past month. The downward trends were especially pronounced on the Russian stock market, where the activity of investors dropped by more than 20 per cent.

The Market for Government Securities

In May, in general Russian Eurobonds demonstrated upward dynamics in terms of levels of yield due to the fact that during that month the RF Government undertook a number of measures aimed at the curbing of inflation, among them the decision of the RF Central Bank to raise the refinancing rates by 0.25 p. p. up to 10.75 per cent per annum, which it made on July 4. This action was aimed at the restraining of inflation rates and the further deceleration of the dynamics of money supply.

As on June 20, 2008, the yield to maturity of Russian Eurobonds RUS 30 increased in comparison with the data registered on May 27, 2008, from 5.40 per cent p. a. to 5.49 per cent p.a. (by 1.67 per cent); RUS 18 – from 5.32 per cent p.a. to 5.53 per cent p. a. (by 3.95 per cent); RUS-28 – from 5.92 per cent p.a. to 5.99 per cent p. a. (by 1.18 per cent); and RUS-10 – from 2.57 per cent p.a. to 2.92 per cent p. a. (by 13.62 per cent). The latter bond demonstrated the most significant growth registered with respect to the quotations of the government Eurobonds during that month. Besides, on the same date the yield to maturity of the Minfin bonds demonstrated a similar trend. Thus, the yield to maturity of Minfin bonds, 7th tranche, increased in comparison with the data registered as on May 27 from 4.32 per cent p. a. to 4.39 per cent p. a. (by 1.39 per cent), see *Figures 1 – 2*).

As concerns the market of Ruble denominated bonds, throughout June there were also observed the positive dynamics demonstrated by government bonds: the yields of both Russian Eurobonds and Minfin bonds grew. The activity on secondary markets remained at the practically same level as a month ago.

⁹ 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 the official web sites of Russian issuing companies.

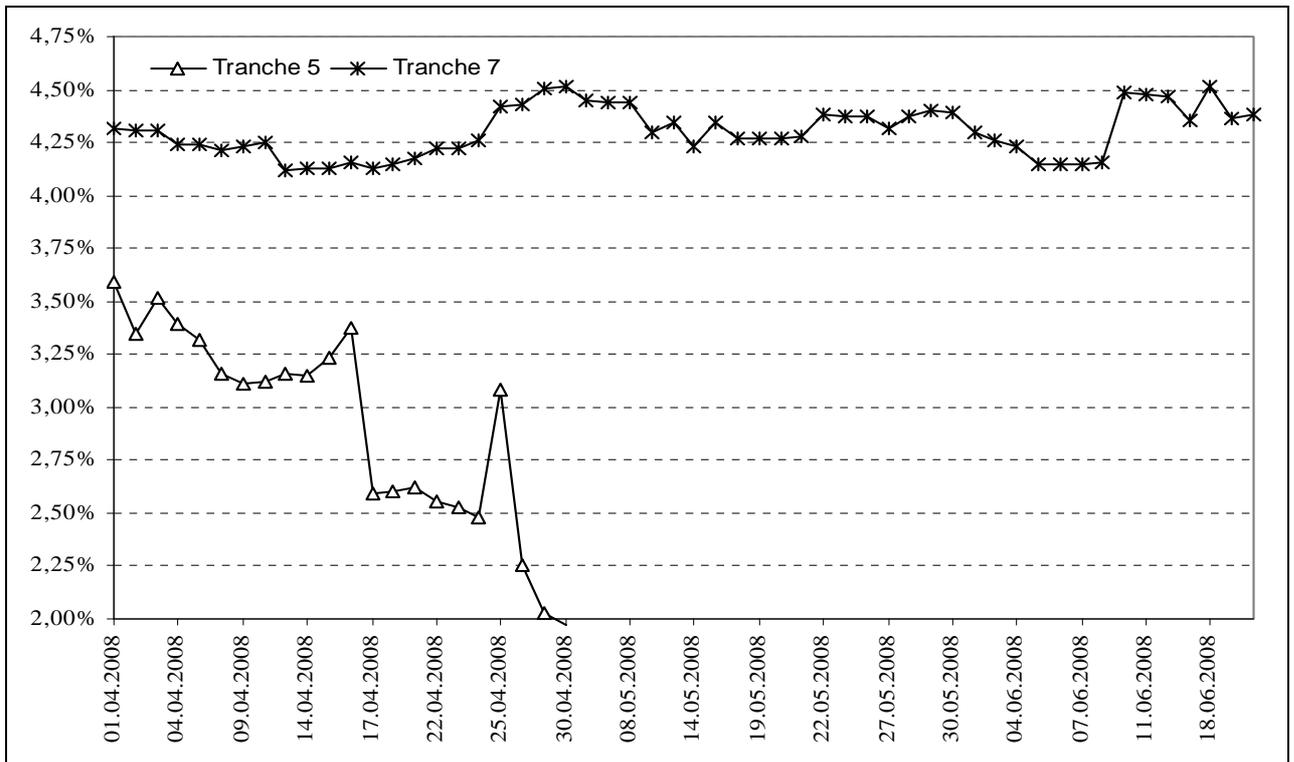


Fig. 1. Minfin bonds' yields to maturity in April - June 2008

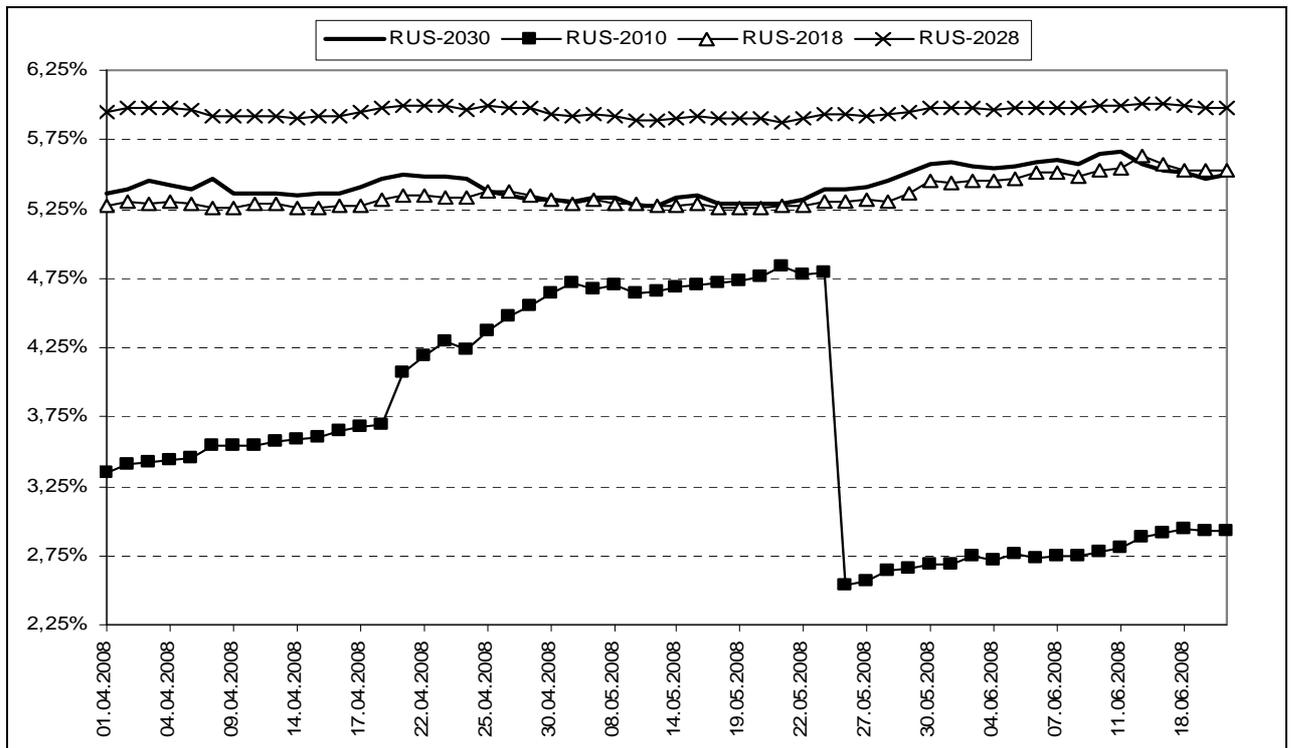


Fig. 2. Yields to maturity of the Russian eurobonds with maturity in 2010, 2018, 2028 and 2030 in April - June 2008

Over the period from May 28 to June 20, the aggregate turnover of the secondary GKO OFZ market made about RUR 47.43 billion, while the average daily turnover was registered at the level of RUR 2.79 billion (about RUR 53.31 billion and RUR 2.81 billion respectively in May). Therefore, the intensity of trade in the sector of government Ruble denominated bonds significantly increased in August in comparison with the figures registered in the preceding month.

During the period from May 28 to June 20, on the primary market there took place two auctions for the additional placement of the federal loan bonds (*Russ. abbr. - OFZ*). Thus, on June 4 there took place an auction for the additional placement of OFZ series 25062, the amount of issue of which was registered at RUR 6 billion, whereas the actual amount of the placement of the 25060 issue at the auction made about RUR 5.99 billion. The weighted average yield of the placement made 6.41 per cent p. a. On June 11, there were held two auctions, where there took place the additional placement of issue of OFZ series 46020 and 26200: the amount of the issues made RUR 7 billion and RUR 8 billion respectively, whereas the actual amount of the placements made RUR 6.98 billion and 7.998 billion respectively. The weighted average yield of these additional placements made 7.2 per cent p. a. and 6.67 per cent p. a. respectively. Therefore, it should be noted that in June primary auctions were characterized by a somewhat smaller amounts of supply (RUR 20.97 billion) in comparison with the figures observed last month, when the actual amount of placement made RUR 26.97 billion.

As on June 27, the amount of the GKO – OFZ market made RUR 1115.51 billion at par and RUR 1111.25 billion at the market value. The duration of the GKO-OFZ market portfolio was 2173.90 days demonstrating a decline by 21.51 days in comparison with the figures registered last month (as on May 27).

The Market for Corporate Securities

The business situation on the stock market

The situation observed on the world commodity markets has reacted negatively on the write down of new losses borne by the largest financial companies because of the persisting credit crisis in the USA, what facilitated a decline in the values of the majority of shares at Russian exchanges registered as a result of the trade carried out during the month, as well as the appearance of a downward trend demonstrated by the quotations of the main Russian stock indices, in particular MICEX (by almost 6 per cent) in comparison with the figures registered last month. In their turn, the oil prices, which have reached a new historical peak of US \$ 141 per barrel in the second half of the month, affected the outflow of investors from the financial market to the commodities world markets. The amount of trade on the Russian stock market has also significantly diminished (by 20 per cent) in comparison with the data collected a month ago. Among the most significant events observed on the stock market there may be singled out the cessation of the circulation of RAO UES of Russia shares at stock exchanges on June 6, 2008, as well as the completion of the final stage of reorganization of the company on June 30, 2008.

Throughout June there was observed a substantial volatility on the Russian stock market. Thus, a trend towards a decline of the MICEX index has been several times changed by short-term periods of growth within the month. (see Fig. 3). On June 2, 2008, the MICEX index reached its maximum value of the month (1915.84, what was below the value of this indicator registered last month by 2.06 per cent). Such a decline in the MICEX index values observed in June reflected the general downward trend demonstrated by the majority of quotations of the shares in Russian companies (see *Figure 3*).

On the whole, in the period from May 28 till June 27 of 2008, the MICEX index dropped by 5.63 per cent, or by 105.34 points in absolute terms (over the year from May 28, 2007 till June 27, 2008, the MICEX index grew by 13.14 per cent). Over the same period, the turnover of the MICEX trading with stocks included in the MICEX index amounted to about RUR 1 052.72 billion, while the average daily turnover at the MICEX made about RUR 47.85 billion (about RUR 1 323.19 billion and the average daily turnover at the level of RUR 66.16 billion respectively during the preceding period from April 28 till May 27 of 2008). Therefore, in June the weekly activity of investors on the stock market decreased significantly (by almost 28 per cent) as compared with the respective figures registered a month ago. The highest and the lowest daily volumes of trade at the MICEX in June made RUR 69.17 billion (on June 4) and RUR 30.86 billion (on June 7).

Over the last month (from May 28 till June 27 of 2008), the majority of the “blue chips” demonstrated negative dynamics of quotations with the exception of shares in Gazprom Neft, the prices of which grew by 10.45 per cent and the shares in Rostelekom (by 3.48 per cent), as well as the shares in RAO UES of Russia¹⁰ (as on June 6, 2008) (by 2.02 per cent) and Mosenergo (by 0.59 per cent). In June, among the leaders of the market in terms of decline in prices during the month there were observed shares in Sberbank of Russia and GMK Norilsk Nickel, the prices of which decreased by 10.38 per cent and 9.68 per cent respectively. Prices of shares in LUKOIL (by 7.67 per cent), Surgutneftegaz (by 5.42 per cent), Gazprom (by 4.05 per

¹⁰ On June 6 of 2008 the circulation of the shares in the RAO UES of Russia at exchanges was stopped due to the reorganization of the company.

cent), Tatneft (by 3.27 per cent), and Rosneft (by 0.83 per cent) were characterized by somewhat less rates of decline. (See Figure 4).

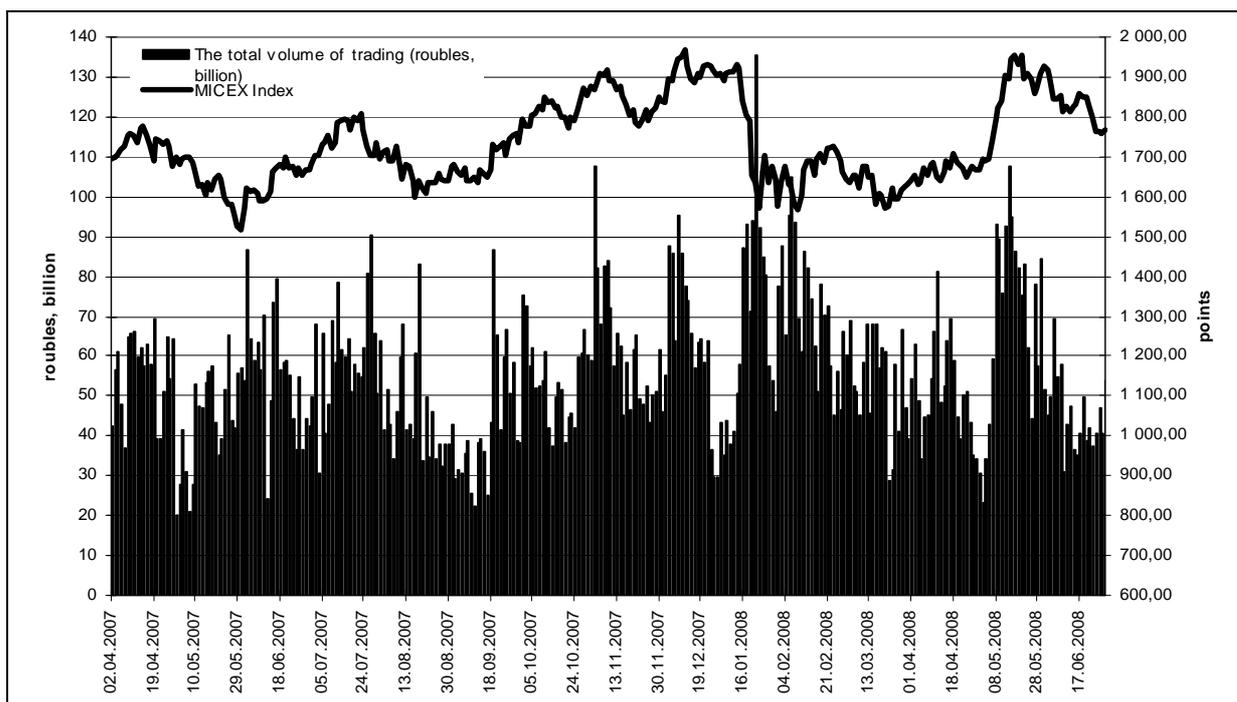


Fig. 3. Dynamics of MICEX Index and trading volume

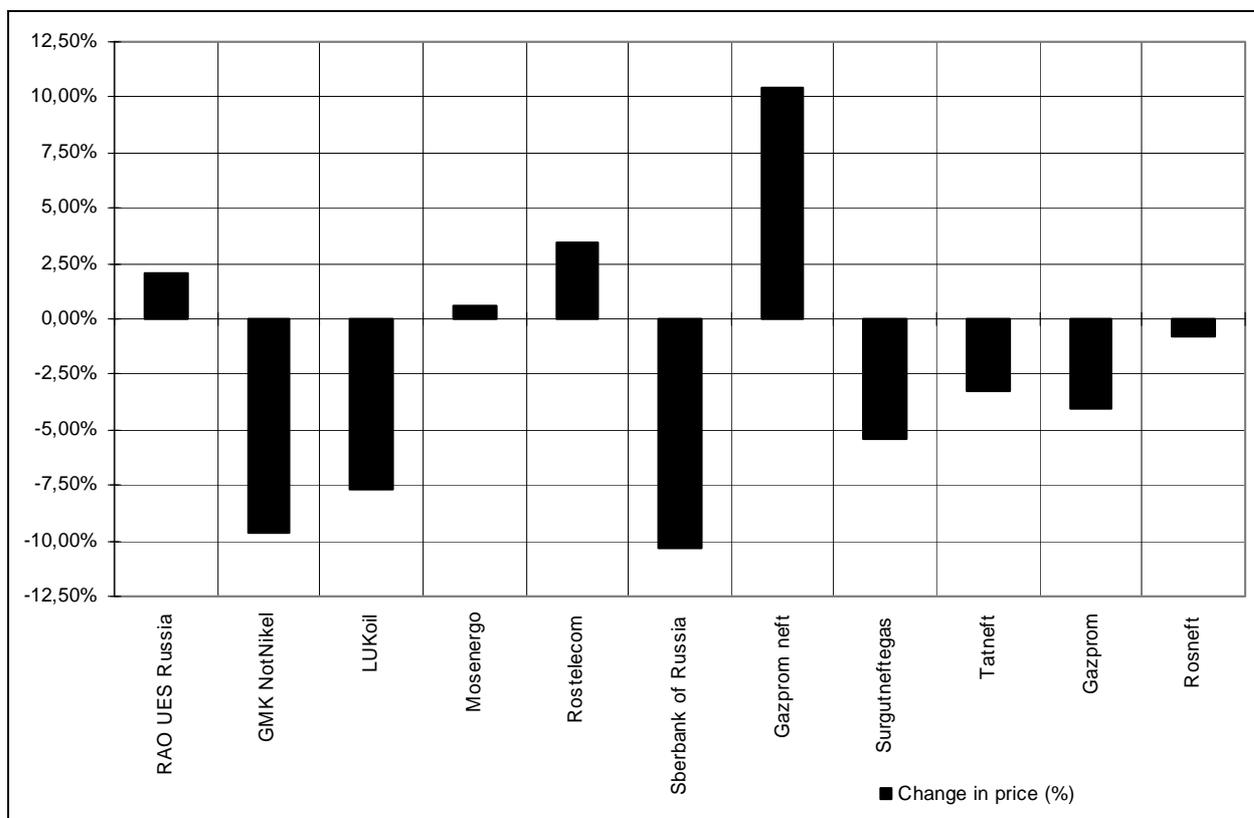


Fig. 4. Dynamics of the Russian Blue Chips from May 28 to June 27, 2008

In August, the list of leaders in terms of the volume of turnover at the MICEX looked as follows: the shares in Gazprom (28.24 per cent of the total turnover), LUKoil (21.63 per cent), GMK Noril'sk Nickel (13.47), Sberbank of Russia (11.41 per cent), and Rosneft (6.50 per cent). Therefore, the aggregate volume

of trade with the shares of all blue chips made about 90 per cent of the total turnover registered in the period from May 28 till June 27.

According to the data presented by MICEX, as on June 27, the list of top five leaders of the national stock market by capitalization looked as follows: Gazprom: RUR 8 152.45 billion; Rosneft: RUR 2 423.02 billion; LUKOIL: RUR 1 990.37 billion; Sberbank of Russia: RUR 1 809.63 billion; and GMK Norilsk Nickel: RUR 1 323.89 billion.

The market for fixed term contracts

In June of 2008, the activity of investors on the market of the MICEX fixed term contracts significantly decreased (by more than 40 per cent) in comparison with the figures registered a month ago; over this time the number of transactions dropped by almost 2.6 times. Thus, in June the aggregate volume of trade in futures and options at the MICEX amounted to about RUR 200.0 billion (683 transactions and 8.26 million contracts) as compared with about RUR 339.6 billion (1787 transactions and 13.9 million contracts) registered in May. In June, similarly to the situation observed a month ago, futures RUR / US \$ accounted for the bulk of trade making RUR 195.6 billion (278 transactions and 8.22 million contracts). A significant decline in the number of transactions observed on the MICEX fixed term contracts in June was primarily related to the fact that the number of transactions involving futures for the MICEX index decreased substantially (by more than 3.2 times in comparison with the figures registered a month ago).

A different situation was observed on the RTS fixed term contracts (FORTS), where in June the activity of investors insignificantly increased (by about 1 per cent) in comparison with the figures registered last month. Thus, in the period from May 28 till June 27, the aggregate volume of trade in futures and options at the RTS amounted to about RUR 1261.1 billion (2080 thousand transactions and 25.2 million contracts) as compared with about RUR 1250.4 billion (1958 thousand transactions and 22.7 million contracts) registered in May. As earlier, futures contracts accounted for the greatest percentage of transactions: the volume of trade in these contracts made RUR 1050.8 billion (2009 thousand transactions and 18.1 million contracts,) over the period under observation. As before, options were in a much lower demand: the respective amount of trading made about RUR 210.3 billion (71 thousand transactions and 7.21 million contracts). In June, the maximum trading volume on this market was observed on June 9 and made RUR 87.3 billion, while the minimum trading volume (RUR 32.5 billion) was registered on June 7.

The amount of transactions involving the "Shares of electric power companies" futures with maturity on December 15, 2008, which were introduced in order to support the electric power companies' securities liquidity upon discontinuation of RAO UES trades on the stock market since June 6, 2008, made 956 transactions in June. Since July 1, the base asset of that futures will be the "basket" composed of 23 securities of the companies from RAO UES of Russia assets, namely: OGK-1 (OGK is power-generating company in the wholesale electricity market), OGK-2, OGK-3, OGK-4, OGK-6, TGC-1 (TGC is regional power-generating company), TGC-2, TGC-4, TGC - 6, UGK TGC-8, TGC-9, TGC-10, TGC-11, TGC-14, Volzhsk TGC, Eniseysk TGC, Mosenergo, Kuzbassenergo, FSK (federal network company), HydroOGK, INTER RAO UES Holding, MRSK Holding (MRSK is the Interregional Distribution Company) and RAO Eastern Energy Systems.

Corporate bond market

Throughout June, in general on the market of corporate debt there were observed mixed dynamics of quotations of the respective bond issues. At the same time, during the month there was observed a significant growth in the activity of investors on the market (more than by 4 times in comparison with the figures registered a month ago). The number of placed securities issues placed on the market also increased in June more than by 1.5 times in comparison with the data collected last month.

From May 28 till June 20, the value of the price index of corporate bonds traded at the MICEX¹¹ decreased by 0.1 point (by 0.09 per cent) similarly to the index of the ten most liquid corporate sector bonds, which demonstrated a decline by 0.38 point (by 0.32 per cent), see *Figure 5*. Over the same period, the total turnover in the bond sector of MICEX made about RUR 250.75 billion and the average daily turnover was at the level of about RUR 14.75 billion (about RUR 72.20 billion and the average daily turnover amounting to RUR 3.44 million in May). Therefore, in June the activity of investors significantly increased in comparison with the situation observed in May.

¹¹ The indices of corporate bonds traded at the MICEX that have been used for the calculations are calculated by Zenit Bank.

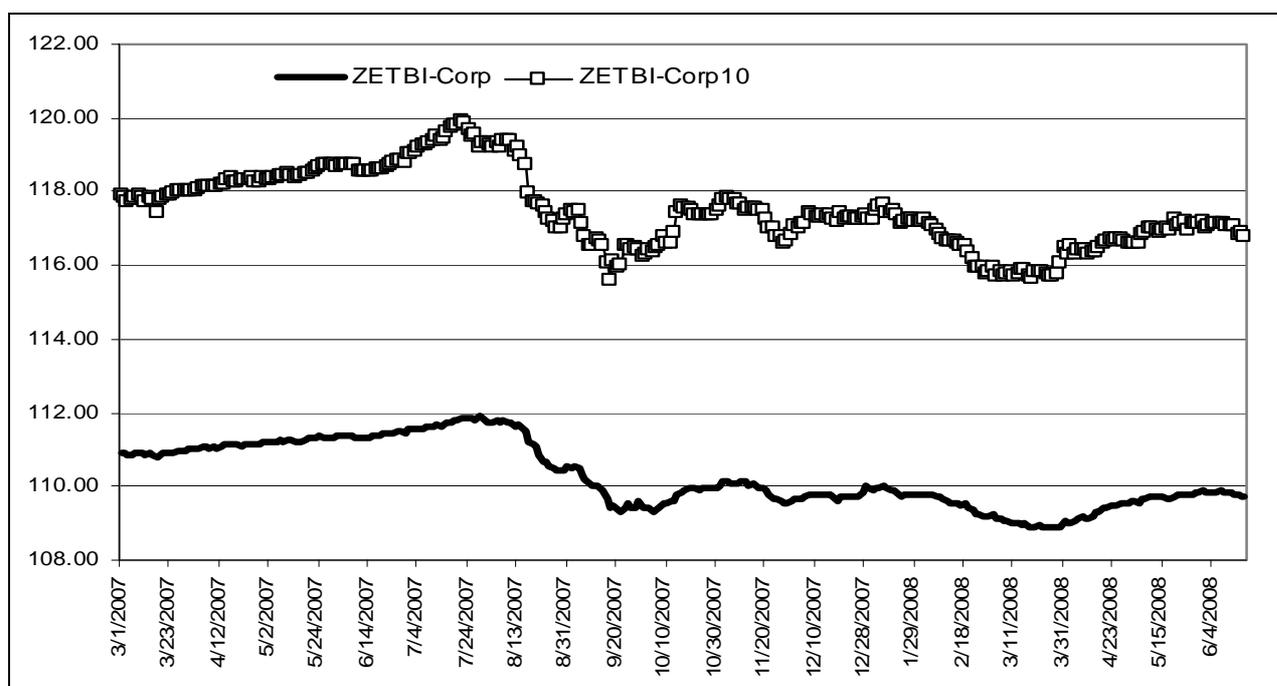


Fig. 5. Dynamics of corporate bond indices

External factors affecting the dynamics of the Russian stock market

In June, the dynamics observed on the Russian financial market were primarily determined by the favorable business situation on the world commodity markets resulting from a sharp increase in the oil prices. The exchange price of oil reached its new historical maximum value of more than US \$ 141 per barrel. The rise in the oil prices was, among other factors, facilitated by the decision of the US Federal Reserve System to retain its discount rate at the level of 2 per cent, concerns about the stability of oil supply from Libya and the possibility of a war situation in Iran. The published that month US statistics, which presented the data on a decline in the volume of gasoline reserves, as well as some corporate news that certain largest financial companies wrote down additional losses they borne in connection with the restructuring of their credit positions in the 1st quarter of 2008, and also higher inflationary expectations resulted in a decline of the major world stock exchange indices. Thus, in June there was observed a decrease in the values of the majority of the world indices in comparison with both the figures registered at the beginning of 2008 and as compared with the values of the respective indicators observed at the end of May. At the same time, it should be noted that if the US and European markets primarily dropped by 6 per cent to 11 per cent (in comparison with the data collected at the end of May), the markets of developing countries were characterized by a less significant level of fall (by 1 per cent to 10 per cent). The downward trend has affected also the main Russian stock exchange indices, which decreased by 3 per cent to 5 per cent during June. Even the high oil prices, which persisted throughout that month, could not prevent this decline (see *Table 1* and *Figure 6*).

Table 1

Dynamics of international stock market indices (according to the data as of June 27, 2008)

	Code	Value	Change within the month (in %)*	Change since the beginning of the year (in %)
MICEX (Russia)	MICEXINDEXCF	1765,91	-4,90	-6,51
RTS (Russia)	RTSI	2318,61	-3,01	1,23
Dow Jones Industrial Average (USA)	DJI	11346,51	-9,58	-14,46
Nasdaq Composite (USA)	NASD	2315,63	-6,67	-12,69
S&P 500 (USA)	SPX	1278,38	-7,72	-12,94
FTSE 100 (UK)	FTSE	5529,90	-8,72	-14,36
DAX-30 (Germany)	DAX	6421,91	-7,71	-20,40
CAC-40 (France)	CAC	4397,32	-10,38	-21,67

	Code	Value	Change within the month (in %)*	Change since the begin- ning of the year (in %)
Swiss Market (Switzerland)	SSMI	6861,54	-7,50	-21,90
Nikkei-225 (Japan)	NIKKEI	13544,36	-2,51	-11,52
Bovespa (Brazil)	BUSP	64321,11	-9,40	0,68
IPC (Mexico)	IPC	29295,00	-6,75	-0,82
IPSA (Chile)	IPSA	3025,10	-1,36	-0,88
Straits Times (Singapore)	STI	2955,91	-5,12	-15,12
Seoul Composite (South Korea)	KS11	1684,45	-7,71	-11,21
ISE National-100 (Turkey)	XU100	35829,40	-10,85	-35,49
Morgan Stanley Emerging Markets Free Index	EFM	882,29	-8,54	-12,16

* In relation to the values of the indices registered as on May 27, 2008.

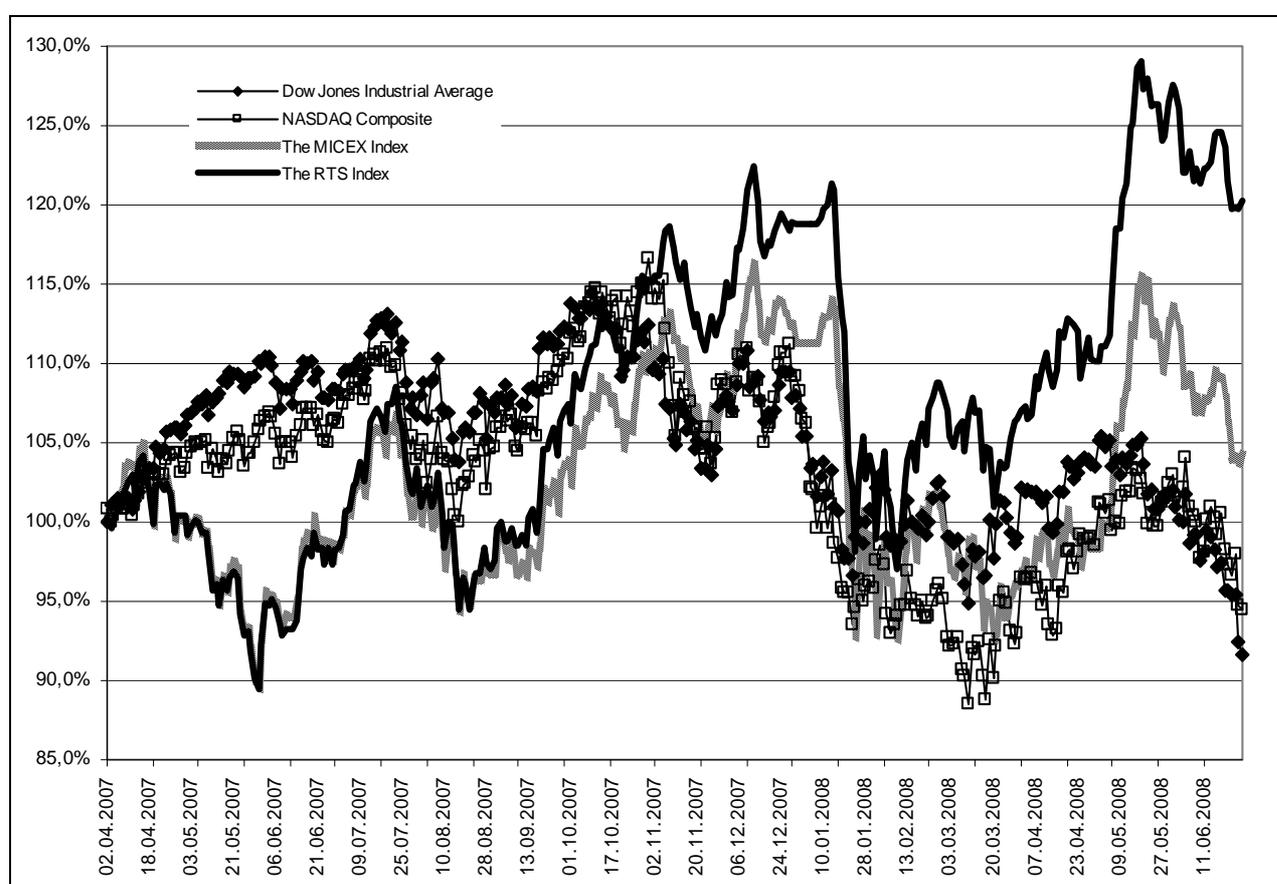


Fig. 6. Dynamics of the main USA and Russian stock indexes (in % to the date 01.04.2007)

Corporate news OAO Gazprom

On May 27, 2008, the Board of Directors of the OAO Gazprom approved an increase in the company's authorized capital and purchase of 50.000008 per cent of shares in the OAO Salavatnefteorgsintez from the NPF Gazfond. On May 29, 2008, there was made a statement on the discovery of a large oil and gas condensate field in the structure "Tsentralnaya" (situated in the central part of the Caspian Sea on the border between Russian and Kazakhstan); at present the exploration of the well is underway. On June 16, 2008, there was opened the first official representation office of the OAO Gazprom on the African continent.

Also on June 27, 2008, the annual General Meeting of the shareholders of the OAO Gazprom approved the annual report and the company's financial statement for year 2007. There was taken the decision concerning the distribution of the company's profit received in that financial year, including the decision to pay annual dividends in the amount of RUR 2.66 per one share (a growth by 4.7 per cent in comparison with the

figures registered in 2006). The total amount due to be allocated for the payment of dividends made RUR 62 971.5 million, or 17.5 per cent of the net profits; the date of completion of the payment of dividends was set on December 31, 2008.

OAo Gazprom Neft

On May 28, 2008, the OAO Gazprom Neft and the OAO Moscow Oil and Gas Company (MNGK) registered a joint venture established on the parity basis (50 per cent of the authorized capital are owned by the OAO Gazprom Neft and 50 per cent are owned by the OAO Moscow Oil and Gas Company (MNGK)) for the purposes of management of the Moscow Oil Refinery – the Moscow NPZ Holdings B.V.

On June 20, 2008, the annual General Meeting of the shareholders of the OAO Gazprom Neft approved the annual report and the company's financial statement for year 2007, as well as the decision to pay annual dividends for year 2007 in the amount of RUR 5.4 per one ordinary share (the payments should be completed prior to May 31, 2009).

OAo LUKOIL

On June 4, 2008, the OAO LUKOIL published its consolidated financial statements for the 1st quarter of 2008 prepared in accordance with the US Generally Accepted Accounting Principles (US GAAP): the net profits made US \$ 3 163 million, what was by 143.5 per cent above the figures registered in the 1st quarter of 2007; the value of the EBITDA indicator grew by 99.3 per cent and made US \$ 4 846 million; the proceeds from sales increased up to US \$ 24 955 million, or by 59.4 per cent.

On June 20, 2008, the OAO LUKOIL drew down a loan amounting in total to US \$ 1 billion; the borrowed sum was used to repay the rest of the debt of the LUKOIL Finance Ltd. to the syndicate of international banks for the loan drawn down in 2005 for the purpose of financing of the purchase of the company Nelson Resources.

On June 23, 2008, the OAO LUKOIL and the Italian company ERG S.p.A. signed an agreement on the establishment of a joint venture for the joint management of the oil refinery complex ISAB situated near the town of Priolo (Sicily). In the created joint venture, the OAO LUKOIL should own 49 per cent of participation, whereas the ERG should have 51 per cent. The amount of this transaction made Euro 1,347 billion with the exclusion of the value of the stock tank oil. It is expected that this transaction will be finalized in the 4th quarter of 2008.

Besides, on June 26, 2008, the annual General Meeting of the shareholders of the OAO LUKOIL approved the annual report and the company's financial statement for year 2007 and the decision to pay annual dividends in the amount of RUR 42 per one ordinary share (as compared with RUR 39 for year 2006). In 2007, the company's net profits increased by 27.1 per cent making the record high US \$ 9.5 billion.

OAo GMK Norilsk Nickel

On June 10, 2008, the OAO GMK Norilsk Nickel published its consolidated financial statements for year 2007 prepared in accordance with the International Financial Reporting Standards (IFRS). The proceeds from sales made US \$ 17.1 billion, what was by 44 per cent above the figures registered in 2006; the value of the EBITDA indicator made US \$ 10.2 billion (by 31 per cent above the figure observed in 2006).

RAo UES of Russia

On May 28, 2008, there was held an open auction for the sale of the 50.9 per cent block of shares in the OAO "Mosenergosbyt" owned by the RAO UES of Russia; on May 29 there were held open auctions for the sale of shares in the companies OAO "Komi energosbytovaya kompaniya" (50.11 per cent of shares), OAO "Stavropolenergosbyt" (55.13 per cent), OAO Bryanskaya sbytovaya kompaniya" (49 per cent) and OAO "Arkhangelskaya sbytovaya kompaniya" (49 per cent) owned by the RAO UES of Russia. On June 17, 2008, there was held an open auction for the sale of the 48.43 per cent block of shares in the OAO "Energosbyt Rostovenergo" owned by the RAO UES of Russia; on June 18, 2008, there was held an open auction for the sale of the 100 per cent block of shares in the OAO "Tyumenskaya energosbytovaya kompaniya" owned by the RAO UES of Russia; and on June 25, 2008, there was completed the transaction involving the sale of the 49 per cent block of shares in the OAO "Chelyabenergosbyt" owned by the RAO UES of Russia.

On June 6, 2008, the shares of the RAO UES of Russia ceased to be circulated at exchanges. At the same time, in order to support the electric power companies' securities liquidity upon discontinuation of the trade with shares in the RAO UES on the FORTS there was introduced the "Shares of electric power companies" futures with maturity on December 15, 2008. The base asset permitted for trade made a block of 1000 ordinary shares in the RAO UES of Russia. Since July 1, 2008, the base asset of that futures will be the "basket" composed of 23 securities of the companies, in which the RAO UES of Russia was divided.

On June 25, 2008, the RAO UES of Russia submitted to the Federal Tax Service the package of documents necessary for the completion of its reorganization. In accordance with the standard procedure, 28 holding companies, in which the RAO UES of Russia was divided, should be registered by the Federal Tax

Service within 5 working days after the date of submission of the documents. Twenty two of them should later be simultaneously merged with the target companies, whereas 5 holding companies should retain the status of holding companies. On the same date as the holding companies are separated, the RAO UES of Russia should be included in the Federal Grid Company and cease its existence as a legal entity. As a result of the final stage of reorganization, shareholders in the RAO UES of Russia should receive the shares in the 23 key energy companies in accordance with the coefficients approved by the extraordinary meeting of the shareholders of the RAO UES of Russia on October 26, 2007. Therefore, on July 1 the reorganization of the head company RAO UES of Russia should be completed.

OAO NK Rosneft

On June 5, 2008, the regular general meeting of the shareholders of the OAO NK Rosneft approved the annual report for year 2007, the annual financial statement for year 2007, as well as the distribution of the company's profits. The net profit was approved in the amount of RUR 162.22 billion. There was taken the decision to allocate RUR 16.96 billion for the payment of dividends for year 2007 in the amount of RUR 1.6 per one ordinary share (the payments should be completed by December 31, 2008); the approved amount of dividends exceeds the dividend related payments made for year 2006 by 20 per cent.

Besides, on June 9, 2008, the OAO NK Rosneft published its consolidated financial statements for the 1st quarter of 2008 prepared in accordance with US Generally Accepted Accounting Principles (US GAAP): the value of the earnings before interest, taxes, depreciation and amortization (EBITDA) increased up to US \$ 4 698 million, what was by 225.3 per cent above the amount of US \$ 1 444 million registered in the 1st quarter of 2007; the net profit grew up to US \$ 2 564 million, what was almost by 7 times above the respective value observed in the respective period of 2007 (US \$ 358 million).

OAO Rostelekom

On June 9, 2008, the regular general meeting of the shareholders of the OAO Rostelekom approved the annual report for year 2007, the annual financial statement for year 2007, as well as the distribution of the company's profits for year 2007 in the following way: RUR 7 067.9 million, or 75 per cent of the net profits were allocated for the increase in the company's own capital, whereas for the payment of dividends for year 2007 there were allocated RUR 2 356.0 million (25 per cent of the net profits).

Sberbank of Russia

On June 7, 2008, Sberbank of Russia and the Deutsche Bank AG signed a Memorandum of Understanding envisaging the further development of cooperation between these two banks as concerns the provision of efficient financial instruments and joint services on the international finance markets in the sphere of project tied lending and structured products, corporate, trade and export financing, as well as in the field of retail business to their customers. The parties were planning to jointly work on the financing of projects in the framework of preparation for and holding of the Winter Olympic Games in the town of Sochi in 2014.

Over the first five months of 2008, the aggregate credit portfolio of the Sebrbank of Russia has increased by RUR 572.5 billion and made RUR 4 676.4 billion. The growth in the bank's earnings before taxes in comparison with the figures registered in the first five months of 2007 made 41.7 per cent; in absolute terms the profits before taxes made RUR 77.2 billion, whereas the net profits were at RUR 56.4 billion.

OAO Tatneft

Over the first 5 months of 2008, the OAO Tatneft extracted 13 535 481 metric tons of oil, or 101.4 per cent of the figure registered in the respective period of 2007; there were drilled 308 thousand meters of oil wells, constructed and commissioned 174 oil wells and capital repairs were performed at 1 052 oil wells.

On June 25, 2008, the OAO Tatneft published its audited consolidated financial statements for year 2007 prepared in accordance with the US Generally Accepted Accounting Principles (US GAAP): in 2007, the proceeds from sales made RUR 356 276 million as compared with RUR 318 284 million registered in 2006; the net profits for year 2007 made RUR 43 279 million as compared with RUR 29 773 million in net profits earned by the company in 2006.

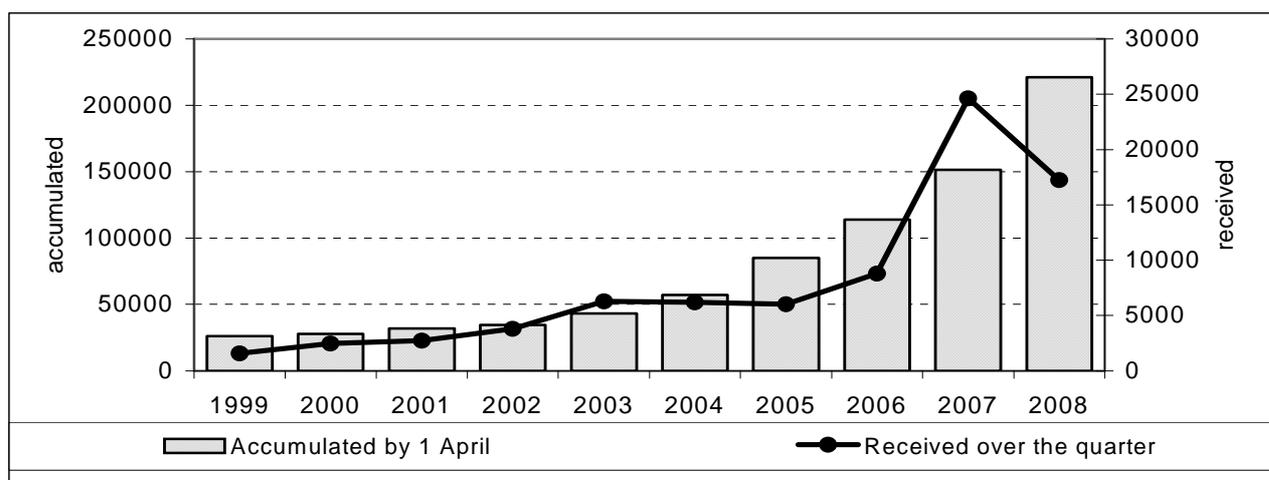
Besides, on June 26, 2008, the regular annual General Meeting of the shareholders of the OAO Tatneft approved the annual report for year 2007 and the financial statements for the financial year, as well as the payment of dividends for year 2007 in the amount of 565 per cent of the face value of one ordinary share and 565 per cent of the face value of one preferred share (the dividends should be paid within the period from July 1 till December 31 of 2008).

Foreign Investments in Russian Economy

E. Ilukhina

In 1st quarter 2008 foreign investments received by non-financial sector of economy were 29.9% below the corresponding figure of the previous year. The most significant decrease was observed in the segment of direct investments – they reduced by 42.8% as compared with 1st quarter 2007. The same as in 2007 the volumes of foreign investments in the Russian economy were nearly double of those from Russia abroad. By the end of March 2008 the volume of accumulated foreign investments in the Russian economy reached the level of USD 221.0 bln, which is 45.9% higher than the level of March 2007.

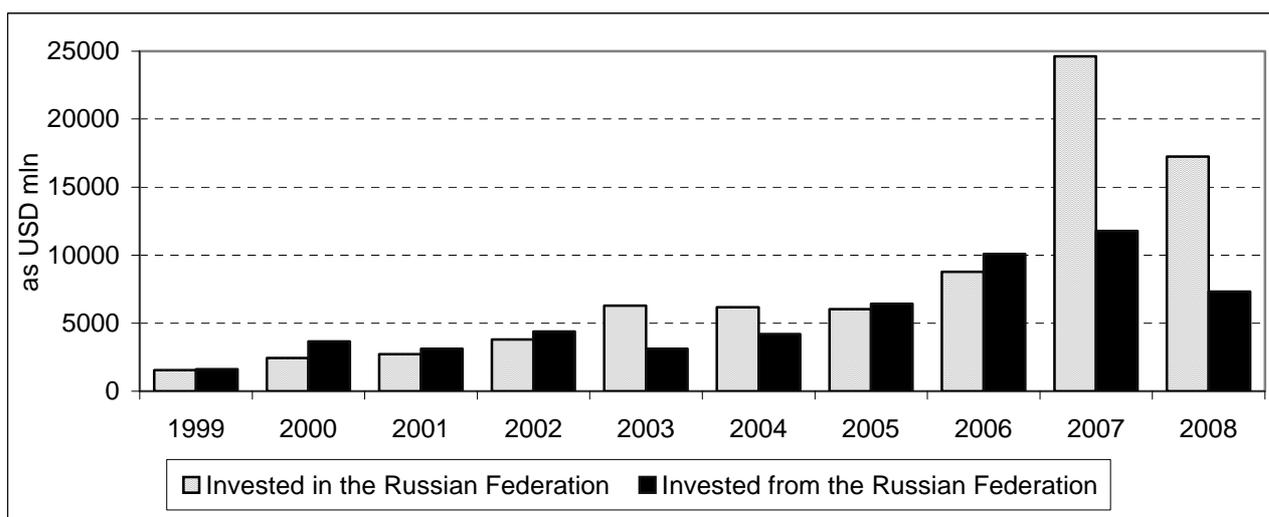
The beginning of the current year was characterized by drop in activity of foreign investors in the Russian economy. The volume of foreign investments received by non-financial sector of economy not taking into account monetary and credit regulations bodies, commercial and savings bank, including ruble investments, recalculated to US dollars, was equal to USD 17.3 bln, which was 29.9% below the figure of 1 quarter 2007.



Source: Federal State Statistics Service

Fig.1 Foreign Investments in the Russian Economy in 1 quarter 1999-2008, as USD mln

The same as in 2007 the volumes of foreign investments in the Russian economy exceeded by more than two times investments from Russia abroad.



Source: Federal State Statistics Service

Fig. 2 Foreign Investments into the Russian Federation and from the Russian Federation abroad in 1 quarter 1999-2008

As compared with the previous year the drop of investments by all directions of foreign investments use occurred. In relative and absolute terms in 1 quarter of the current year the biggest decrease was observed in the segment of direct investments, which reduced by 42.8% (down to USD 5.6 bln) as compared with 1 quarter 2007. The volumes of other and portfolio investments reduced as compared with 1 quarter 2007 by 21.3% (down to USD 11.5 bln) and by 37.6% (down to USD 123 mln), correspondingly.

Taking into account more intensive decrease rates of direct investments in 1st quarter of the current year, their share in the structure of aggregated investments in the Russian economy decreased.

Table 1

**Structure of Foreign Investments received by the Russian Federation
in 1 quarter 2003-2008, as percentage**

	2003	2004	2005	2006	2007	2008
Direct investments	16.5	23.9	31.9	43.7	39.5	32.4
Portfolio investments	0.3	1.4	1.3	2.6	0.8	0.7
Other investments	83.2	74.6	66.8	53.6	59.6	66.9

Source: Federal State Statistics Service

Speaking of direct investments, it should be noted that contributions to authorized capital stock of enterprises situated in the territory of the Russian Federation increased by 2.1 times (up to USD 4.2 bln). Their share in the structure of direct foreign investments went up to 75.9% (20.6% in 1 quarter 2007). Credit component of direct investments has reduced by 6.6 times down to USD 1.1 bln, which has led to the decrease in the share of credits, received from the foreign co-owners of organizations in the structure of direct investments down to 20.3% (76.5% in 1 quarter 2007).

The same as in the preceding years, the biggest volumes of foreign investments is directed to the industry. Their share in the industry structure increased up to 48.9%, though in the absolute terms foreign investments in industry reduced by USD 3.5 bln. It is trade and catering that hold the second place by attractiveness for foreign investors. In this sphere there is also a decrease of foreign investments observed as compared with the 1st quarter 2007 by USD 2.4 bln. The most significant reduction of foreign investments (by 7.6 times) was noted in the sphere of communication and transportation.

Table 2

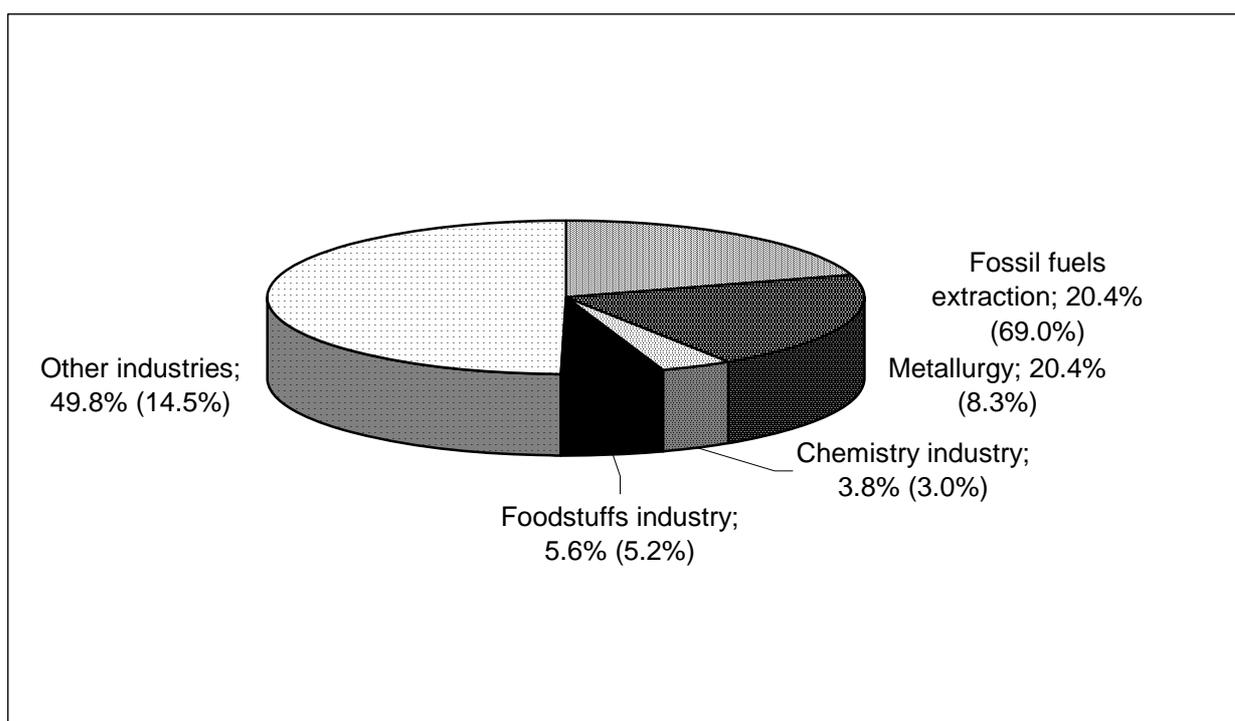
**Structure of Foreign Investments in the Russian Economy by Branches of Industry
in 1 Quarter 2006-2008**

	As USD mln			As percentage to the total			Change as percentage on the corresponding period of the previous year		
	2006	2007	2008	2006	2007	2008	2006	2007	2008
Industry	5 214	11 899	8 445	59.3	48.3	48.9	155.8	by 2.3 times	71.0
Construction	25	272	474	0.3	1.1	2.7	125.0	by 10.9 times	174.3
Transportation and communication	701	2 740	361	8.0	11.1	2.1	89.8	by 3.9 times	13.2
Trade and catering	1635	7 895	5473	18.6	32.1	31.7	149.5	by 4.8 times	69.3
Commercial activity on market servicing	434	891	1779	4.9	3.6	10.3	94.1	by 2.1 times	199.7
Finance, credits, insurance, pension provisions	689	821	513	7.8	3.3	3.0	by 2.6 times	119.2	62.5
Other branches of industries	792	106	210	9.0	0.4	1.3	by 13.7 times	13.4	198.1

Source: Federal State Statistics Service

As a result of 1 quarter 2007 the decrease of foreign investments concentration in a number of industrial branches was observed. Investments in fossil fuels extraction, which were immensely popular in 1 quarter 2007, in the current year decreased by 4.8 times down to USD 1.7 bln. In 1 quarter 2008 foreign investors showed much interest in the manufacturing sector of the Russian economy. Investments in Russian manufacturing sector went up to USD 4.2 bln - by 26.3% as compared with the previous year. In 1 quarter 2008 the biggest amount of investments was directed of all manufacturing industries to metallurgy – they were equal to USD 1.7 bln or 40.5% of the total amount of foreign investments received by manufacturing industries

(only 29.3% in 1 quarter 2007), investments to foodstuff production were equal to USD 471 mln or 11.1% (18.5%), to chemistry industry – USD 323 mln or 7.6% (10.7%).



Source: Federal State Statistics Service

Fig. 3 Structure of Foreign Investments into the Industry by Branches in 1st Quarter 2008 (data for 1st quarter 2007 are given in brackets)

Direct investments in minerals extraction reduced by 6.1 times as compared with 1 quarter 2007 and were equal to USD 1.3 bln. Other investments in this branch of industry increased over the same period by 25%, which resulted in reduction of direct investments share in the amount of total investments in extracting industries from 90.8% to 56.5% and increase of the share of other investments from 8.9% to 42.3%.

In 1 quarter 2008 direct and other investments increased correspondingly by 6.4% and 33.3% as compared with the analogous figures of the previous year – this also has led to the increase of other investments share in the structure of foreign investments in manufacturing industry by 82.6% (1 quarter 2007 – 78.3%) and decrease of the proportion of direct investments down to 17.2% (20.5% in 1st quarter 2007).

Structure of foreign investments directed into the industry in 1st quarter 2008 differs from the corresponding structure of total foreign investments in the Russian economy – the proportion of direct investments in the former is higher. Direct investments in the industry decreased by 2.2 times as compared with 1st quarter 2007, while other investments went up by 30.4%.

Table 3

Foreign Investments in Industry in 1 Quarter 2003-2008, as percentage

	2003	2004	2005	2006	2007	2008
Direct investments	27.0	35.5	43.2	56.2	70.3	46.0
Portfolio investments	0.8	0.3	2.2	3.5	1.0	1.2
Other investments	72.2	64.2	54.5	40.3	28.7	52.8

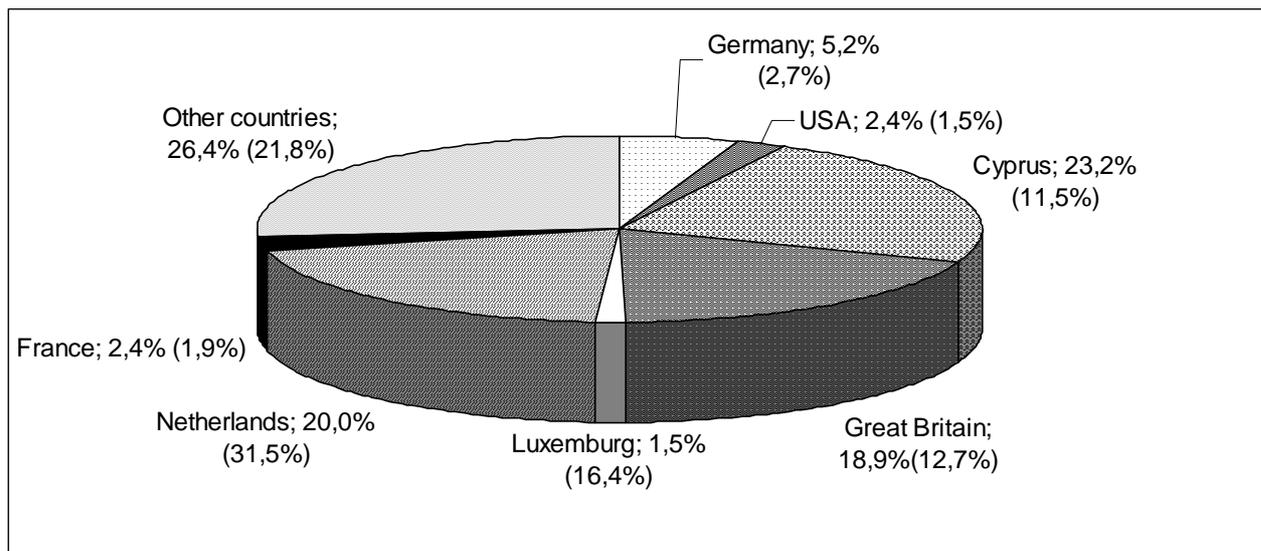
Source: Federal State Statistics Service

In 1st quarter 2008 direct investments in industry comprised 69.6% of total direct foreign investments into the Russian economy (85.8% in 1st quarter 2007). The proportion of portfolio and other investments in industry is estimated at the level of, correspondingly, 84.6 and 38.6% (58.9% and 23.3%, respectively, in 1st quarter 2007).

In 1st quarter of the current year changes occurred in geographical structure of foreign investments received by Russian economy. As a result of 1 quarter 2008 it is Cyprus, the Netherlands, the UK, Germany, and Switzerland that comprise five leading countries investing in the Russian economy – their proportion in

the total amount of foreign investments received by the Russian Federation is 71.3% (78.8% for five leading countries-investors in 1st quarter 2007).

In 1st quarter of 2008 the Netherlands gave the first place in the list of the main investing to Russia countries to the Cyprus (in 1st quarter 2007 there were the Netherlands that held the leading position). Their investments reduced by 2.3 times as compared with the corresponding figure of the preceding year and were equal to USD 3.4 bln (in 1st quarter 2007 the growth of investments from the Netherlands by 7 times was observed). About USD 750 mln, which corresponds to 21.7% of the total investments to the Russian Federation from the Netherlands, fall for fossil fuels extraction (in 1st quarter 2007 the figure was equal to USD 7.4 bln or 95.5) – this is equal to 43.5% of the total foreign investments in this branch of industry. The main part of Netherlands investments (USD 1.9 bln or 55.7%) was directed to electricity, gas and water production and distribution – this comprises 97.7% of the total foreign investments in this sphere. 99.9% of Netherlands investments in electricity, gas and water production and distribution were direct ones.



Source: Federal State Statistics Service

Fig. 4 Geographic Structure of Foreign Investments, Received by the Russian Federation in 1 Quarter 2008 (data for 1st quarter 2007 are given in brackets)

It is the Cyprus that demonstrated the biggest growth of investments in 1st quarter 2008 – by 42.1% up to USD 4.0 bln. the same as in 1st quarter 2007 the main part of total investments from the Cyprus into the Russian Federation was aimed to trade and catering – USD 1.9 bln (46.4% of the total Cyprian investments into the Russian Federation), and market servicing – USD 1.1 bln (28.4%). The proportion of Cyprian investment in the field of commercial activity on market servicing was equal to 64.0% of the total foreign investments in this branch, and in the field of trade – to 34.0%. The figures for these kinds of activities in 1st quarter 2007 were 31.6 and 41.9%, correspondingly.

Investors from the Great Britain prefer investing into metallurgy this year (USD 629 mln or 13.3% of investments from the Great Britain to Russia over 1st quarter 2008) and trade (USD 2.1 bln or 64.3%). For reference, in 1st quarter 2007 the metallurgy and trade accounted for USD 242 mln (7.7%) and USD 2.7 bln (85.5%) investments from the Great Britain, correspondingly.

The most significant decrease in investments from leading investing in the Russian economy countries was observed for those from Luxemburg at the beginning of the current year: in 1st quarter 2008 they reduced by 15.9 times as compared with the corresponding period of 2007 and were equal to USD 254 mln. France and Ireland also decreased the amount of their investments into the Russian Federation as compared with 1st quarter 2007 by 11.5% and by 4.5 times, correspondingly.

On the whole, according to the state of affairs by the end of March 2008 the volume of accumulated foreign investments reached the level of USD 221.0 bln, which exceeds by 45.9% the figures of the end of March 2007. The most significant growth on the end of March 2007 of accumulated investments was observed for investments from the Great Britain – by 2.3 times. As compared with the beginning of the current year, though, a small decrease in investments from the Great Britain, is observed (–7.4%).

Structure of Accumulated Foreign Investments as Broken by Major Investing Countries

	Accumulated by 01.04.2008, as USD bln				Change on 01.01.2008, %			
	Total	Direct	Portfolio	Others	Total	Direct	Portfolio	Others
USA	8 207	3 277	1110	3 820	95.7	90.2	92.0	102.2
Germany	11 789	4 714	33	7 042	100.0	104.9	33.7	97.9
France	6 068	1551	5	4 512	102.5	99.8	16.1	104.1
Great Britain	27 076	3 136	2371	21 569	92.6	91.2	102.5	91.8
Cyprus	50 793	38 283	1822	10 688	102.4	108.1	107.2	85.7
Netherlands	41 060	37 071	82	3 907	105.1	105.2	157.7	103.9
Luxemburg	29 752	750	307	28 695	102.0	102.0	140.2	101.7
Other countries	46 300	17 822	911	27 567	98.0	96.2	82.3	99.8
Total	221 045	106 604	6 641	107 800	100.2	103.4	98.7	97.3

Source: Federal State Statistics Service

The combat readiness of the RF regular troops: an assessment of military and economic aspects¹²

V. Tsymbal

This study focuses on analyses of the military aspects of the measures, which has been undertaken over the recent years and are still underway in the sphere of development and implementation of the human resources policy pursued with respect to the military organization. This paper attempts to answer some urgent questions, among them those concerning the benefits (if any) for the RF Armed Forces (as concerns their combat readiness) and RF citizens (as concerns their military security) have obtained because of the switching of the mission ready troops to the contract based principle of recruitment; possible outcomes of retaining of the one year service term for regular troops, etc.

The important for the military and the society problems of manning of the RF Armed Forces are very complex as concerns the methods to be employed in order to assess them. Experts of military scientific organizations and staffs are engaged in the research of reasoned solutions in this sphere¹³. As concerns an evaluation of the factors being of importance for the society with respect to these problems, there are used somewhat different approaches, among them those employed by the IET researchers. In the international practice, there is widely used an approach developed by the United Nations Organization, which comprises a simple rule: when comparing military capabilities of states differing by recruitment systems, there is counted the total number of contracted servicepersons, whereas from the total number of conscripted servicepersons there is deducted the number of those, who served less than 6 months. Due to this reasoning, it is an accepted method to analyze not only the strength of the military as per its table of organization (TO) and its actual strength (AS) as concerns the enlisted servicepersons and junior command personnel (ESJCP), but also the so called registered strength (RS), which is calculated without taking into account the conscripts, who served less than 6 months by the time such a calculation is carried out.

¹² This publication benefits from the results of the research carried out in the framework of RGNF Project No. 08-02-00038a.

¹³ See, for instance, "Osnovy teorii i metodologii planirovaniya stroitelstva Vooruzhennykh Sil Rossiyskoi Federtatsii: Voyenno-teoreticheskiy trud" [Theoretical and methodological principles underlying the development of the Armed Forces of the Russian Federation: A military theoretical treatise] / A. V. Kvashnin, Ed. – M.: Voyentekhizdat, 2002. – 232 pages.

In fact, a similar view with respect to the low combat effectiveness of newly drafted recruits is shared by the majority of experts in the Russian Federation. However, the most simple perceptions and rules are not sufficient to assess the efficiency of a military reform. That is why the development of other approaches is being continued. In particular, the IET researchers use the expert evaluations presented by the Chief Directorate for Combat Training of the RF Armed Forces in 2002. The comparison between the combat effectiveness of enlisted servicemen and junior command personnel (ESJCP) with different terms of service behind them is based on the perception of a “model” soldier. It has been supposed that a serviceman, who completed the mandatory two year term of military service as a conscript and served three additional years on the basis of a contract (an important condition is that such a serviceman was constantly engaged in combat training during the term of service), should most closely approach to such a model. The results of the averaged expert evaluation with respect to the combat effectiveness of servicemen, whose length of service differed, and the “model” soldier permitted to arrive at the conclusion that a decline in the combat effectiveness of servicemen with different terms of service behind them begins after a serviceman was 30 years old (what corresponds with about 11 years of service), when in the majority of people there is observed a decline in psychical and physiological characteristics necessary for them to perform jobs requiring agility, strength, stamina and many other qualities a modern serviceman should possess. Family situation also affect the combat effectiveness, especially as concerns senior persons. This circumstance was noted yet by Charles de Gaulle¹⁴: “These professional troops must have nothing to bind them: habits, family ties, various interests.” He recommended: “For twenty year old volunteers, six years will be enough to go through the full course. After that, veterans while still in their full vigor, they will furnish ready cadre for training of reservists and new recruits.”

In case contracts are made on the voluntary basis, the average length of service in the positions held by enlisted servicemen and junior command officers may differ depending on the pursued human resources policy (HRP). In some countries, almost all servicemen are employed on the basis of contracts and stay in the Armed Forces until reaching the age of retirement. This variant of the human resources management policy used, for instance, in Canada, is indicated as **KP-1** in *Table 1* (see below). In this case, it becomes necessary to take into account the coefficient of decline in the combat effectiveness with age.

A number of states, including the USA, uses not the KP-1, but a different human resources management policy with respect to enlisted servicemen and junior command personnel. In the framework of this policy, hereinafter referred to as **KP-2**, the procedures governing recruitment and the motivation methods work in a different manner. Approximately half of soldiers (sailors) leaves the Armed Forces after the expiration of their first contract term, yet another half of the rest serves two contract terms, and so on; the rest soldiers and sailors already serve rather as non-commissioned officers (sergeants first class) than rank and file servicemen. In this case the age related decline in the combat effectiveness of the enlisted servicemen and junior command personnel is of less importance. It should be noted that the average length of service under contracts in the USA is close to the 6 year term recommended by Charles de Gaulle.

Unfortunately, in modern Russia the attractiveness of voluntary service under contract is very low, whereas in the recent years there have been even observed cases, where servicemen were laid under the necessity to sign their first contracts. These facts resulted in a decline in the number of persons ready to sign their second contracts down to 20 – 30 per cent. This human resources management policy will be indicated as **KP-n**.

The estimates of the assessment of the effective and registered strength are presented in *Table 1*, where k is the indicator of the combat effectiveness of a serviceman depending on the length of service t . It should be noted that the effectiveness of conscription based service will have to be evaluated also in the future, since the version of a document on the long term strategy published by the RF Defense Ministry mentions the conscription based service without any hint that it will be ever abolished.

In any case, summing up the number of servicemen with different terms of service behind them as adjusted for their average combat effectiveness, there can be calculated the effective strength (ES) of a group.

The respective top rows of the table contain the assessments of the effective and registered strength in terms of the number of persons serving different terms on the basis of conscription: $t = 0.5$ year; 1 year; 1.5 years and 2 years; as well as longer periods for those serving on the basis of contracts. In order to explain the nature of the problem, it is more convenient to calculate the respective values of ES and RS not in absolute terms, but in the shares r of the total number of serviceman in each homogenous group.

¹⁴ Za professionalnuyu armiyu. Idei Sharlya de Gollya i ikh razvitiye v XX veke. [For a professional army. Charles de Gaulle’s ideas and their development in the 20th century.] – M.: Voennyi universitet. 1998. – 570 pages.

Table 1

Assessments of the effective and registered strength

t, years	<=0,5	<=1,0	<=1,5	<=2,0	<=2,5	<=3,0	3,5–6,0	6,5–10	10–25
k (t)	0,13	0,34	0,50	0,62	0,71	0,78	0,88	1,0	0,63
<i>Assessments of the effective and registered strength as concerns service on the basis of conscription</i>									
Share r in case T = 0,5	1	In the case the hypothetical term of service on the basis of conscription makes 0.5 year, the combat effectiveness of the group. ($ES_{0,5} = 0,13$) is extremely low; in this connection, the registered strength is assumed to be equal to zero ($RS_{0,5} = 0$)							
R*k	0,13								
Share r in case T = 1,0	1/2	1/2	In the case the term of service makes 1 year, $ES_1 = 0,235$, whereas the registered strength $RS_1 = 0,5$ of the total strength						
R*k	0,065	0,17							
Share r in case T = 1,5	1/3	1/3	1/3	In the case the term of service makes 1.5 years, $ES_{1,5} = 0,323$, whereas $RS_{1,5} = 0,67$ of the total strength					
R*k	0,043	0,113	0,167						
Share r in case T = 2,0	1/4	¼	1/4	1/4	In the case the term of service makes 2 years, $ES_2 = 0,398$, whereas $RS_2 = 0,75$ of the total strength				
R*k	0,033	0,085	0,125	0,155					
<i>Assessments of the effective and registered strength as concerns service on the basis of contracts</i>									
Policy KP-1, in the framework of which it is expected that a serviceperson remains in the Armed Forces until retirement (minimization of renewal)									
Share r	1/50	1/50	1/50	1/50	1/50	1/50	6/50	7/50	31/50
r*k	0,0026	0,0068	0,01	0,0124	0,0142	0,0156	0,1056	0,1400	0,3906
Assessment results for KP-1	The actual strength of the group of servicepersons under contract $AS_{kp1} = RS_{kp1} = 0,98$ of the total strength taking into account the volunteers and potential contracted servicepersons. The effective strength of the group $ES_{kp1} = 0,698$								
Policy KP-2 envisaging the reduction by stages (approximately by 2 times at each stage) of the number of servicepersons concluding their next contracts									
K	0,13	0,34	0,50	0,62	0,71	0,78	0,88	1,0	0,63
Share r	2/30	2/30	2/30	2/30	2/30	2/30	6/30	3/30	9/30
r*k	0,0087	0,0227	0,0333	0,0407	0,0473	0,0520	0,176	0,1	0,189
Assessment results for KP-2	Actual strength of the group of servicepersons under contracts $AS_{kp1} = RS_{kp1} = 0,93$ of the total strength taking into account the volunteers and potential contracted servicepersons. The effective strength of the group $ES_{kp1} = 0,67$								
Policy KP-n, using low attractiveness of the service plus coercion									
Share r	1/10	1/10	1/10	1/10	1/10	1/10	3/20	2/20	3/20
r*k	0,013	0,034	0,050	0,062	0,071	0,078	0,132	0,1	0,063
Assessment results for KP-n	Actual strength of the group of of servicepersons under contracts $AS_{kpn} = RS_{kpn} = 0,9$ of the total strength taking into account the volunteers and potential contracted servicepersons. The effective strength of the group $ES_{kpn} = 0,5$								

Assessments of the effectiveness of recruitment

The assessments presented in *Table 1* demonstrate that in the case of the switching from the 2 year term of service to 1 year term, the effective strength of the same number of conscripted servicepersons (all other things being equal) will decline by 30 per cent in comparison with its initial value.

Below in *Table 2* there are presented the assessments of the effective strength of the enlisted servicepersons and junior command personnel under contracts. In the course of the calculation it was taken into account that all of them make their first contracts for a 3 year term, which includes (it is permitted by the law) the first 6 months of service under conscription. It is apparent that such a procedure of “set off” of the service under conscription diminishes the “net” term of service under contract and therefore reduces the average value of combat effectiveness of contracted personnel in comparison with the procedure envisaging the signing of the contracts for the full term on their part.

The calculations demonstrate that the difference between the KP-1 and KP-2 policies in terms of the values of the effective strength is rather insignificant, what offers such states (for instance, the USA and Canada) an opportunity to choose one of them, which is more attractive not in terms of effective strength, but proceeding from other considerations. The third variant of the human resources management policy KP-n significantly loses out to KP-1 and KP-2.

However, at this point of time the assessments of the effectiveness of mixed recruitment (on the basis of contracts and conscription) for the RF Armed Forces are more urgent.

It should be reminded that in the framework of a federal targeted program completed in 2007 the main expected outcome should have been a significant increase in the number of military personnel serving in the mission ready troops of the RF Armed Forces, RF Interior Ministry troops and Federal Security Service on the basis of contracts from 22.1 thousand to 147.6 thousand servicepersons. Later, after the program parameters had been adjusted, this number was reduced to 138.7 thousand, of which 125.4 thousand should have served in the mission ready troops of the RF Armed Forces.

So, how did the situation with the federal targeted program indicators stand at the end of 2007 and what was the degree of influence of this program on the combat effectiveness of the RF Armed Forces?

As concerns the Border Guard Service, the planned indicator values were exceeded as all military personnel was switched to contract service that year. Therefore, an analysis of the policy pursued by this agency deserves is of special importance. In the case all the border guards serving on the basis of conscription for a two year term had been replaced by contracted servicepersons and the strength of these troops remained the same, it would have resulted in a growth in the effective strength of the border guards from 0.40 to 0.67, i.e. more than by 1.5 times in the framework of policy KP-2. However, there would have persisted the problems related to the attractiveness of the service and selection of the personnel suitable for this service. Therefore, the command personnel of the RF Border Guard Service preferred to use the factor of growth in the combat effectiveness in a different manner by reducing somewhat the strength of the troops without a decline in their combat effectiveness they could (at the same cost) increase the attractiveness of the service and select the best soldiers for contracted service without having to force to sign contracts unwilling conscripts. It is possible that the next step will be the switching to KP-1 policy in the case it turns out that it is more advantageous to have experienced border guards personnel and to reduce the rate of replacement.

The situation in the RF Defense Ministry appears to be quite different. For instance, the head of the Chief Organization and Mobilization Directorate of the General Staff of the RF Defense Ministry could not present anything more exact than words “about 100 thousand persons” with respect to the main indicator of the federal targeted program. Nevertheless, it means that the Defense Ministry is more than 25 thousand persons below the target values set forth in the framework of the federal program. At the same time, about 25 thousand contracted servicepersons left the RF Armed Forces units not included in the number of mission ready troops, since money allowances there was even smaller than in the mission ready troops. Therefore, all these positions will be filled in with the conscripted citizens. This development will aggravate the conscription problem and therefore gives rise to concerns on the part of the society.

These developments should also to a significant degree affect the RF military organization. The quantitative indicators presented in *Table 2* permit to evaluate the rather serious negative consequences of the failure to implement the federal target program for the RF Defense Ministry.

First, in the nearest future the positions not filled in by contracted staff (the shortage makes more than 50 thousand) will be taken by young people drafted for a one year term. As a result, the effective strength of this number of servicepersons will decline from 0.67 to 0.13, i. e. by 5 times. Besides, the conscripts will

have to fill in not only auxiliary positions. Already at present “at the matter of high priority conscripts should be sent to the troops on combat alert, as well as the mission ready troops and even “nuclear submarines.”¹⁵

Second, the plans of mixed recruitment had been deformed; as a result there began to work the factor of declining combat effectiveness. This process is illustrated by the results of calculations presented in *Table 2*.

Table 2

Comparison between the variants of recruitment in terms of effective strength

Variant of the recruitment system	Share of conscripts	Term of service; k	Share of contracted ESJCP	Human resources management policy, k	Total effective strength of ESJCP
Initial situation, 2002	0,75	2 years, 0,40	0,25	KP-1; 0,70	$0,75*0,40 + 0,25*0,70 = 0,48$
IET proposal	0,25	0,5 year; 0,13	0,75	KP-2; 0,67	$0,25*0,13 + 0,75*0,67 = 0,53$
GS concept underlying FTP	0,50	1 year; 0,23	0,50	KP-1; 0,70	$0,5*0,23 + 0,5*0,70 = 0,47$
FTP implementation results as at the end of 2007	0,60	1 year; 0,23	0,40	KP-n; 0,50	$0,6*0,23 + 0,4*0,5 = 0,34$

Some other facts are also evidence of a decline in the quality of recruitment. Yet at the time the federal targeted program was launched, Yu. Baluyevsky, who at that time held the office of the Head of the General Staff, stated in his interview to the *Krasnaya Zvezda* newspaper published on November 6 and 11 of 2004: by the end of 2007 “the number of contracted servicepersons holding positions of sergeants and soldiers will make half of the total number of such positions,” and as a result of this in the RF Armed Forces there will be introduced the “rational system of mixed recruitment.” However, in the November of 2007, the report presented by the RF Defense Minister it was noted that not 50 per cent, but of only 45 per cent of such positions could be taken by contracted servicepersons, whereas in the annual report of the RF Government there was mentioned the figure making “about” 40 per cent. Therefore, proceeding from the words of Yu. Baluyevsky, the system of recruitment, which the RF Defense Ministry could create, was not rational from the military point of view. Our calculations only confirm these figures in quantitative terms.

From the point of view of international comparisons made in accordance with the methods developed by the United Nations Organization, these variants of mixed recruitments are approximately similar; however, the very fact of mandatory conscription does not agree with the announced ambitious plans to raise our Armed Forces to the level of leading states.

On the whole, the calculations presented in the paper provide evidence that even now it would make sense to return to the proposal envisaging that only contracted soldiers should serve in the regular troops. Due to their smaller numbers they could be more easily equipped with modern weapons; besides, it would permit to increase the intensity of combat training and the quality of combat alert. In its turn, it would facilitate a growth in the combat effectiveness of the RF Armed Forces and the defense capabilities of the state. The experience of the Border Guards Service would be useful both for the RF Armed Forces and all other troops.

In conclusion it should be noted that in the framework of policy KP-1 only 4 per cent of the total strength of the enlisted servicepersons and junior command personnel is required to replace the contracted soldiers leaving the Armed Forces, whereas in the framework of policy KP-2 this figure makes about 7 per cent of their total strength. It is less than the present size of conscription even in the case the terms of service on the basis of conscription is half year making a small burden on the citizens and the economy. Therefore, in the framework of this variant of the reform of the system of recruitment there exists an opportunity to reduce the number of conscripts without negative consequences for combat effectiveness of regular troops in case there arises a favorable military and political situation or unfavorable demographic situation, whereas in the case it is needed the conscription may be expanded to increase the mobilization potential of the country. At the same time, policy KP-n, which has been pursued in the Russian Federation so far requires a significant number of conscripts to replace the contracted enlisted servicepersons and junior command personnel annually leaving the RF Armed Forces, what in the end causes social tensions in the society.

¹⁵ V. Khudoleyev. Prizyv na finishnoi pryamoi [Conscription on the homestretch] / *Krasnaya zvezds* No. 105 of June 20, 2008.

Adjustment of the rates of excise duties on tobacco products – on the way of harmonization with EU policies

M. Kazakova

For the second year in a row the RF Finance Ministry declares a high rate of adjustment of the rates of excise duties on tobacco products in its “Principal guidelines of the tax policy.” Taking into account the amendment of the procedures governing the calculation of excise duties, which took place in 2007, the pursuit of this policy results in the annual increases in the tax burden on consumers of cigarettes. This section focuses on an analysis of the consequences of the pursuit of such a policy of adjustment on the Russian market of tobacco products. представлен в настоящем обзоре.

In the first half of the 2000s, the Russian market of tobacco products actively developed: the volumes of adult per capita production and consumption of cigarettes (a year) grew by about 20 per cent in the period from 2000 till 2006¹⁶, what resulted in a significant change of its structure. According to the data presented by the Association of manufacturers of tobacco products “Tabakprom”, while in 2001 the share of non filter cigarettes and mouthpiece cigarettes in the total volume of tobacco products made 40 per cent (150 billion pieces), in 2007 this figure made only 8 per cent (30 billion pieces). Accordingly, the share of filter tip cigarettes increased from 40 per cent registered in 2001 to 82 per cent in 2007. Nevertheless, the decline in the share of purchased mouthpiece cigarettes was compensated by the growth in consumption of filter tip cigarettes belonging to the low price segment, the share of which amounts to almost half of the total domestic market volume (46.4 per cent).

The make or break year was 2007, when the decline in the demand for tobacco products and the decrease in the rates of growth in consumption of such goods in per capita terms resulted in a 4 per cent decrease in production as compared with the figures registered in 2006, whereas the amounts of import dropped by 15 per cent in accordance with the data presented by the Federal State Statistics Service. These dynamics may be explained by both the reaching of the level of saturation of the domestic market with tobacco products at the background of the persisting demographic drop observed in the country, and the increase in the level of retail prices predominantly with respect to cheap brands of cigarettes resulting from the changes in tax rates and the procedures governing the collection of excise duties on tobacco products.

Indeed, since January 1, 2007, for the purposes of excise duty taxation there was fixed the maximum retail price (MRP) of tobacco products, on the basis of which there should be calculated the ad valorem component of the excise duty. The switching from the use of wholesale prices to the maximum retail price set by the manufacturer was determined by the necessity to prevent the evasion from this tax with the use of transfer prices in the framework of control measures introduced with respect to retail trade with tobacco products. The same year, Federal law No. 75 FZ “On the introduction of amendments to chapter 22 of the second part of the Tax Code of the Russian Federation” and later the “Principal guidelines of the tax policy to be pursued in 2009 and in the planning period of 2010 and 2011” issued by the RF Finance Ministry determined the new scheme of adjustment of the rates of excise duties on excisable goods for the period from 2008 till 2011; in accordance with the new procedures the excise duty on tobacco products should be raised by almost 2 times (in nominal terms) over a 3 year period¹⁷.

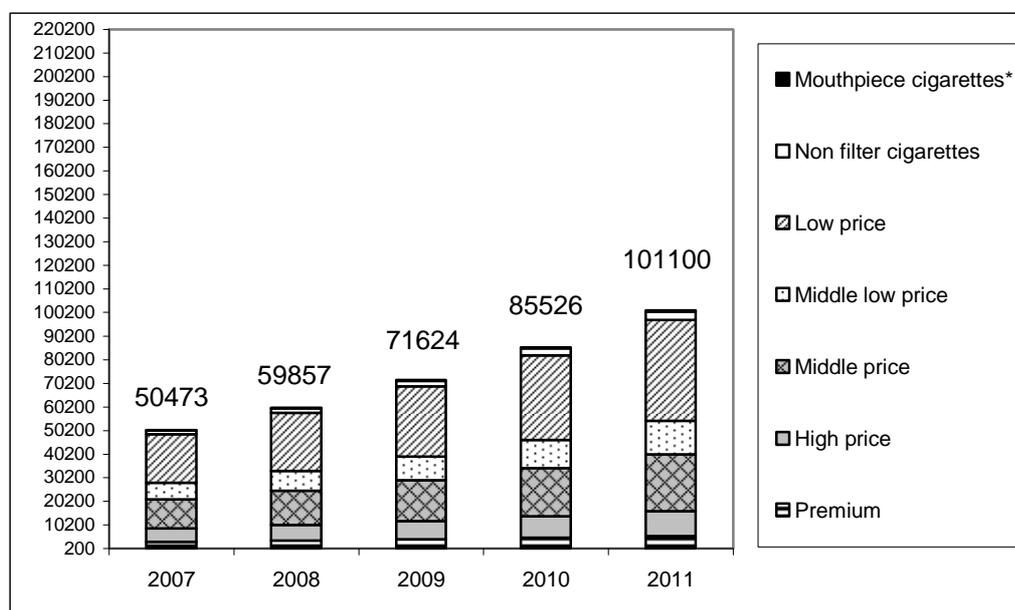
The raising of the excise duties on tobacco products and introduction of the maximum retail price had a favorable effect on the revenues of the budget system of the country. The collection of tobacco excise duties increased at the rates outpacing the excise duties on other excisable goods growing from 0.14 per cent of GDP in 2004 through 2006 to 0.15 per cent of GDP in 2007.

The implementation of the new procedures governing the indexing of rates of excise duties on tobacco products in 2008 through 2011 in the situation, where the size of the Russian market of tobacco products

¹⁶ According to the data presented by the World Health Organization (WHO) (<http://www.who.int/research/en/>) and the Association of manufacturers of tobacco products “Tabakprom” (<http://tabakprom.ru>).

² Thus, the rate of the tax on filter tip / non filter cigarettes and mouthpiece cigarettes made Rub. 120 / 55 per 1000 pieces plus 5.5 per cent of the maximum retail price (MRP), but no less than Rub. 142 / 72 per 1000 pieces in 2008; in 2009 the respective figures should make Rub. 145 / 70 per 1000 pieces plus 6 per cent of the maximum retail price (MRP), but no less than Rub. 172 / 90 per 1000 pieces; in 2010 the respective figures should make Rub. 175 / 90 per 1000 pieces plus 6.5 per cent of the maximum retail price (MRP), but no less than Rub. 210 / 115 per 1000 pieces; in 2011 the respective figures should make Rub. 210 / 138 per 1000 pieces plus 7 per cent of the maximum retail price (MRP), but no less than Rub. 252 / 138 per 1000 pieces.

persists at the level of about 360 to 380 billion pieces a year and the structure of production does not change will result in a significant increase in excise duty generated revenues of the RF budget system, primarily at the expense of the segment of low quality brands (see Fig. 1), what answers the objective envisaging the raising of excise duty generated revenues set forth by the “Principal guidelines of the tax policy to be pursued in 2009 and the planning period of 2010 and 2011.”



Note: * - the share of revenues generated by the excise duty on mouthpiece cigarettes in the total amount of revenues makes on the average 0.5 per cent.

FIG. 1. Contribution of different segments of the market in the revenues generated by the excise duties on tobacco products across the industry as a whole in 2007 through 2011, Rub. billions.

Yet another significant outcome of this policy of adjustment of excise duty rates will be a substantial increase in the tax component of the retail prices in the low price segments of the market of tobacco products. In accordance with the calculations, in the period from 2008 till 2011 the rates of excise duties on tobacco products in the segments indicated above is indexed by more than 20 per cent a year. This increases the tax burden on the pack of filter tip cigarettes manufactured in Russia pushing prices up and creating incentives for changes in the structure of consumption in favor of tobacco products of higher quality (see Fig. 2). Примечание: * - доля поступлений от акцизов на папиросы в общем объеме поступлений составляет в среднем 0,5%.

In the period from 2007 till 2011, according to the plans developed by the RF Government, there should be expected similar trends of increase in the share of excise duties in the retail price of the pack of non filter cigarettes and the pack of filter tip cigarettes in the low price segment of the market (a growth up to about 40 per cent).

According to the data presented by experts¹⁸, the excise policy pursued over the recent years is a significant factor of wellbeing on the Russian market of tobacco products, where illegal goods make below 0.5 to 1.0 per cent of the market, whereas in accordance with the data presented by the Federal Tax Service the collectability of the excise duty in the tobacco industry makes 99 per cent.

The introduction of the maximum retail price and an active policy aimed at the indexing of the tax rates permit not only to influence the shift of consumer preferences “upwards” and to tie the amounts of revenues to the changes in the market situation, but also to raise the quality of administration of the excise duty on tobacco products. За период с 2007 по 2011 г., по планам правительства, следует ожидать наблюдается одинаковой тенденция увеличения доли акциза в розничной цене пачки сигарет без фильтра и пачки сигарет с фильтром низкоценового сегмента рынка (рост примерно до 40%).

¹⁸ <http://tabakprom.ru>.

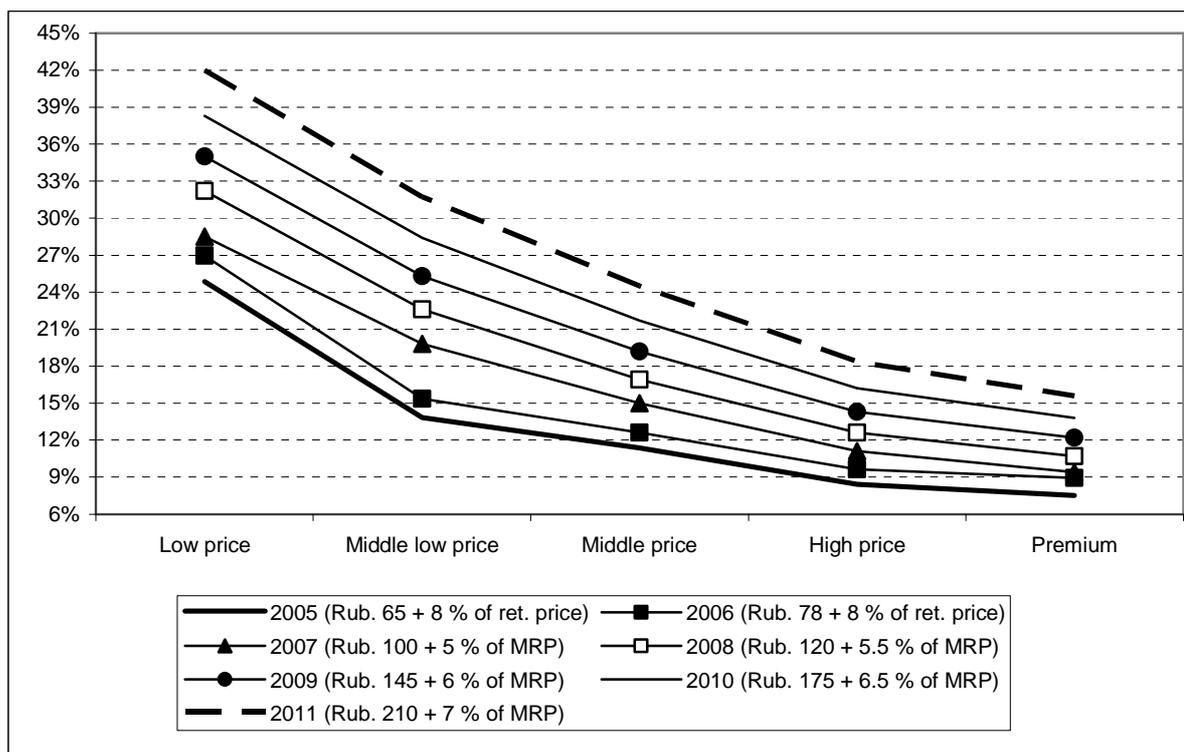


FIG. 2. The share of excise duty in the retail price of a pack of filter tip cigarettes in 2007 through 2011, in %.

Besides, the measures taken with respect to the adjustment of the excise duty rates facilitate the harmonization of the Russian tax legislation with the current tax legislation of the EU, which envisages the general structure (definition of goods and tax instruments) as concerns the excise duties on tobacco products, minimal levels of the rates permitting the individual countries to set their own higher rates adequate to their respective internal situations, as well as the necessity to revise the structure and rates of excise duties on tobacco products every 4 years.

In accordance with the European legislation, non zero minimal rates have been introduced only with respect to cigarettes (as on January 1, 2007, in the EU the minimal specific rate made Euro 5.51 per 1000 pieces (Greece), whereas the ad valorem component amounted to 13.04 per cent of the maximum retail price (Latvia and Cyprus)¹⁹). It should be noted that at present Russia is still somewhat behind these requirements in terms of excise duty rates, since, taking into account the new procedure governing the indexing of excise duty rates, in 2008 through 2011 the specific rate of the excise duty should increase from Euro 3.43 to Euro 5.45 for filter tip cigarettes and from Euro 1.57 to Euro 2.81 for non filter cigarettes²⁰, whereas the ad valorem component should grow from 5.5 per cent of MRP to 7 per cent of MRP. In fact, taking into account the individual data specific for each EU member country the gap in the excise duty rates is much more significant, what determines the necessity to more actively index the rates of the excise duty on cigarettes. Therefore, as concerns the rates of excise duty on tobacco products the general picture is that in order to harmonize these rates with those used in the EU, it will be necessary to continue an active policy of smooth adjustment of the rates at a pace exceeding the inflation rates observed in the country.

¹⁹http://ec.europa.eu/taxation_customs/resources/documents/taxation/excise_duties/tobacco_products/rates/excise_duties-part_III_tobacco-en.pdf.

²⁰ This assessment is made on the basis of a forecast of exchange rates presented in the "Concept of long term social and economic development of the Russian Federation until year 2020" issued by the RF Ministry of Economic Development and Trade.

Review of the Most Important Issues Considered at the Meetings of the Government of the Russian Federation

M. Goldin

26 May the first meeting of the newly formed Presidium of the Government of the Russian Federation occurred. In June at the meetings of the Government of the Russian Federation the following most important issues were considered: main directions of tax policy for 2009 and for the plan period of 2010 and 2011 and drafts of the law aimed at their realization; changes made to the laws on the federal budget for 2008-2010 and off-budget funds; results of federal budget execution in 1 quarter 2008; on the course of federal target programs execution and realization of the federal addressed over the 1 quarter 2008.

At the meeting of the Government of the Russian Federation on **26 May**²¹ the project “Main direction of the tax policy for 2009 and for the plan period of 2010 and 2011” (further referred to as Project) and a number of federal laws aimed at their realization.

The following most important novelties that it is suggested to realize in the tax legislation in accordance with the document mentioned are to be listed:

- **Introduction of the consolidated taxpayer regime** and special procedure to calculate organization’s profit tax for participants of these groups. It is suggested to refer a voluntary association of taxpayers on the basis of the agreement as a consolidated group of taxpayers. The Consolidated group of taxpayers consists of companies, directly or indirectly belonging to the paternity unit on the basis of the criterion of minimum share of participation. The organizations that are participants of one consolidated group of the taxpayers cannot join other groups. The consolidated group of taxpayers submits single tax declaration, which reflects the data on consolidated calculation base, defined on the whole for a group, as well as on the taxation base of every group participant. Consolidated calculation base is defined by addition according to established rules the taxation base of profit tax of all organizations that are members of the group. For instance, when defining consolidated calculation base for organization’s profit tax this index does not include profits and expenditures of inter-organization operations between the members of the consolidated group of taxpayers. Profit and losses from operation among organizations that are members of the consolidated group of taxpayers also are not taken into account. The system of consolidated accounts on profit of a group of companies should take into consideration the procedure for losses accounting, reserves formation, including in case of the changes occurring in the list of persons forming consolidated taxpayers, group liquidation etc.;

- **Reforming transfer pricing institution.** At the moment there are two alternatives for reforming of the institution. The first was suggested by the Ministry of Finance of the Russian Federation and is reflected in the Project. According to this variant the list of interdependent persons definition characteristics has been broadened but at the same time the opportunity to prove interdependence in court is sustained. It is envisaged to reduce the number of controlled deals. However there will still be control over the deals between interdependent persons and barter deals. The market price is defined on the basis of the range of market prices, which is established as a result of deals made between independent persons under comparable conditions and whose subject is identical (similar) goods. The price of a controlled deal if in the range of market prices will be recognized as market. If contract price is beyond the interval mentioned, tax bodies, basing on the minimum and maximum value in the interval will have a right to make decision on additional accrual of taxes basing on market price.

Besides the method of comparable market prices for a taxpayer it is envisaged to use five other methods of contract price definition. However the method of comparable market prices will be prevailing.

In December 2007 the chairman of the Government of the Russian Federation V. A. Zubkov commissioned the Ministry of Finance of the Russian Federation to take the alternative project supported by the Ministry for Trade and Economic Development, President’s Administration and Russian Union of Manufacturers and Entrepreneurs as the basis. In contrast to the ideas of the Ministry of Finance of the Russian Federation it neither concerns the existing criteria of companies’ interdependency nor introduces the new methods for market prices definition but suggests restricting the application of the law to the deals with non-residents.

On **18 June** at the meeting by the first vice-prime minister I. I. Shuvalov the decision on taking the project of the Ministry for Trade and Economic Development as the basis was practically disavowed. Neither did

²¹ The review of this meeting of the Government was not reflected in May review by the IET

the variant suggested by the Ministry of Finance get the support. Thus, the final concept of transfer pricing control institution reform is yet to be defined.

- **VAT** There was no political decision made concerning VAT – it is indirectly testified by the absence of any innovations regarding the issue mentioned in the Budget Address by the President of the Russian Federation D. A. Medvedev to the Federal Assembly. At the same time in 2009 it is planned to cancel the special procedure for VAT deduction when carrying out barter operations, offsets of mutual claims, using securities in calculations, and to excuse the taxpayers using non-monetary forms to pay for the goods (works, services) purchased from the liability to transfer to their contracting party the tax sums by separate payment order.

- **Income tax and Single Social Tax** Starting with 2009 it is planned to increase the level of tax deductions from income tax rendered to taxpayers maintaining children (parents, adopting parents, guardians) from RUR 600 to 800 with cancellation of establishing the limiting level of income below which the deduction is applied. The limit income level below which a taxpayer has a right to enjoy standard tax deduction for income tax will also be increased from RUR 20000 to 40000. As to single social tax, it is planned to increase the upper limit of the lowest schedule from RUR 280000 to 300000.

- Concerning **profit tax** one can expect considerable changes in the rules of amortization calculation, for instance the conditions for application of amortization premium application, it is also suggested to cancel object by object amortization calculation and transfer to calculation by the method of reducing remains for bigger amortization groups (pools).

On the whole the project at the meeting of the Government of the Russian Federation was approved. The final version of the Project is to be submitted to the Government on 1 August 2008.

On **2 June** at the meeting of the Government of the Russian Federation amendments to the Federal Law “On the federal budget for 2008 and for the planning period of 209 and 2010” and to federal laws on budgets of the Pension Fund of the Russian Federation, Social Insurance Fund of the Russian Federation, Compulsory Health Insurance Federal Fund for 2009 and for the planning period of 2010 and 2011 were discussed and approved. It is suggested to increase the total sum of federal budget’s expenses as compared with the approved volume by RUR 120.4 bln (1.7%) in 2008, by RUR 463.9 bln (5.6%) in 2010 and by RUR 632.7 bln (7.0%) in 2010. Federal budget earnings increasing, the volume of federal budget allotments given to Pension Fund, Social Insurance Fund and Compulsory Health Service Fund also increases.

At the meeting of the Government of the Russian Federation on 5 June the results of federal budget execution over the 1st quarter 2008 were discussed. As the speaker, deputy Chairman of the Government of the Russian Federation, Minister of Finance A. L. Kudrin underlined, in 1st quarter 2008 the indices of federal budget execution as to earnings were better than in the corresponding period of 2007. The earnings of the federal budget in the 1st quarter 2008 were equal to RUR 1931.8 bln or 22% of the GDP, which by 0.9% more than in the 1st quarter 2007. Expenses of the federal budget in the 1st quarter were equal to 12.9% of the GDP and in the first quarter of the current year – to 15.2% of the GDP.

On **16 June** at the meeting of the Government of the Russian Federation the course of federal target programs execution and realization of Federal targeted investment program in the 1st quarter 2008 were discussed. The report concerning this issue was made by Minister of economic development of the Russian Federation A. R. Belousov. As it was noted in the report in the 1st quarter 2008 there was a delay in financing of federal target programs as well as construction sights and objects for government needs.

Therefore in June 2008 federal executive bodies being the government representatives for federal target programs as well as for constructions and objects for federal government needs are commissioned to finish the following works:

- chief superintendents of the federal budget – on having received approval of the subjects of budget planning, Ministry for Trade and Economic Development of the Russian Federation and Ministry of Finance of the Russian Federation – to distribute object by object budget investments among complex events included in the list of construction sights and objects for federal government needs, which are financed at the expense of budget allotments aimed at carrying out the budget investments in the objects of capital construction of the government property of the Russian Federation, included in the federal targeted investment program;

- signing of contracts on provision of subsidies from the federal budget to the budgets of subjects of the Russian Federation for co-financing of the objects of capital construction in the state property of the Russian Federation and (or) for provision of corresponding subsidies to local budgets from the budgets of subjects of the Russian Federation to co-finance objects of capital construction in municipal property.

Review of Economic Legislation

I. Tolmacheva

In June the following changes were made to the legislation: the citizens are granted the opportunity to privatize the living quarters they were given on the basis of social rent contracts after 1 March 2005, beginning with 1 January 2009 the minimum wages was established at the rate of RUR 4330 per month; the Central Bank of the Russian Federation ratified the procedure for estimation of banks' economic situation; a new refinancing rate is applied starting with 10 June 2008, it is equal to 10.75%; the Ministry for Trade and Economic Development of the Russian Federation made changes to the Procedure of Rent Calculation for Land Plots Renting Contracts that are signed with SEZ residents, Tax Service has prepared for application the data used to calculate severance tax with regard to oil for May 2008.

I. Federal Laws of the Russian Federation

1. "ON MAKING CHANGES TO ARTICLE 4 OF THE LAW OF THE RUSSIAN FEDERATION "ON PRIVATIZING THE LIVING QUARTERS IN THE RUSSIAN FEDERATION" from 11.06.2008 No 84-FZ.

Comes into effect on the day of official promulgation.

Living quarters granted to citizens in accordance with the social rent contracts after 1 March 2005 can be privatized. Changes made to part 1 article 4 of the Law of the Russian Federation "On privatizing the living quarters in the Russian Federation" have excluded the date mentioned from the law.

2. "ON MAKING CHANGES TO ARTICLE 1 OF THE FEDERAL LAW "ON MINIMUM WAGES" from 24.06.2008 No 91-FZ.

Starting with 1 January 2009 the minimum rate of wages is established at the level of RUR 4330 per month. At present minimum wages are equal to RUR 2300. Its increase by 88% is aimed at making the wages equal to the subsistence level of the able-bodied population. First, the minimum wages is not applied to regulate the labor remuneration and to define the rates of temporary disability.

II. Letters, orders, instruction

1. Guidelines of the Central Bank of the Russian Federation "ON ESTIMATION OF BANK'S ECONOMIC SITUATION" from 30.04.2008 No 2005-U.

Registered in the Ministry of Justice on 26 May 2008 No 11755.

The Bank of Russia established the procedure for estimation of a bank's economic situation, which should be carried out by its territorial bodies not less often than once a quarter by ascription of banks to one of five qualification groups. For instance, such indices as capital, assets, profitability, liquidity, compulsory norms, management quality, and transparency of bank's property structure will be estimated. The banks, in whose activity no current difficulties are found, that is all indices mentioned are estimated as "good" are ascribed to the first group. The second group consists of the banks some of whose indices are considered to be "satisfactory", the third – those, whose indices are regarded as "doubtful", the fourth – those, who received the grade "unsatisfactory", the fifth – the banks, whose situation if no measures are not taken can lead to stopping of their operation. Information on ascription of the bank to the corresponding classification group is submitted to the Bank of Russia (Department of Bank Regulation and Supervision) and to individual executive body of the bank. These data are considered the information of limited access and are not to be disclosed to third parties.

2. Order of the Central Bank of the Russian Federation "ON REFINANCING RATE OF THE BANK OF RUSSIA" from 09.06.2008 No 2022-U.

In accordance with the Order of the Bank of Russia the refinancing rate of the Central Bank of the Russian Federation was raised by 0.25%. Starting with 10 June 2008 the rate equal to 10.75% is applied. Thus, the trend for refinancing rate growth sustains: in February of the current year it was increased from 10% to 10.25%, in April - to 10.5%.

3. the Order of the Ministry for Trade and Economic Development of the Russian Federation "ON MAKING CHANGES TO THE PROCEDURE FOR CALCULATION OF RENT FOR LAND PLOTS RENT CONTRACTS, SITUATED WITHIN THE SPECIAL ECONOMIC ZONES, ESTABLISHED BY THE ORDER OF THE MINISTRY FOR TRADE AND ECONOMIC DEVELOPMENT OF THE RUSSIAN FEDERATION ON 14 JULY 2006 No 190" from 29.05.2008 No 147.

Registered in the Ministry of Justice of the Russian Federation 09 June 2008 No 11828.

The rate of the coefficient influencing the amount of rent by the contracts of land plots rent, signed with the residents of the special economic zones will now depend on the amount of investments it made.

The general rule envisages that the coefficient mentioned is applied to calculate the rent at the rate equal to 1. According to changes made to the procedure of rent calculation this coefficient can be applied at the reduced rate, equal to 0.01 for residents, making investments at the sum of no less than Euro 50 mln during the first 15 years of tourist and recreation activity and at the sum of no less than Euro 30 mln during the first 8 years of such agreement, at the sum of no less than Euro 20 mln - during the first five years of the agreement.

4. Letter of the Federal Tax Service of the Russian Federation "ON DATA, NECESSARY TO CALCULATE SEVERANCE RATE IN REGARD TO OIL FOR MARCH 2008" dated 18.06.2008, No SchS-6-03/289@

In connection with the growth of prices for oil severance tax rate with regard to oil has increase over May 2008.

Federal tax service provides information on the data necessary to calculate severance tax. As compared with the previous taxation period the coefficient correcting the severance tax rate (Cp) has increased by nearly 15% and is equal to 9.9455 (8.6646 in April). This is connected on the one hand with the considerable increase of average level of prices for oil grade Urals at Mediterranean and Rotterdam markets of oil raw materials from USD 105.18 to USD 118.39 per barrel, and on the other hand average US dollar exchange rate against ruble of the Russian Federation over all the days of the tax period from 23.5129 to 23.7296.

Review of Budgetary Legislation

M. Goldin

In June 2008 the following events took place in the field of budgetary legislation: according to the decree of the Government of the Russian Federation the procedure for distribution of subsidies from the federal to regional budgets is approved, the Ministry of Finance of the Russian Federation established the procedure for planning of budget subsidies for 2009 and for the planned periods of 2010 and 2011.

According to the decree of the Government of the Russian Federation from 26.05.2008 No 392 "On formation, provision and distribution of subsidies from federal budget to budgets of subjects of the Russian Federation" the procedure for definition of aims for which subsidies from the federal budget to subjects of the Russian Federation are allocated, conditions for subsidies provision and principles of their distribution among the subjects of the Russian Federation.

The rules do not apply to provision of subsidies from reserve funds of the President and the Government of the Russian Federation, reserve fund of the Government of the Russian Federation on prevention and liquidation of emergencies and consequences of natural disasters and Investment Fund of the Russian Federation.

Subsidies are given in order to provide financial support when executing expense liabilities arising from fulfillment by government bodies the authorities concerning the subjects for which the subjects of the Russian Federation are responsible as well as for which both the Russian Federation and subject of the Russian Federation have the joint responsibility and by local government bodies the authorities concerning the issues of local importance.

The aims for which subsidies are provided are defined by the federal executive bodies – subjects of the budget planning in correspondence with the list of priority expense liabilities of subjects of the Russian Federation and municipal formations, co-financed at the expense of the federal budget.

Subjects of the budget planning develop separate rules with regard to every kind of federal subsidies provision and distribution to the budgets of the subjects of the Russian Federation and submit it to the Ministry of Regional Development of Subjects and Ministry of Finance of the Russian Federation for approval and submit it to the Government of the Russian Federation together with the materials which are submitted to consider the project of the federal budget for the next financial year and for the planning period.

In case subsidies are given to realize target programs, financed at the expenses of the budgets of subjects of the Russian Federation (local budgets), rules for provision and distribution of these subsidies are established by the corresponding long-term (federal) target programs.

The rules also state the conditions for subsidies granting as well as principles for their distribution among subjects of the Russian Federation. The sphere of these Rules application is established, the authorities of subjects of budget planning are defined, the requirements for the content of the rules for subsidies provision as well as to the content of agreements signed between the chief superintendent of federal budget means and the supreme executive body of the subject of the Russian Federation are stated. The procedure for calcula-

tion of the level of co-financing rate of an expense obligation of a subject of the Russian Federation is established, which is financed by subsidies.

The Order of the Ministry of Finance of the Russian Federation from 17.04.2008 No 47 N "On approval of the procedure for planning of the federal budget allotments for 2009 and for the planning period of 2010 and 2011" (registered at the Ministry of Justice of the Russian Federation 26.05.2008 No 11756) establishes the procedure for budget allotments planning in 2009-2011.

The procedure under examination defines, for instance, the set of notions for this document to be applied; authorities of the Ministry of Finance of the Russian Federation and subjects of budget planning when planning budget allotments and the procedure for their interaction, establishes the procedure for planning the changes in the volumes of budget allotments for execution of current expense liabilities of the Russian Federation in 2009, 2010 and 2011; procedure for planning of execution of newly taken expense liabilities of the Russian Federation for the period of 2009-2011, the procedure for the formation of the specified list of budget allotments.