

RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES
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Major Developments and Trends

In September, Russia has withdrawn troops from the territory of Georgia outside the self-declared republics and made it clear to the world community that the decision to recognize the independence of Abkhazia and South Ossetia is final. The EU and USA have not yet taken any actions against the Russian authorities, but a discussion of possible sanctions is a pressing issue. Strengthening of control over political situation is continued in the internal policy: this time the authorities have initiated the self-liquidation of not particularly successful, but fairly well-known Agrarian Party of Russia and the Union of Right Forces.

As of August results, the CPI in the RF made 0.4 per cent, having grown again as compared with the relevant period of the preceding year. The growth in consumer prices within January - August reached 9.8 per cent, which is considerably higher than the growth rate of prices in 2007. With the indicator of inflation index in the consumer market, kept up in January-August at the level of 109.7 per cent, prices for foodstuffs increased by 11.3 per cent and by 5.8 per cent for non-food products. In August - September as a result of capital outflow from the country, ruble has declined against the two-currency basket units, whereas the Russian stock market indices fell down and the RF banking system was faced with a lack of liquidity resources. To maintain stability of the financial system, the Bank of Russia has reduced interest rates on its credits and the threshold of deductions to mandatory reserve fund. In addition, the Russian Ministry of Finance has increased the amount of funds placed on auction basis at the deposits of commercial banks. Oil export duties have been considerably reduced.

In September the Russian financial market dynamics was largely determined by the critical situation at the global financial and commodity markets. Moreover, on September 19 Standard & Poor's Agency has *downgraded* the forecast for the Russian sovereign rating from "positive" to "stable". These negative trends were particularly expressed in the Russian stock market (decline in quotations of "blue chips" reached 40 per cent), as well as in reducing the main Russian stock indices in MICEX and RTS (over 20 per cent) as of month results.

The Russian GDP in the first six month of 2008 amounted to RUR 19,112.8 trillion, having grown by 8.0 per cent against the same period of 2007. Changes in the structure of industrial sector took place against in the background of decline in the dynamics of industrial growth to 5.3 per cent and reduction of investment in the fixed assets to 13.4 per cent. In January-August 2008, individual real incomes increased by 7.7 per cent as compared with 10.0 per cent in the same period of 2007, while the growth of trade turnover was maintained close to the previous year level (115.2per cent).

In August negative trends in the Russian industry became more expressed. The emerged absolute decline in demand is forcing the producers increasingly to restrain the growth of output. Profit decline in real terms provoked deterioration of financial performance assessments for the first six months of the year. Demand and production output estimates have reached the minimum level within the three-year term.

As per the first six months of 2008 results, the share of investments in the fixed assets made 17.0 per cent of GDP. The trend to a faster growth of investments in the fixed assets as compared with GDP dynamics is sustained. However, in July - August there was a significant slowdown in investments rate, especially in housing construction. As a result of the first six months of 2008, investment in the fixed assets from the budget amounted to 14.9 per cent of the total investment in the economy, including 4.4 per cent from the federal budget.

Foreign investments in the non-financial sector of the Russian economy in the first six months of 2008 were 22.9 per cent lower than in preceding year. As in 2007, in the first half of 2008, growth rate of direct foreign investment lagged behind other similar indicators and total aggregate investments. The allocation of foreign investments in the Russian economy sectors is characterized by reduced investment in the industry, as well as in trade and catering, whereas a significant increase of investment in operations with real estate, rent and services was noted. In the first six months of 2008, foreign investors have transferred outside the country USD 34.6 bln of their income, which exceeds the indicator of the relevant period of preceding year by 36.0 per cent.

Unlike the last year, when import was growing faster than export, in this year, export is growing faster. In general, indicators of the Russian foreign trade in July 2008 once again reached the peak level in the current year. However, high export growth rate is almost entirely attributable to the in-

crease in export prices. There was nearly no growth in the volume of exports. The RF Government adopted a decree on the abolishment of import duties on constituent parts for the production of plasma and LCD TVs.

At the meetings of the Presidium of the Russian Government the federal budget execution results for the first half of 2008, the federal targeted programs and the federal targeted investment program implementation were reviewed. The gap in the federal targeted program financing has been considerably reduced.

Two laws have been adopted in 2008, aimed at improvement of legal approach to the small and medium-size businesses. In September the State Duma has also reviewed a number of draft laws, addressed to reduce administrative constraints in business, small and medium-size businesses in particular. Taken together, both, adopted laws and those ones under review of the Parliament demonstrate an attempt to build a new approach to the small business regulation, that can reduce the risks of abuse. Nevertheless, measures for the small businesses support can not be regarded completed and consistent as yet.

The political and economic results of September 2008

S. Zhavoronkov

In September Russia withdrew its troops from Georgia's territory beyond the borders of the self-declared republics and made it clear for the international community that the decision concerning the recognition of these republics is a final one. The EU and the USA so far have been refraining from undertaking any measures against the Russian authorities, although the issue of possible sanctions remains constantly on the agenda. In the domestic political sphere control over the political space is becoming increasingly strong: this time the authorities have initiated the self-liquidation of two parties which, without being particularly successful, have been rather well-known: the Agrarian party of Russia and the Union of Right Forces (SPS). D. Medvedev continues to come forth with his habitual eclectic rhetoric, mingling democratic declarations with outbursts against the West.

September began with some important developments in the sphere of foreign politics: the second, within one month, visit to Moscow of President of France N. Sarkozy; and the convening of the Extraordinary Summit of the European Union concerning the issue of the situation around Georgia.

The August war between Russia and Georgia, as is known, broke off with the attempt of the Georgian government to establish control over the territory of the self-declared republic of South Osetia, and ended with the effective military defeat of Georgia and the occupation by Russian troops of a large portion of its territory. President of France N. Sarkozy, who acted as an intermediary, negotiated the so-called six points with D. Medvedev and M. Saakashvili, two of which – the withdrawal of Russian troops to their positions prior to the onset of the conflict and international discussion of the status self-declared republics of South Osetia and Abkhazia – were not fulfilled. Moreover, the Russian authorities declared their recognition of these territories' independence, while Russian troops began to move into the territory outside of the conflict zone in the first few days after the signing of the August agreements.

By the time of N. Sarkozy's second visit, the Russian diplomacy had prepared for a cunning political move: by announcing the withdrawal of the Russian troops from the territory of Georgia outside of the conflict zone by 15 September (this obligation was indeed fulfilled), it complied with the urgent demand voiced by Sarkozy and the UN on the one hand, while on the other it, in fact, effectively avoided a discussion of another issue of no less – and actually even greater – importance (the status of the self-declared republics), thus forcing the European diplomats to accept the final character of Russia's standpoint in respect of its unilateral recognition of South Osetia and Abkhazia. However, it is possible that Russian authorities will yet be reminded of their diplomacy's know-how – the declaration of an imprecise translation of the text of the August agreements – during the conclusion of future agreements.

The EU summit was also marked by the need for a compromise: it was declared that Georgia's territorial integrity should be supported, while Russia's recognition of the independence of Abkhazia and South Osetia was deplored. However, no assessment was offered concerning the operation of Russian troops as such (some EU members insisted on the condemnation of the troops' invasion) – which, however, was also true in respect of Georgia's actions. The only development represented as sanctions

of sorts – the refusal to discuss in the nearest future a new agreement of partnership and cooperation between Russia and the EU – has nothing new to it (this theme being already a year and a half old). Besides, the EU procedures allowing any of its members to place a ban this agreement make this position by no means an all-European one. The Russian authorities have commented the summit's results as the EU's actual refusal to follow the US political course and as strengthening of Russia's position in Europe, but they are by no means so simple. The EU governments attempted to demonstrate, at any cost, their unity – the price being a refusal to offer any meaningful assessments of the Russian - Georgian conflict. However, the resolution of the issue of relations with Russia cannot be postponed indefinitely, considering that some EU members are seriously frightened; in any event, in terms of politics the EU countries are much closer to one another than to Russia.

In this connection it will be interesting to observe how the autumn session of the Parliamentary Assembly of the Council of Europe (PACE) convened at the end of September will go. For the first time since 1999 there has been raised the question as to the possibility of depriving Russia of the right of vote in that organization. The Russian representatives in response to that threat declared that they would suggest to their Government to withdraw altogether from the Council of Europe, although in reality they could hardly be overjoyed at such a prospect. As for the PACE's commission, after visiting Moscow, Tbilisi and Tskhinvali it largely accepted the Georgian version of events. In the report both sides were accused of having committed military crimes during their combat operations, because they had used banned types of weapons and had not tried to avoid civilian casualties. At the same time, the PACE's report declared that it was impossible to establish who had been the first to open fire, since military actions in the region had been started prior to the escalation of the conflict on 7 August; and Russia was accused of organizing ethnic cleansing of Georgian villages¹ in the territory of South Osetia after the ceasefire on 12 August. Thus, the European parliament has so far been acting in a more radical way than the heads of governments, which, however, is not surprising.

As for the USA, the main culprit, according to the Russian authorities, in the engineering of the Russian - Georgian confrontation, it attempted no specific actions apart from the tough political rhetoric of President G. W Bush and both presidential candidates – B. Obama and J. McCain. Several navy ships with humanitarian aid² arrived at Georgian seaports, while Abkhazian President Sergey Bagapsh and South Ossetia's head Edvard Kokoita were denied US visas.

From the point of view of Russia's domestic situation, the events in Osetia gave rise to exacerbated aggression and jingoistic passions expressed through government TV channels and in the speeches of top state officials. D. Medvedev, imitating V. Putin's style, attempted to combine differently vectored declarations. On the one hand, at a meeting with representatives of public organizations in the Kremlin, he said the following: "All the time there are talks that finally they are going to show their true face. The regime will shed its mask, and finally the regime will triumph in Russia that is the most characteristic of the Russian state – authoritarian, turning into dictatorship. The "hawks" have won, and there is nothing else to prove. We understand why this is being said. We are in effect being pushed down a path that is founded not on fully-fledged, civilised partnership with other countries, but on autonomous development, behind thick walls, behind an Iron Curtain. I should like to emphasize that this is not our path. There is no use in returning to the past." On the other, the speech of Medvedev also contained some strange passages concerning US plans to corrupt judges in Russia and, "if this becomes common practice, they will choose presidents"; some curses and gossip aimed against M. Saakashvili; references to «hundreds of millions" (!) of people across the globe who had supported Russia, and so on. On the whole, no definite standpoint has been explicitly put forth so far.

Against the backdrop of events in Osetia one more restructuring of the party system took place, aiming at reducing the number of parties and narrowing the political space. The lists of registered parties for the forthcoming regional elections on 12 October contained the same parties as represented in the State Duma – *United Russia*, the Communist Party of the Russian Federation (CPRF), the Liberal Democratic Party of Russia (LDPR), and *Fair Russia*; all the others were denied registration.

Despite the objections voiced by some regional organizations, the congress of the Agrarian Party of Russia (APR) declared that it was going to join the party in power - *United Russia*. APR is a veteran of Russian politics, with its fraction participating in the first calling of the State Duma, and later its

¹ Approximately 25 % of South Osetia's population.

² Russian authorities believe that the US ships were carrying not only (if any at all) humanitarian aid.

deputies being represented within the framework of CPRF's list at the federal level, and by independent fractions at the regional level. At the federal elections in 2007 APR gained 2.5 %, despite having virtually no funding. Now its niche has been needed by the authorities, or, more precisely, it became necessary that there should be no independent agrarians.

More importantly, the chairman of the only party that did not support the Kremlin at the time of the Russian - Georgian conflict – N. Belykh, Chairman of *SPS*, announced his retirement from the post. During the past year, after failed attempts to negotiate an agreement with the authorities before the parliamentary elections, *SPS* had come to be the most radical among the officially registered parties, trying, for example, to mobilize its supporters before the 2007 elections with slogans like “We are against Putin's plan!” Nearly all its promotion printed matter was confiscated by the Ministry of Internal Affairs, and the party did not managed to get into the Duma, having failed, according to the official version, to earn even 1% of votes. At the same time, old traditions, political activity in the two capital cities and the existence of numerous live regional organizations, coupled with loyalty on the part of the majority of the unofficial mass media, all had been sustaining hopes that *SPS* would be capably of further development and “rebranding”, given, moreover, that Belykh had declared his readiness to unite with other members of the opposition. However it seems that the Kremlin has succeeded in finding appropriate arguments that the party's leader found quite convincing, because he said that any further activity in the format of radical opposition was hopeless, and that it was necessary to create a new organization with a different position towards the authorities. We believe that such an organization, in case it is indeed created, will at best be turned into a technological project like *Fair Russia* – if it is headed by a new politician close to the authorities, and at worst will become a project similar to DPR, whose aim is not to find its way into bodies of authority but to spoil the chances of others to do so.

In September, as before, the North Caucasus remained the focus of attention. Near the RF Government's building in Moscow the former military commandant of Chechnya S. Kiziun was wounded, and the deputy to the State Duma of the previous calling, Ruslan Yamadaev, was killed. The latter belonged to a prominent Chechen clan, which in the early 2000s sided with the Russian authorities, and last year was openly campaigning against R. Kadyrov. Sulim Yamadaev, commander of the “Vostok” battalion under the RF Ministry of Defense³, is, however, still alive, after having given an interview to the newspaper “Kommersant” with a characteristic title “Many have told me that Ramzan did it”⁴. In Ingushetia, after the unpunished murder, by employees of the Ministry of Internal Affairs, of M. Evloyev, owner of the independent website *Ingushetia.ru*, his family declared vendetta against head of the Republic M. Ziazikov and Minister of Internal Affairs M. Medov, promising to revenge his death. During that month, Ziazikov's cousin and deputy director of the republican FSS were killed, and a blast hit the cortege of Minister Medov (he himself was saved by his armored limousine). One should expect further armed struggle for power and interests in the republics of the North Caucasus.

In September D. Medvedev dismissed L. Melamed (who had also formerly worked at “RAO UES”) from the post of general director of the state corporation “Rossiiskaia korporatsia nanotekhnologii” [“The Russian Nanotechnologies Corporation] and replaced him by A. Chubais. The latter declared that he fully supported “the mission and main goal of the corporation – the winning for Russia leading positions on the international market of nanotechnological products. This means that by 2015 Russia's volume of sales of nanotechnologies must become the same as the current turnover of the energy-producing companies included in the RAO UES. And this amounts to 1 trillion rubles per annum.” It is quite probable that Chubais will become successful in his new job and reorient the corporation from holding tenders for money placement with commercial banks toward its core activity. However, despite certain expectations, after Medvedev's entry in his office there has been no raising of Chubais' status in the state administration system.

In September two rather symbolic commercial conflicts were in part resolved. BP and the Russian shareholders in TNK-BP (M. Fridman, G. Khan, V. Vekselberg, and others) signed a memorandum of mutual understanding. It envisages that until the end of the year 2008 the current head of TNK-BP THK-BP R. Dudley should retire from his post – something that Russian shareholders have been trying to achieve for a long time in vain. After that BP is going to suggest a new independent candidate

³ According to another source, he was dismissed from the Army; anyway, this unit has no new commander.

⁴ The interview contains just some general statements about the need to conduct an investigation.

for the director's post, to be then approved by a unanimous decision by the board of directors of TNK-BP. This candidate must have experience in the oil and gas sector of Russia and be fluent in Russian (previously BP could appoint the company's head on its own). The board of directors will be enlarged to 11 persons, where the two parties will be represented by four directors each, while the three remaining members will be independent (now this ratio is 5 : 5). Thus, it can be stated that the Russian shareholders in TNK-BP, who in this corporate war enjoyed open support from the Russian authorities, and first of all Vice Prime Minister I. Sechin, have won an important victory by cardinally changing the initially established rules for the company's management. In this connection it is interesting to note that the Russian shareholders disagreed with BP primarily with regard to profit investment: BP had wanted to invest it in Russian mining and infrastructure, while the Russian shareholders – to pay dividends and invest in foreign acquisitions. However, it is still too early to consider this conflict to be over: no new director has been appointed so far, and the memorandum is not a binding document.

In September there was a change in the ownership of the major retailer in the sphere of mobile communications – “Evroset”. Its former co-owners – E. Chichvarkin and T. Artemiev – sold the company to the structures owned by A. Mamut, the amount of transaction being approximately \$ 400 billion (previously the company's value had been estimated as being by several times higher). On the eve of the sale “Evroset” became target of an unprecedented attack launched by law-enforcement agencies: the company's vice president for security B. Levin and several his subordinates were arrested on the accusation that four years previously (!) they had allegedly kidnapped their former employee and forced him to return the money stolen from the company (!). The employee in question is presently alive and in good health, and all these years he had been free. The public character of this action left no doubts as to it being a warning, and the arrested persons were not released even after the completion of the transaction. “Evroset” has become famous in the Russian business community, among other things, by successful lawsuits filed against criminals from the RF Ministry of Internal Affairs, who had confiscated a big consignment of the company's goods and at once sold it at giveaway prices. E. Chichvarkin was one of the few who were granted the right to officially canvass for D. Medvedev during his election campaign, and besides, he participated in the events stages by United Russia and spoke of a new agenda for the development of the Russian elite and Russian business. However, it appears that he has been too rash in his judgments, and the participation in the promotion of D. Medvedev is no safeguard against anything.

At the same time it should be noted that both these stories represent nothing extraordinary: the businessmen working in Russia are used to such occurrences, and it all did not go to such extremes as had been observed in the Yukos case. However, the lack of confirmation of the reality of those positive expectations that were displayed by the market participants last spring has given rise to certain feelings as far as investors are concerned, which are becoming stronger in view of the crisis developing on foreign and Russian markets.

Monetary and Credit Policy

P. Trunin

As of August results, the CPI in the RF made 0.4 percent, having grown again as compared with the relevant period of the preceding year. The growth in consumer prices within January - August reached 9.8 percent, which is considerably higher than the growth rate of prices in 2007. In August - September as a result of capital outflow from the country due to the development of the global financial crisis and conflict in South Ossetia, ruble has declined against the two-currency basket units, whereas the Russian stock market indexes fell down and the RF banking system was faced with a lack of liquidity resources. To maintain stability of the financial system, the Bank of Russia has reduced interest rates on its credits and the rate of deductions to the mandatory reserve fund. In addition, the Russian Ministry of Finance has increased the amount of funds placed on auction basis at the deposits in commercial banks.

Consumer price index in August made 0.4 per cent (versus 0.1 per cent in August 2007) (See Fig. 1). Therefore, as of August results, prices growth rate has again exceeded the level of previous year. The utmost growth rates were observed in prices for public services, which have grown within the month by 0.9 per cent. Significant growth was observed in regard to international tourism (+2.2 per cent), public transport (+ 2 per cent), education (+ 2 per cent) consumer services (+1.4 per cent) and

entertainment (+1 per cent). Herewith, some decline was observed in insurance services (- 0.2 per cent).

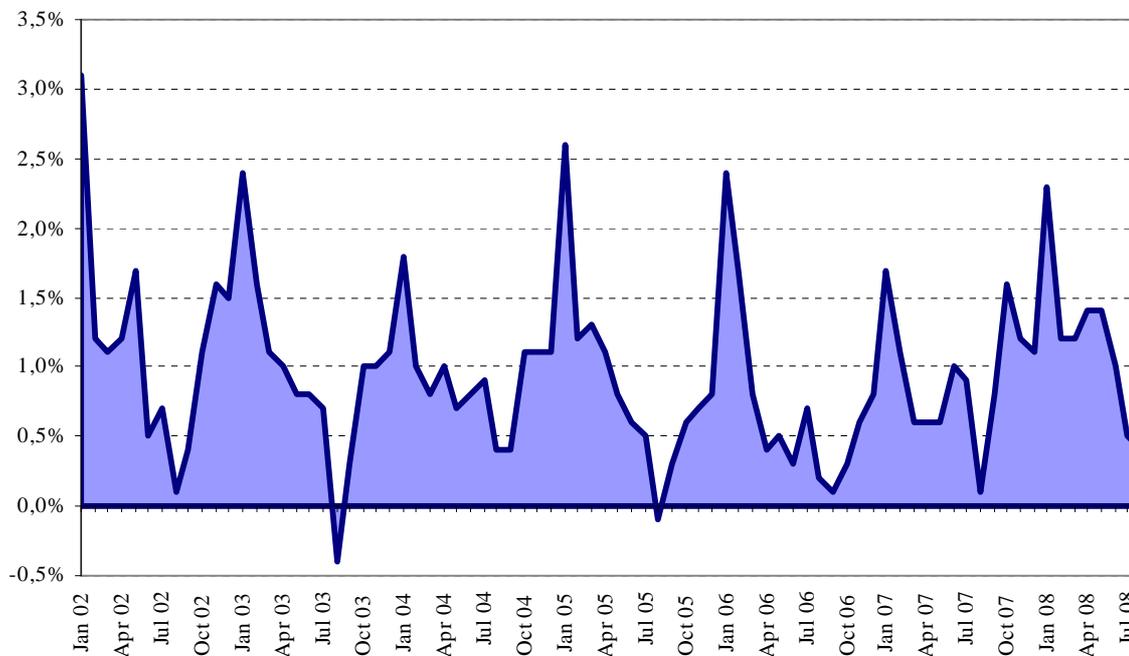
Food stuffs got cheaper in August by 0.2 percent primarily due to seasonal factor: prices for vegetable and fruit have declined by 11.3 per cent within the month. The utmost growth rates were observed in prices for meat and poultry (+2.2 percent), grits and beans (+ 2 per cent), pasta (+ 1.4 per cent), fish and seafood (+ 1 per cent). Prices for eggs and granulated sugar continued further downgrading in August: their average countrywide decline within the month made 0.5 per cent and 0.6 per cent accordingly.

In August, the growth was observed also in regard to non-food items, which prices have increased during the month by 0.6 per cent. The highest growth rates were noted in August for tobacco (+2.1 per cent), detergents and cleaning agents (+1 per cent), medical supplies (+1.1 percent) and construction materials (+0.9 per cent). Herewith, prices for gasoline remained unchanged in August.

As mentioned in the earlier surveys, downgrading of monetary offer growth rate at the beginning of current year, as well as the grown offer of agricultural products have restrained the inflation in summer. Herewith, inflation inertia stays rather explicit, what provides serious grounds for higher CPI level in 2008 against the indicator of preceding year.

The basic consumer price index⁵ in August 2008 made 1 per cent (versus the level of the relevant period of preceding year 1.1 per cent). In our estimates, CPI in September will make 0,7 – 0,9 percent.

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



Source: RF Statistical Service

In August 2008 the monetary base (in broad definition⁶) has been increased by RUR 76.4 bln, up to RUR 5360 bln (+1.4 per cent). The volume of monetary base in broad definition made as of August 1, 2008 RUR 5283.6 billion. Let us consider the dynamics of the monetary base in broad definition by components.

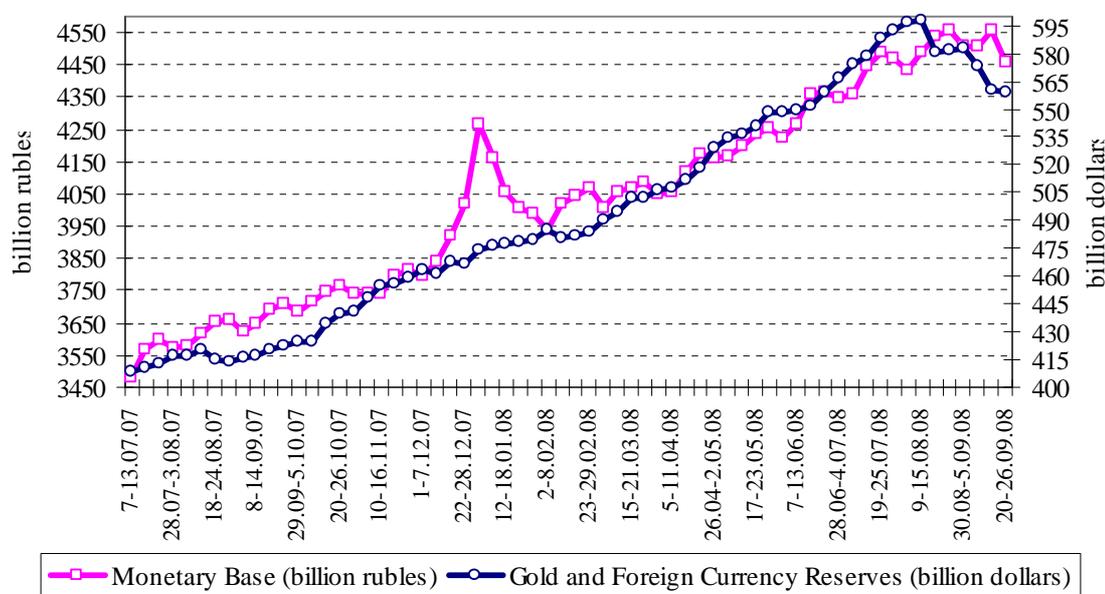
⁵Basic index of consumer prices is an indicator of the inflation level without regard to seasonal price reduction (fruit and vegetable products) and to administrative measures (tariffs for government-regulated services, etc.). It is estimated by the RF Statistics Service

⁶ The RF monetary base in broad terms with no regard to the cash issued by the Bank of Russia and the balance of Compulsory Reserve Accounts on credit organizations in national currency, deposited in the Bank of Russia, taking into account the assets of correspondent accounts and bank deposits, allocated in the Bank of Russia.

As of September 1, 2008, cash in circulation with regard to the fund balances in credit organizations made RUR 4.2 trillion (2.3 per cent growth against July 1), correspondent accounts of credit organizations in the Bank of Russia made RUR 610.4 billion (+ 9 per cent), mandatory reserves made RUR 397.7 billion (plus 2.4 per cent), banks' deposits in the Bank of Russia made RUR 74.2 billion (- 50.2 per cent), the value of shares of the Bank of Russia with credit organizations made RUR 38.6 billion (- 5.2 per cent). Therefore, in August the reduction of excessive reserves of commercial banks has reached RUR 26.8 bln, what is based primarily on higher banks' demand in the background of the global financial crisis. The current situation with bank liquidity remains rather tense due to massive capital outflows and sharp downfall in the Russian stock market, leading to a significant reduction in the value of securities on the balance of credit organizations. However, to maintain financial stability, government authorities have taken a series of emergency measures, among which are the reduction of the threshold for deductions to mandatory reserve fund from 18th of September, the possibility to provide credits to banks by the Central Bank without a pledge, the increase of deposits, placed by the Russian Ministry of Finance in commercial banks, etc. At the same time, in case the trend of capital outflow is sustained and energy sources prices are declined, banks may face more serious shortages of liquidity in the nearest future.

Herewith, foreign currency reserves of the RF Central Bank have grown by 2.4 per cent and made on September 1 USD 581.6 bln. The volume of public authorities deposits has grown within August by 2.3 per cent and accounted to RUR 8.45 trillion.

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



Source: Central Bank

In July, the inflow of currency into the country has somewhat declined, leading to a slowdown of ruble in real terms. Thus, RUR real effective exchange rate remained unchanged as of July results (against the relevant period of preceding year): the real effective exchange ruble rate made 135.5 (See Fig. 3). As a result, ruble strengthening in real terms against the two-currency basket accounted to 3.3 per cent within January-August, as compared with 3.9 per cent within January-August 2007. According to our estimates, that indicator for the year of 2008 will reach 5 per cent.

As a result, official exchange rate of USD against RUR has grown only by RUR 1.13: by the end of August the dollar rate was RUR 24.58, as compared with 23.45 as of April 1. Herewith, RUR has declined in two-currency basket: the value of the two-currency basket has grown by 49 kopeks, from RUR 29.34 to RUR 29.82. As a result, EURO rate at the end of February has downgraded to RUR 36.23.

Indicators of Ruble's Exchange Rate Dynamics

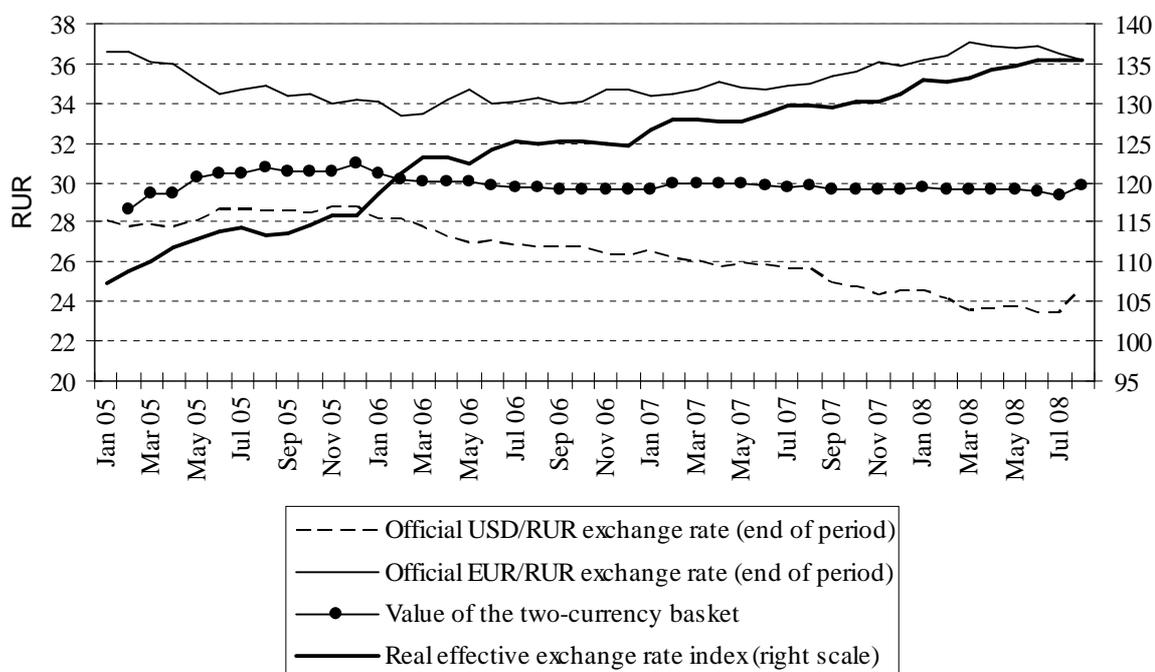


Fig. 3. Ruble exchange dynamics in January 2005 – August 2008.

Source: Central Bank, author's estimates

By the decision of the Board of Directors of the Bank of Russia as of September 17, the rate of deductions to the Fund of mandatory reserves is increased from September 18 of the current year: from 8.5 per cent to 4.5 per cent per annum under the debts of Russia to foreign credit organizations, from 5.5 per cent to 5.5 per cent under the banks' ruble obligations to individuals and from 6 per cent to 2 per cent under other liabilities of credit organizations. At the same time, the Central Bank increased averaging ratio of mandatory reserves, from 0.55 to 0.6, which enables the banks to utilize the greater portion of obligatory reserves within the month. At the same time, standards are decreased only for a specified term: Since February 1, 2009 they will be raised by 2 p.p. and from March 1, 2009 - by another 2 p.p., returning to their values of September 17.

In addition, the Bank of Russia has reduced the interest rates on its credits:

- From 9 to 8 per cent per annum for 1-day lombard credits, for 1-day direct REPO transactions and for 1-day "cross-currency swap" transactions;
- From 10 to 9.5 per cent for borrowing against bill pledging, under credit organizations contracts, provided for 30 calendar days;
- From 9 to 8.5 per cent per annum for borrowing against bill pledging, under credit organizations contracts or secured by them and provided for 90 days, and from 9 to 8.5 per cent per annum for credits, provided for the term from 91 to 180 days.

In addition, the minimum interest rate on the lombard credit operations on an auction basis for a period of 2 weeks was fixed at 7.5 percent per annum, but the values of the Bank of Russia adjustment factors, used to assess the security for credits was increased by 0.2.

Therefore, the RF Central Bank has taken a series of emergency measures aimed at stabilizing the situation in the Russian financial market. In early September, as a result of capital outflow from the country and energy sources prices decline, the RF banking system has faced with the lack of liquidity resources. In particular, on September 17, the average interest rate on the interbanking credit market for large banks has reached 11 percent, as compared with 6 percent at the beginning of the month, and at auctions for placement of the federal budget assets at the commercial bank deposits, the banks received from the Ministry of Finance of Russia nearly 300 billion rubles on September 16-18. In addition, during the same period at the auctions on direct REPO the Bank of Russia has also provided

funds to commercial banks, exceeding 340 billion rubles. Herewith, banks' refinancing operations, carried out by the Ministry of Finance and the Central Bank of Russia, traditionally were available only to a small group of large banks. The temporary downgrading in the rates of payments to the Social Development Fund would release the funds to relatively greater number of banks, which will help reduce the strain at the national financial market. At the same time one should realize that this mitigation of monetary policy could lead to inflationary pressure growth to some extent, but the priority for the RF Central Bank at this point is the support of the national financial system stability.

In our view, in this situation, the measures taken by the government authorities are quite reasonable. In the background of the global financial crisis, the bankruptcy of even small financial institutions may provoke panic and aggravate the situation. Of course, the monetary infusions into the economy will provide a surplus inflationary pressure, but they will help the financial system to survive the period of financial instability.

Financial Markets⁷

N. Burkova

In September the Russian financial market dynamics was determined by the negative situation in the global financial and commodity market. Tense expectations of the USA largest investment banks prospective, decreased global economic growth rates and sustained downgrading of the world oil prices caused the downfall in the Russian stock market in September. Moreover, on September 19, Standard & Poor's Agency has downgraded the forecast for the Russian sovereign rating form "positive" to "stable". These negative trends were clearly evident particularly in the Russian stock market (decline in quotations of the "blue chips" to 40 per cent), as well as on reducing the main Russian stock indices in MICEX and RTS (over 20 per cent an average) as of month results.

History of the developments in the Russian stock market in September. External and internal factors:

Date	Major developments
September 1	- the rate for deductions to mandatory reserve fund upgrading from September 1
September 11	- RF Central Bank published the information on reduction of the gold and foreign currency reserves by USD 8.9 bln within August 29 – September 5
September 1-14	- moderate downgrading of the majority of "blue chips" value in the Russian market by 2-4per cent at the background of oil securities quotations decline at the global stock market
September 15	- notification on bankruptcy of Lehman Brothers, one of the largest US investment banks - acquisition of another US large investment bank Merrill Lynch by the commercial Bank of America (for USD 44 bln) - the news on the forthcoming bankruptcy of AIG, the largest insurance company - the news on a tentative acquisition of Morgan Stanley investment bank by Wachovia bank - rejection of the US Federal Reserve Service to amend the official refinancing rate - downfall in the world stock markets, including the Russian one
September 16	- downfall of the major Russian stock indices to the level of the three-year minimum: MICEX by 17.5per cent to 881.17 p.p., RTS - by 11.5per cent to 1131.12 p.p.; "blue chips" downfall by 10-20per cent) - FRS has invested USD 70 bln in the national financial system to reduce the interest rate on inter-banking credits
September 17	- downfall of "blue chips" quotations (to 30 per cent) and as a result, RTS and MICEX indices, downfall in the Russian exchange market, the decision of the

⁷ In the course of preparation of the survey, there were used analytical materials and surveys published by the Zenith Bank, investment company ATON, MICEX, and the materials presented at web sites of Russian issuing companies.

	<p>Federal Financial Market Service on suspension the MICEX and RTS activities for two days (September 17 and 18, 2008)</p> <ul style="list-style-type: none"> - panic at the global financial markets; pessimistic expectations in regard to Morgan Stanley investment bank, whose shares declined by 42 per cent within September 15-17 - FRS purchases 79.9 per cent of shares of the largest insurance company AIG
September 18	<ul style="list-style-type: none"> - FRS provided a credit to the banks in the amount of USD 55 bln - the European Central Bank, Bank of England, Bank of Japan, Bank of Canada and Swiss National Bank allocate USD 180 bln to support financial markets - the RF Central Bank reduced the rate of deductions to Mandatory Reserve Fund by 4 p.p. (herewith, stepwise upgrading of reserve funds volume is foreseen, by 2 p.p. from 1.02.2009 by 2 p.p. more from 1.03.2009) - the RF Central Bank reduced the interest rate on credits, provided to commercial banks by 0.5 – 1 p.p. -the RF Central Bank increased adjustment indices, used to assess credit guarantees, provided under “non-market” pledges - the RF Central Bank has published the information on foreign currency reserves reduction by USD 13.3 bln within September 5 - 12
September 19	<ul style="list-style-type: none"> - rally in the global stock market at the background of the US government decision to allocate USD 700 bln for purchasing the problem assets from the banks and a ban, introduced in the USA and Great Britain on the short sales of financial companies securities, as well as promises to provide support to the co-op share funds of the US monetary market; growth of the basic global indices (by 3-8per cent); active growth of trading activity in the American market (Morgan Stanley securities quotations have grown by 20.7per cent) - trades are renewed at the Russian stock markets MICEX and RTS, more active trading activity was noted (“blue chips” have upgraded by 8 – 60 per cent, the leaders among them were WTB Bank and “Rosneft”), a sharp upsurge of stock indices (MICEX by 28.7 per cent, up to 1098.95 p.p., RTS by 22.4 per cent, up to 1295.91 p.p.); suspension of trades at MICES and RTS for a few hours to restrain the market boom - RF government decision to allocate over RUR 3 trillion to support the national stock and financial markets - downgrading of the Russian sovereign rating by Standard & Poor's Agency from “positive” to “stable” due to the “growing uncertainty in economic policy” and reduction of the world banks credit volume to the Russian debtors” - news on acquisition of a part of bankrupt bank Lehman Brothers by Barclays and Nomura banks - Ameribank Inc. bankruptcy, the twelfth American bank since the beginning of the year
September 22	<ul style="list-style-type: none"> - notification on the changed status of the only two remaining “Big Four” banks Goldman Sachs и Morgan Stanley, the largest independent investment banks, to banking Holding Companies from September 21. Due to the status revision, those banks obtained the right for emergency credits from the FRS on a permanent basis - Message form Mitsubishi UFJ Financial Group Inc. On agreement for acquisition 10-20 % share in Morgan Stanley news on the planned upgrading of inflation estimates and a new mechanism of VAT payment in the framework of liquidity crisis suppression (quarterly VAT can be paid in three tranches) - “blue chips” quotations upgrading, US securities downgrading
September 24	<ul style="list-style-type: none"> - suspension of MICEX trades for one hour for technical reasons; - W. Buffet decision to invest USD 5 bln in Goldman Sachs has supported all global stock markets - oil price growth - disclosure of the USA economy recovery plan, where purchase of American financial companies’ bad debts is foreseen

September 29	<ul style="list-style-type: none"> - decline of the basic US stock indices due to rejection of the draft law on the support of the US financial market and allocation USD 700 bln to that end; stronger investors' expectations for aggravation of the economic crisis in the US; downfall of the major US stock indices by 7-10 per cent - message on the acquisition of Warchovia banking business by the US Citigroup bank for USD 2.1 billion through intermediary of the US government - Bradford & Bingley British bank nationalization by the British Government - largest Belgian financial group Fortis nationalization - oil prices downfall (lower than USD 100 per barrel) - message on acquisition of 21 per cent in Morgan Stanley by Mitsubishi UFG Financial Group for USD 9 billion
September 30	<ul style="list-style-type: none"> - suspension of MICEX and RTS trades by the Federal Service of Financial Markets from 10.30 A.M. to 12.20 P.M. due to historical downfall in the US market, provoked by the rejection of the draft law on the US financial market support.

Government securities market

Stock market dynamics

In September Russian Eurobonds demonstrated in general a growing dynamics in profitability due to declined demand in the government securities market at the background of the Russian securities market downfall on the one hand, and aggravated liquidity crisis (despite all measures, taken by the government to mitigate liquidity problems), on the other hand.

As of August 28, 2008, the Russian Eurobonds' RUS-30 yield to maturity has increased as compared with the level of August 22, 2008 from 5.72 to 6.97 per cent per annum (growth by 21.85 per cent), RUS-28 – from 6.15 per cent to 7.01 per cent per annum (by 13.98 per cent, RUS-18 – from 5.68 to 6.00 per cent per annum (by 5.63 per cent). As opposed to that, RUS-10 yield to maturity has declined from 4.89 to 1.96 per cent per annum (by 59.92 per cent). The latter indicators are based on the forthcoming coupon payments date (September 30, 2008). As of the same date, the downgrading trend was also observed in the yields of external currency debt bonds. Thus, the yield to redemption of the seventh tranche of external currency debt bonds has declined from 4.41 to 4.11 per cent per annum, i.e., by 6.80 per cent against August 22, 2008 (see *Figs 1-2*).

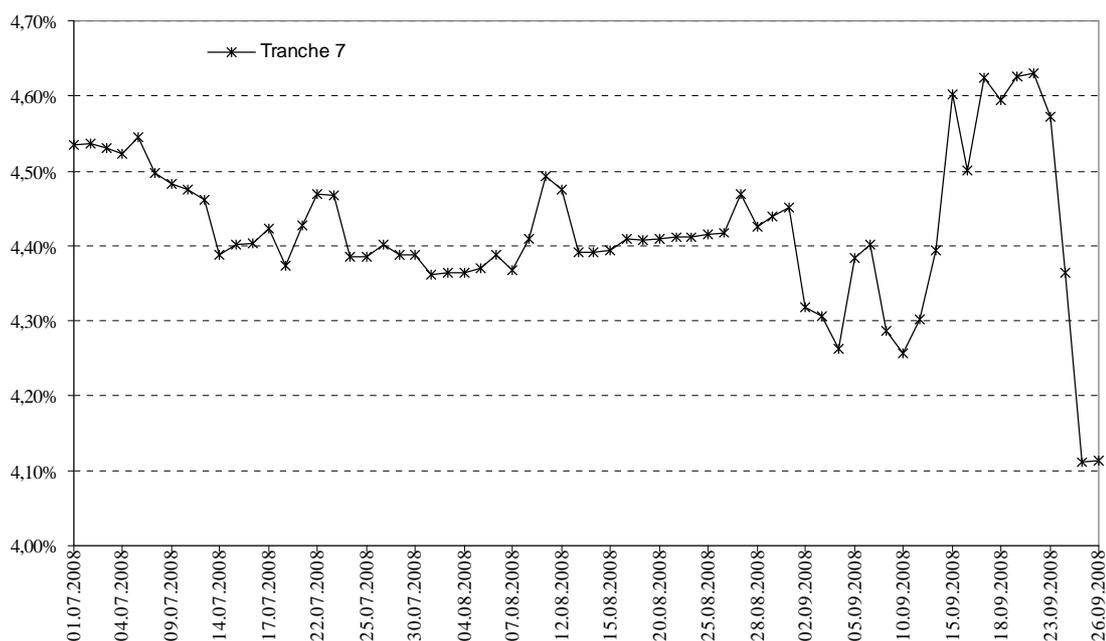


Fig. 1. Minfin bonds' yields to maturity in July - September 2008

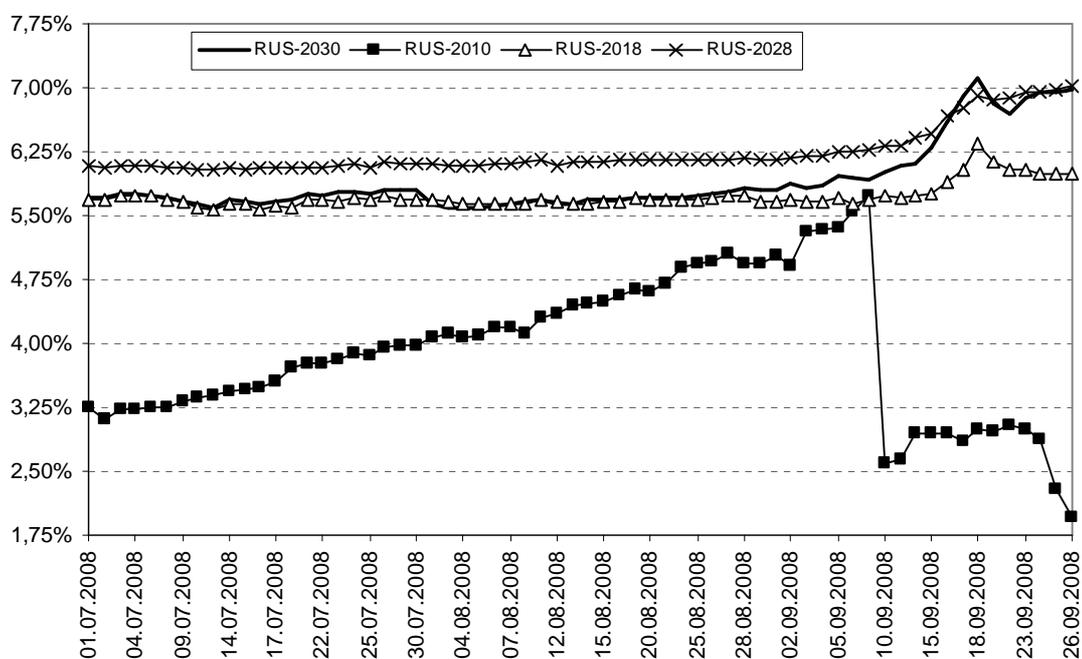


Fig. 2. Yields to maturity of the Russian eurobonds with maturity in 2010, 2018, 2028 and 2030 in July - September 2008

Within the period from August 23 to September 28 the total turnover of GKO- OFZ secondary market amounted to approximately RUR 58.61 billion with an average daily turnover of RUR 2.34 billion. (about RUR 42.31 billion with an average daily turnover of RUR 2.12 billion in August), what demonstrated an increase of average daily turnover in September as compared with preceding month by 10.38 per cent due to the end of vocational season.

A number of auctions on additional OFZ placements were arranged in the period from August 23 to September 28. Thus, an auction on additional placement of OFZ series 46021 and 46020 were held on September 5 for the amount of RUR 5 billion, actual placement made RUR 3.79 billion with an average weighted yield of 8.37 per cent per annum. Therefore, the turnover in the primary OFZ market in September (RUR 5.00 billion) has decreased 8 times as compared with August (RUR 40.00 billion), while the total actual amount of placement within the month (RUR 3.79 billion) has declined more than 6.5 times as compared with August (RUR 24.59 billion). At the same time, in September the actual placement volume made 75.80 per cent against 61.48 per cent of the planned one in August.

As of September 28, the GKO-OFZ market amounted to RUR 1144.25 bln at face value and to RUR 1064.97 bln at market value. The duration of the GKO-OFZ market portfolio was 2053.50 days, having decreased by 5.36 days as compared with preceding month (as of August 31, 2008).

Equity Market

Stock market situation

The situation in the global financial and commodity markets, reflecting the negative external background (in connection with the bankruptcy of one of the largest US investment banks Lehman Brothers, acquisition of Merrill Lynch by a commercial bank, as well as to tentative similar fate of the two remaining major US investment banks, the nationalization of the two leading mortgage agencies, forced government support of the largest U.S. insurance company AIG and others, being on the verge of bankruptcy) provoked a collapse at the Russian stock market, as well as such unprecedented measures on the part of the Federal Service of Financial Markets, as the suspension of the Russian stock exchanges MICEX and RTS trades on September 17 and 18, 2008 due to the panic in the markets, happened, among other things, because of the «blue chips» quotations downfall, exceeding 30 per cent. Moreover, on September 19 Standard & Poor's Agency has downgraded the forecast for the Russian sovereign rating from "positive" to "stable" due to the support, provided to financial market from the federal budget and decreased level of reserves at the background of aggravated liquidity crisis.

All those factors have provoked the downgrading of the most liquid securities value in the Russian stock markets in September (up to 40 per cent), as well as the market stock indices, in particular, the MICEX and RTS indices over 20 per cent as compared with preceding month.

Throughout September a strong negative dynamics was observed in the Russian stock market. Thus, throughout the month, a general trend to decline in MICEX index was observed. The maximum value for the month the MICEX index reached on September 17: 853.93 points (which is by 33.95 per cent lower than the relevant indicator of the preceding period). MICEX index has reached its peak for the month on April 1 (1492.55 points, which was by 1.74 per cent higher than the corresponding indicator for the previous period). The maximum value for the month the MICEX index reached on September 2: 1368.99 points (which is by 8.28 per cent lower than the relevant indicator for the previous period). Such MICEX index downgrading has reflected a general decline trend in the quotations of the Russian companies' equities (*Fig. 3*).

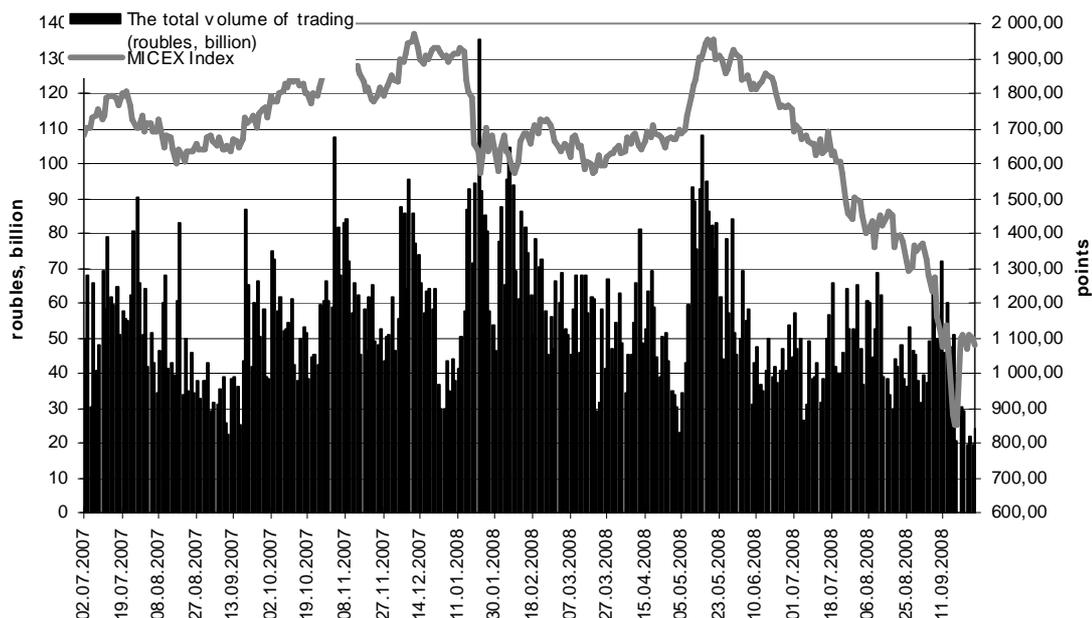


Fig. 3. Dynamics of MICEX Index and Trading Volume

In general, within the period from September 1 to 28, 2008, the MICEX index has fell down by 21.02 per cent in absolute terms and made about 287.20 points (within the year, from September 29, 2007 to September 28, 2008 the MICEX index has downgraded by 38.67 per cent). Over the same period the turnover of trades in shares, included in the MICEX index, made about RUR 757.38 bln at an average daily turnover of RUR 37.87 bln. (against RUR 1185.41 billion with an average daily turnover of RUR 47.42 billion in the preceding period from July 28 through August 31). Therefore, the investors' activity in the stock market in September has declined as compared with the preceding month by more than 20 per cent. The indicators of maximum and minimum daily turnover in the market trades in September made, accordingly, RUR 72.12 bln. (as of March 10) and RUR 19.33 bln (on September 23) accordingly.

As of month results (from July 1 through August 28), the majority of "blue chips" have shown an expressed downfall, excluding "Gazpromneft", the value of which has upgraded in September by 1.09 per cent. Thus, the utmost downgrading rates were demonstrated by "Mosenergo" and "Rostelecom", declined by 43.84% and 31.14, accordingly. Significant downfall was observed also about shares of Sberbank of Russia (by 24.91 per cent), VGMK "Nornickel" (by 23.79 per cent) Surgutneftegas (by 23.00 per cent), and VTB Bank (by 22.63 per cent). Some lower decline rates were observed about the shares of "Tatneft" (by 18.61 per cent), "Gazprom" (by 16.07 per cent), LUKOIL (by 15.32 per cent) and "Rosneft" (by 12.64 per cent) (See *Fig. 4*).

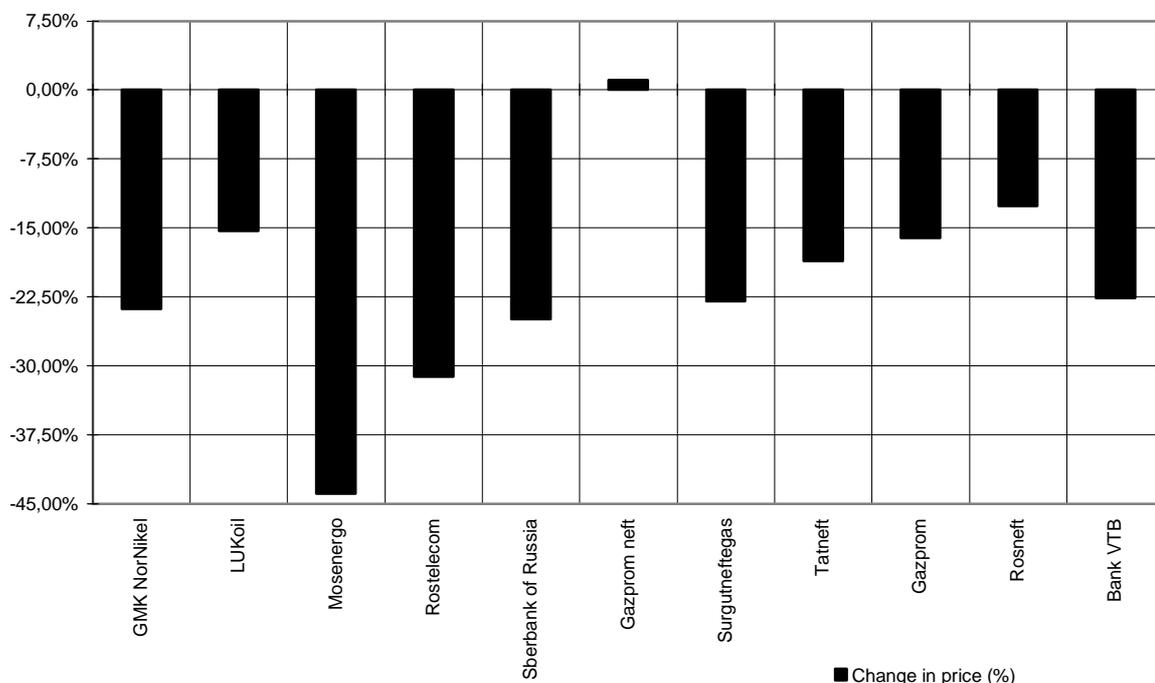


Fig. 4. Dynamics of the Russian Blue Chips from September 1 to 28, 2008

In September the MICEX turnover leaders were: “Gazprom”(32.80 per cent of the total turnover), , “Sberbank of Russia” (18.54 per cent), “LUKOIL” (15.02 per cent), GMK “Nornickel” (10.25 per cent), and “Rosneft” (7.17 per cent). Total share of transactions with the above five companies’ equities (“blue chips”) made about 83.78 per cent (all “blue chips” - 94.46per cent) of the gross turnover in the MICEX stock market in the period over September 1 - 28.

In terms of capitalization, as of August 28, the top five leaders of the domestic stock market were: Gazprom “– RUR 5 887.60 (RUR 7 117.92 bln in preceding month), “Rosneft” - 1 989.29 bln , “LUKOIL” - RUR 1536.68 bln (RUR 1 652.13 bln in August), RF Sberbank - RUR 1 336.45 bln (against RUR 1 564.62 bln), GMK “Nornickel” - RUR 941.10 (RUR 1 017.73 bln in preceding month).

Futures and options market

In September 2008 the investors’ activity in the MICEX futures and options market has somewhat increased (over 13 per cent) as compared with the preceding month, while the number of transactions has decreased by 12.5%. Thus, in September the total turnover in the MICEX futures market made about RUR 448.83 bln. (663 transactions, 17.30 mln of contracts) against about RUR 396.45 bln (758 transactions, 15.95 mln of contracts) in August. Herewith, in September, like in preceding month, the utmost volume of trades was observed in RUR/USD futures contracts, which amounted to RUR 445.02 bln. (595 transactions, 17.299 mln of contracts). The turnover with those futures within this month has grown over 30per cent as compared with the preceding month.

An adverse situation was observed in the RTS FORTS futures market, where the investors’ activity in September has expressly decreased (nearly by 40 per cent) as compared with the preceding month. Such a decline in September was mainly based on the sharp decline, starting from September 17 till the end of the month, in the volume of daily trades at the futures market (several times as compared with preceding days). Thus, in the period from September 1 to 28, the total turnover in the RTS futures and options market amounted to approximately RUR 815.35 bln. (2,221 transactions, 19.85 mln of contracts) against about RUR 1,349.70 bln (2,820 thousand of transactions, 28.26 mln of contracts) in August. The greatest demand, as before, was for futures: the volume of trading in futures in the period under review was RUR 697.79 bln (2,147 thousand of transactions, 17.70 mln of contracts). Herewith, "Shares of electric power companies" futures with maturity date on December 15, 2008, addressed at the support of the electric power companies’ securities liquidity upon discontinuation of RAO UES trades in the stock market since June 6, has reached in August RUR 139.07 mln (632 transactions, 32.98 mln of contracts) against about RUR 804.21 bln (1,310 transactions, 7.71 mln of contracts) in August. Options enjoyed a far lower demand, with the volume of trading at about RUR 117.56 bln

(74 thousand of transactions, 2.15 mln of contracts). The highest daily level of trading in the RTS futures market was RUR 69.46 bln (as of September 12), the lowest level was RUR 7.37 bln (on September 18) accordingly.

Corporate bond market

In September, general decline was observed in the dynamics of securities quotations, traded in the corporate debt market. Thus, the investors' activity decline was observed in market within the month (average daily turnover has declined by 6 per cent as compared with preceding month). Herewith, the amount of placed issues in September remained at the same level as a month earlier.

From August 23 through September 28 the price index of corporate bonds, traded on MICEX⁸, has decreased by 4.60 points (by 4.23 per cent), as well as the index of the ten most liquid corporate bonds, which has downgraded by 4.53 points (by 3.93 per cent) (see Fig. 5). Within that period the total turnover in MICEX corporate bond sector amounted to RUR 71.65 bln with an average daily turnover of RUR 2.87 bln (about RUR 60.97 billion with an average daily turnover of RUR 3.05 billion in August), what demonstrated an insignificant decline trend in the investors' activity in September.

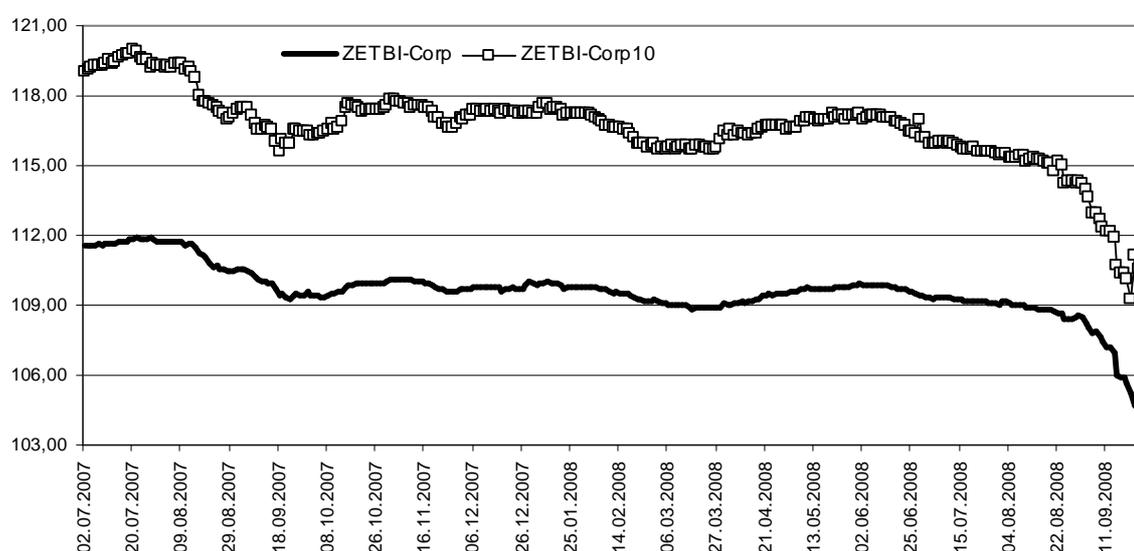


Fig. 5. Dynamics of corporate bond indices

External factors behind Russian stock market dynamics

In September the Russian financial market dynamics was determined by the situation in the global financial and commodity markets. Among the adverse global market factors, affecting the Russian market, one should note the downfall in the US stock market, followed by the European and Asian markets due to the news of September 15 on the bankruptcy of one of the largest US investment banks Lehman Brothers and Merrill Lynch acquisitions by the commercial Bank of America, as well as information about the impending bankruptcy of the largest US insurance company AIG, which has been afterwards provided a credit by FRS in exchange for 79.9 per cent of its shares. The collapse of shares in all world markets was provoked also by negative expectations about the prospects of the two remaining major US investment banks Goldman Sachs and Morgan Stanley, which were approved the status of the bank holding companies by the Federal Reserve System Board on September 21, thus giving them the opportunity to receive credit from the Central Bank, if necessary, as well as the nationalization of the two leading US mortgage agencies Freddie Mac and Fannie Mae. The deterioration of the situation was urged by the global liquidity crisis, negative macroeconomic statistics from the US, the slowdown in the global economy, the continued significant decline in oil prices (which fell down below the USD 100 per barrel), the weakening of the ruble to the US dollar, the negative forecasts on the emerging markets and reduced demand for commodities.

⁸ Estimates are based on "Zenit" bank indices, used for corporate bonds trading at MICEX.

All those factors resulted in the downfall of the world's major stock indices. Thus, in September the downfall of the majority of the global indices was noted as compared with the indicators of early 2008, (by 20-40 per cent on average). A similar trend was observed in the indicators of the late August of 2008. Thus, the markets of developing countries were characterized by the decline of the major indices by 3-12 per cent, US and European markets - by 3-10 per cent. (see Table 1 and Fig. b).

Table 1

Dynamics of international stock market indices (as of September 2008)

Index	Ticker	Value	Dynamics within the month (%)*	Dynamics since the year beginning (%)
MICEX (Russia)	MICEXINDEXCF	1079,04	-20,01	-42,87
RTS (Russia)	RTSI	1285,47	-21,91	-43,88
Dow Jones Industrial (USA) Average (USA (USA) (USA))	DJI	11143,13	-3,47	-15,99
NASDAQ Composite (USA)	NASD	2183,34	-7,78	-17,68
S&P 500 (USA)	SPX	1213,27	-5,42	-17,37
FTSE 100 (UK)	FTSE	5088,47	-9,72	-21,19
DAX-30 (Germany)	DAX	6063,50	-5,59	-24,84
CAC-40 (France)	CAC	4163,38	-7,12	-25,84
Swiss Market (Switzerland)	SSMI	6815,52	-5,85	-22,43
Nikkei-225 (Japan)	NIKKEI	11893,16	-9,02	-22,31
Bovespa (Brasil)	BUSP	50782,99	-8,80	-20,51
IPC (Mexico)	IPC	25593,77	-2,65	-13,35
IPSA (Chile)	IPSA	2784,23	-3,83	-8,77
Straits Times (Singapore)	STI	2411,46	-11,99	-30,75
Seoul Composite (South Korea)	KS11	1476,33	0,14	-22,18
ISE National-100 (Turkey)	XU100	36556,61	-8,25	-34,18
Morgan Stanley Emerging Markets Free Index	EFM	670,18	-13,90	-33,27

** Versus indices, valid on August 31, 2008.

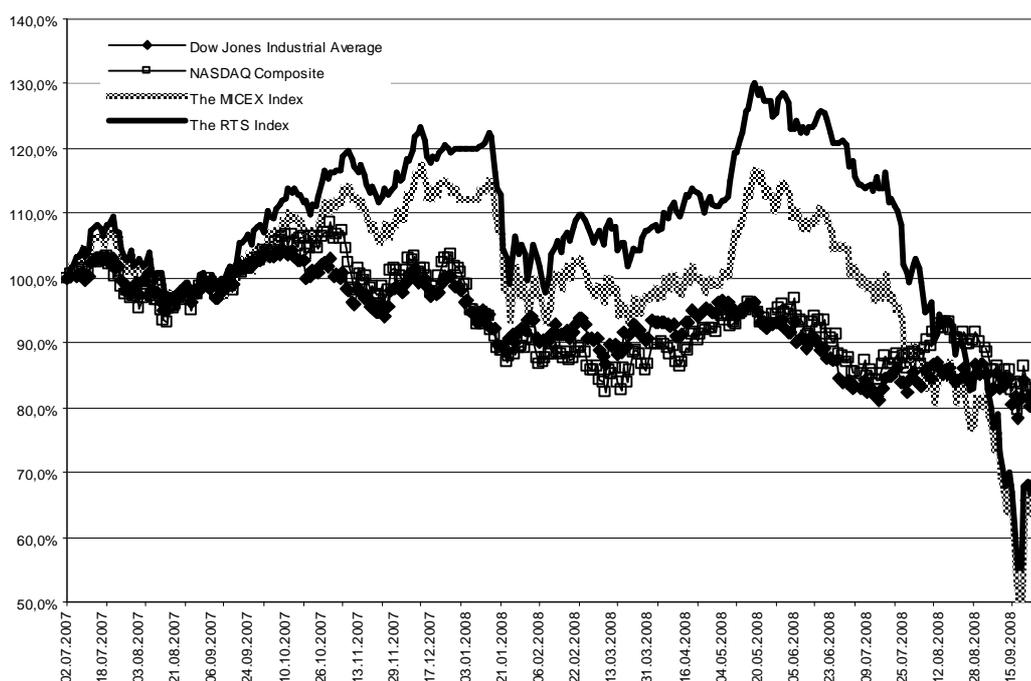


Fig. 6. Dynamics of the main USA and Russian stock indexes (in per cent to the date 01.07.2007)

Corporate news

OAO WTB Bank

On August 26 2008 WTB Group has signed an agreement for a syndicated loan in the amount of USD 150 million to be provided to the Russian cargo carrier «Volga-Dnepr», the funds from which will be addressed for refinancing of «Volga-Dnepr» group of bridge-credit, provided by WTB Group in July 2007, amounting to USD 80 million, as well as partial refinancing of the short-term debt under other bank loans Seven banks by are participating in the syndicate.

On September 2, WTB Bank obtained an approval to open a subsidiary bank DO AO WTB Bank (Kazakhstan) in Kazakhstan; the authorized capital of a subsidiary bank is USD 50 million.

OAO «Gasprom»

On September 3, OAO «Gazprom» and «Nigerian National Petroleum Corporation» have signed a Memorandum of Understanding, providing for the implementation of joint projects for exploration, extraction and transportation of hydrocarbons, design and processing of associated gas, the construction of electric power generating plants in Nigeria. To implement those objectives, it is planned to establish a Russian-Nigerian joint venture.

On September 8, OAO «Gazprom» has set up the price of the stock bonds, placed on July 22 at face value with the coupon rate of 7.51 per cent per annum, amounting to USD 500 million with maturity date on July 31, 2013, in the framework of the OAO «Gazprom» program on bond participation in the loan for USD 30 billion.

On September 18, OAO «Gazprom», YPFB, Bolivian public oil company and Total E & P Bolivia have signed a three-party memorandum on joint assessment of Asero deposit (Bolivia), which is one more step towards the establishment of a joint venture for the production of hydrocarbons in Bolivia. On September 22, OAO «Gazprom» and Petroleos de Venezuela SA (PDVSA) have signed a memorandum of understanding on the project «Blanks Este and Tortuga» (Venezuela), which includes exploration and production of natural gas on the shelf, deliveries to the domestic market, as well as liquefaction and export. According to the Memorandum, it is envisaged to conduct a joint analysis of the project to determine incentives for further participation in the exploration and development of hydrocarbon deposits in the area. In addition, on September 26, OAO «Gazprom» and PDVSA signed a memorandum of understanding for the a large-scale interaction of the companies. In particular, in hydrocarbons deposits development and infrastructure construction, oil and gas extraction and processing, including joint efforts in extraction of low-pressure gas.

On September 24, OAO «Gazprom» and OAO «Inter RAO UES» have signed an investment contract for the construction of a second power unit of Kaliningrad TPP-2 (the upper limit of capital investment will reach RUR 22.3 billion, the construction should be finalized by December 31, 2010). OAO «Gaspromneft»

On September 2, OAO «Gazpromneft» and OAO «Moscow Oil and Gas Company» completed the formation of a joint venture to manage the Moscow Oil Refinery, having transferred their shares (90.02 per cent of voting shares) in the Moscow refinery to the joint venture Moscow NPZ Holdings B.V. and contributed EURO 1 million to the authorised capital.

On September 24, in the framework of the public program of the RF Ministry on Transportation on establishment of the system of alternative aircraft fuel complexes, OAO «Gazprom oil» and OAO «International airport Sheremetyevo» have concluded a general agreement on cooperation in air transport activities and aircraft fuel supply.

OAO «Mosenergo»

On September 29, OAO «Mosenergo» has disclosed unaudited consolidated interim financial reporting for the 6 months up to June 30, 2008, prepared in accordance with International Financial Reporting Standards (IFRS). Profit from major activities amounted to RUR 708 million, which exceeds the indicators of the relevant period of preceding year by RUR 523 million; net profit for the reporting period amounted to RUR 764 million.

OAO «HK «Rosneft»

On September 17, 2008, the NK «Rosneft» has disbursed the third and the last tranche (USD 2.3 billion) of the bridge-loan in the amount of USD 22 billion, attracted at the beginning of 2007. The loan consisted of two credits amounting to USD 13 billion and USD 9 billion dollars, which were provided in March 2007 by ABN AMRO, Barclays, BNP Paribas, Calyon, Citibank, Goldman Sachs, J. P. Morgan Chase and Morgan Stanley.

OAO «Rostelecom»

On September 25, OAO «Rostelecom» and AK «Uzbektelecom» have signed an agreement to provide global access to the public information resources of IP-networks of the Russian Federation through «Rostelecom» network.

«Sberbank of Russia»

On September 22, OAO «Sberbank of Russia» has disclosed financial results for the eight months of 2008, developed according to the Russian Accounting Standards (unconsolidated figures): profit before tax increased as compared with the results of the eight months of 2007 by 42.2 per cent and amounted to RUR 121, 3 billion; net profit of the bank as of 8 months of 2008 amounted to RUR 92.7 billion, i.e., by 39.7 per cent more than in the same period of the last year.

Real Economy Sector: Trends and Factors

O. Izryadnova

Over the first half of 2008 the GDP volume in Russia made RUR 19112.8 bln and has increased by 8.0% in real terms as compared with the corresponding period of the previous year. Structural shifts occurred against the background of slackening of the industrial growth dynamics down to 5.3% and investments into the fixed assets – down to 13.4%. In January-August 2008 real disposable incomes went up by 7.7% against 10.0% in the corresponding period of 2007, goods turnover growth rates sustaining at the level nearly equal to that of the previous year (115.2%). Inflation index at the consumer market being at the level of 109.7% in January-August 2008, prices for foodstuffs increased by 11.3% and for non-food goods – by 5.8%.

In accordance with the Regulations for data elaboration and presentation, the Federal State Statistics Service has made the first estimation of the GDP over the first half of the year and corrected the figures for the 1st quarter of the current year. In the first half of 2008 the GDP volume in Russia was equal to RUR 19112.8 bln in current prices and went up by 8.0% in real terms as compared with the corresponding period of the previous year. The structure of the GDP produced was primarily influenced by the construction, trade, transportation, communication and service sphere anticipating growth rates.

Table 1

GDP and Gross Added Value Growth Indices as Broken by Kinds of Economic Activities in the First Half of 2007-2008, as percentage to the corresponding period of the previous year

	2007			2008		
	1 st quarter	2 nd quarter	First half of the year	1 st quarter	2 nd quarter	First half of the year
Gross domestic product	107.4	108.1	107.8	108.5	107.5	108.0
including:						
Agriculture, hunting and forestry	102.9	102.6	102.6	101.5	99.0	100.2
Minerals extraction	102.4	97.4	99.8	103.2	103.2	103.2
Processing industries	108.5	107.4	107.9	107.6	105.6	106.6
Electricity, gas and water production and distribution	90.1	99.6	94.0	105.3	101.7	103.8
Construction	128.1	119.6	123.0	128.3	118.7	122.7
Wholesale and retail trade	111.1	113.2	112.1	111.9	111.7	111.8
Transportation and communication	108.7	108.4	108.5	109.8	109.4	109.5
Net taxes for goods	106.7	110.3	108.6	110.5	110.0	110.2

Source: Federal State Statistics Service

Structural shifts occurred against the background of slackening of the industrial growth dynamics. In January-August 2008 the increase in the industrial production made 5.3% and was 1.8 per cent below the level of the previous year. The growth rates of processing industries production slowed down to 107.6% in January-August 2008 as compared with 111.0% in the corresponding period of the previous year, and of extractive industries production – down to 100.2% as compared with 102.4%. As to

electricity, gas and water production and distribution, the drop in production by 2.7% observed in January-August 2007 was succeeded by the 4.2% increase in the current year.

The potential of idle facilities being exhausted, it is the investments in the fixed assets that became one of the main factors of industrial growth. As a result it was the productions focused on the output of the goods of the investment demand, for instance, machinery and equipment production (growth index of 108.3%), transport vehicles and equipment production (116.2%), that had the prevailing effect on the sustenance of the steady dynamics of processing industries development. This growth in production, however, turned out to be insufficient to maintain the trend of the last years of the decrease in import machinery and equipment share in the structure of the investments in the fixed assets. Investments for purchase of the import machinery, equipment, transport vehicles comprised 19.4% of the total amount of the investments in machinery, equipment and transport vehicles in the first half of 2008 as compared with 18.6% in the first half of 2007.

Comparing the goods output dynamics and the use of the main production factors, attention should be drawn to the fact that the growth in the capital intensity of the production proceeds along with the trend for labor efficiency slow-down, growth of the demand for the labor force and steady anticipating growth of wages.

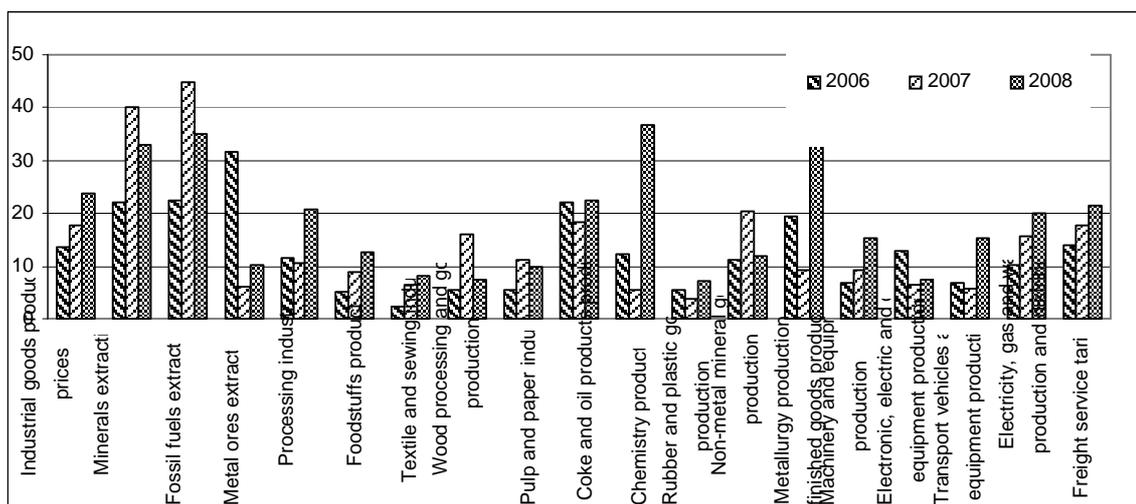


Fig. 1. Changes in Producers' Prices Indices by Kinds of Economic Activities of the Industrial Goods in 2006-2008, August on December of the previous year, as percentage

According to the data of the random survey of the population concerning the employment problems, the number of the employed in the economy has increased by 0.8 mln of people as compared with August 2007 and made 72.0 mln, the number of the unemployed, calculated according to the methodology of the International Labor Organization, decreasing down to 4.0% (5.3% of the economically active population). As compared with January-August 2007 the total number of the unemployed has reduced by 259 thousand of people and the number of the unemployed officially registered – by 160 thousand of people and was equal to 1.29 mln of people or 1.75 of the economically active population. The demand for employees reported by the employers to the state employment services went up to 1542 thousand of people by the end of August. Tension coefficient (the number of the unemployed registered in the state employment services per one vacant position) has decreased down to 1.0 as compared with 1.2 in August 2007. Situation at the labor market is aggravated by the increasing shortage of the specialists and qualified workers in the main processing industries, which is the factor restricting the development of the finished goods with high added value production. In January-August 2008 wages and labor efficiency growth rates were 13.4% and 6.9% against, correspondingly, 16.5% and 6.7% in the analogous period of the previous year.

Among the factors, determining the peculiar features of the economy development in 2004-2008, one should highlight the anticipating growth of prices of the industrial goods producers as compared with the consumer prices index. The inflation index at the consumer market being at the level of 109.75 in January-August, producers' prices went up by 23.9%, tariffs for freight service – by 21.5% and for construction products – by 13.5%.

Increase in producers' prices was determined by the factors of the structural nature: anticipating as compared with the inflation growth of tariffs for gas and electricity, weak competition at the domestic market of oil products, negative influence of the local monopolies, limited production possibilities of Russian producers to increase the supply of high-quality goods.

The prices dynamics is different for extractive and processing industries.

The dynamic growth of prices for fossil fuels and resources by 35.2% over January-August 2008 was still a factor generating growth of prices for the goods of the final demand. Internal prices for light oil products were established according to the principle of the equal profitability of the internal and export prices excluding export duty rates and transportation abroad (net-back), so the growth of internal prices for oil products was primarily accounted for by the world prices pressure. Since the beginning of 2008 producers' prices have increased by 21.3%, growth of prices for car petrol being 26.5%, for diesel fuel – 33.7%, for fuel oil – 38.5%. More intensive growth of prices for diesel fuel is due to the increase in external demand for it.

In processing industries producers' prices index was equal to 120.7% Since the beginning of 2008, exceeding by 10.2 per cent the figures of the previous year. The price policy of the domestic producers was considerably influenced by the change in the economic situation, the trend for the rapprochement of the world and internal prices, increase in import pressure against the background of ruble appreciation.

In connection with the favorable situation in the world the prices for the export goods and first of all for ferrous metals and mineral fertilizers went up at high rates. Despite the introduction of export duties in the middle of April, the growth of prices in chemistry industry has been 36.6% since the beginning of the year as compared with 5.6% in January-August 2007.

Prices in foodstuffs production, including beverages and tobacco, rose by 12.5% over January-August 2008, in textile and sewing industry – by 8.1%. Intensive prices growth is connected with the sustaining lag of consumer goods supply from the growing solvent demand, high growth of prices for raw materials for foodstuffs production and the maintenance of the anticipating import growth rates as compared with the dynamics of the domestic production. In the first half of 2008 the share of import in the trade resources of the retail trade turnover was equal to approximately 45%, and in the foodstuffs group – to 36%.

Over January-August 2008 foodstuffs went up by 11.3% as compared with 7.0% in the corresponding period of the previous year. It was high prices for agriculture goods, as well as the costs growth, including transportation costs, that acted as considerable factors for accelerated growth of prices for foodstuffs. Prices for grain-crops went up at especially high rates: by 20.7% over January-July and by 1.56 times over the year, July 2008 on July 2007, and for sunflower seeds – by 20.7% and by 2.3 times. The prices for goods of agriculture organizations increased over the year (August 2008 on August 2007) by 29.2%, which makes double inflation rates.

In January-August 2008 the real disposable incomes went up by 7.7% as compared with 10.0% over the corresponding period of 2007, the goods turnover growth rates sustaining at the level of the previous year (15.2)%. As a result of the considerable prices growth and high inflation expectations there is a decrease in the population's savings norm observed by 0.9 per cent as compared with January-August 2007, and by 1.7 per cent for savings in the form of deposits and securities. In the environment of the existing level of the population differentiation by the incomes level, the spread in inflation rates for the first and the tenth group is observed, due to the high share of expenditures for foodstuffs in the less secured groups of population. Thus, in January-August 2008 the inflation of the first group was 1.4 times as high as for the tenth and exceeded the average Russian level by 2.1 per cent.

Investments in Real Economy Sector

O. Izryadnova

As a result of the first half of 2008 the share of the investments in fixed assets was equal to 17.0% of the GDP. The trend for the anticipating growth of the investments in the fixed assets as compared with the GDP dynamics sustained: increase in investments in the fixed assets made 15.4% and in GDP – 8.0%. In July-August, however, there occurred a significant slow-down of the investment growth rates and primarily in the housing construction. As a result of the first half of 2008 investments in the fixed assets at the expense of the budget funds were equal to 14.9% of the total amount of the investments in the economy, and at the expense of the federal budget – to 4.4%. It should be noted that in 2008 in-

vestments at the expense of the federal budget are directed only into the objects of capital construction of government property as well as the joint-stock companies.

The trend for the anticipating growth of investments in the fixed assets as compared with GDP dynamics was observed in the first half of 2008: the increase of the investments in the fixed assets was equal to 15.4%, increase of the GDP – to 8.0% against, respectively, 23.7% and 7.8% in the corresponding period of the previous year. In the first half of 2008 the share of investments in the fixed assets in the GDP was equal to 17.0%, exceeding by 0.7 per cent the corresponding figure of the previous year.

Over January-August 2008 the volume of the investments in the fixed assets reached RUR 4761.8 bln, having risen by 13.4% as compared with the corresponding period of the previous year. The slow-down of the investments growth rates in July-August changed the situation in the investment sector. For the current situation the anticipating growth in construction of infrastructure and production objects as compared with the sharp decrease in the housing implementation rates from 134.0% in January-August 2007 to 105.2% this year is characteristic.

The structure of the investments in the fixed assets experienced some positive shifts. Concentration of the financial resources in the extractive sector has reduced a bit and the share of the processing industries, electricity, gas and water production and distribution has expanded. Investments in construction, transportation and communication continued to grow at anticipating rates.

Table 1

Structure of Investments in Fixed Assets for Large and Medium-Scale Enterprises in the 1st half of 2006 - 2008

	2006	2007	2008
Investments in fixed assets - total	100	100	100
Of which:			
Agriculture	3.7	4.7	4.3
Industry	43.7	44.8	44.7
Including:			
Minerals extraction	19.5	20.4	19.8
Processing industries	17.9	17.5	17.6
Electricity, gas and water production and distribution	6.3	6.9	7.3
Construction	3.6	2.9	3.8
Transportation	21.2	18.8	19.2
Communication	4.5	4.5	4.2
Operations with the real estate	10.6	11.6	11.8

Source: Federal State Statistics Service

In the first half of 2008 the change in the structure of the investments in the fixed assets by the sources of financing was due to the sustention of the trend for the expansion of the borrowed funds share. The maintenance of the trend for the expansion of the banking sector participation in the investment process crediting was a positive feature. The share of the Russian banks' credits in the structure of the investment in the fixed assets financing went up to 10.5%, and the share of the foreign banks' credits – to 1.8%. the development of this trend was partially responsible for slow-down of crediting of non-banking organizations. The share of the borrowed funds of other organizations and institutions in the sources of investments in the fixed assets financing decreased by 0.3 per cent as compared with the first half of 2007 (table 2).

The share of foreign investments in the total volume of the investments in the fixed assets was equal to 5.3% in the first half of 2008. There was USD 46.5 bln of the foreign investments received by the Russian economy in the first half of the current year, which is by 22.9% below the figures of the first half of 2007. The biggest proportion of the accumulated foreign investments is accounted for by the credits of international financial organizations, trading credits (48.7%), the share of direct investments being 48.4% and of portfolio – 2.9%.

Despite recent changes at financial markets, international rating agency Moody's Investors Service, sustains positive forecast for Russia's rating, underlining, in spite of the crisis, strong fundamental indices of the Russian economy, considerable foreign exchange reserves and high-quality policy of the monetary authorities.

Table 2

**Structure of Investments in Fixed Assets by the Sources
of Financing in the 1st half of 2006 - 2008
(not taking into account small business and parameters of informal activities)**

	2006	2007	2008
Investments in the fixed assets	100	100	100
As broken by the sources of financing			
Own funds	47.0	44.5	44.3
Including			
Profit remaining for the enterprise management	20.8	20.1	19.9
Depreciation	23.2	21.3	20.5
Borrowed funds	53.0	55.5	55.7
Including			
Bank credits	9.3	9.8	10.5
Of which foreign banks' credits	2.2	0.7	1.8
Borrowed funds from other organizations	7.3	7.0	6.7
Budget funds	15.2	16.4	14.9
Including			
From the federal budget	4.9	4.6	4.4
From the budgets of the Subjects of Russian Federation	9.4	10.4	9.3
Investments from abroad in the total volume of investments in fixed assets	6.5	4.5	5.3

Source: Federal State Statistics Service

As a result of the first half of 2008 investments in the fixed assets at the expense of the budget funds were equal to RUR 328.0 bln (14.9% of the total volume of the investments in the economy), of which at the expense of the federal budget – to RUR 96.6 bln (4.4%) and at the expense of the budgets of the Subjects of the Russian Federation - to 205.3 bln (9.3%).

It should be noted that in 2008 investments at the expense of the federal budget are directed only into the objects of capital construction of the government property of the Russian Federation as well as into open joint-stock companies. Objects in property of the subjects of the Russian Federation as well as the objects of municipal property are not included into the List of construction sights and objects for 2008.

In 2008 Federal Targeted Investment Program (FTIP) envisages financing of 2346 construction sights, objects and measures, of which 1084 are to be put into commission this year (*table 3*). As on 1st August 2008 there are 715 objects fully financed, and 416 objects are technically ready at the extent from 51.0% to 99.9%. As a result of 7 months of 2008 47 objects were put into commission, 43 of which were put into commission at the full capacity and 4 – partially.

As on the beginning of August 2008 the volume of the budget allotments envisaged by the Federal Targeted Investment Program comprised RUR 495.9 bln. Within the framework of federal target programs (FTP) it is suggested to allot funds at the rate of 312.2 bln, and for the objects not included in FTP – at the rate of RUR 183.7 bln. The volume of funds envisaged for financing of special works, included in the government defense order, is equal to RUR 102.2 bln.

In July of the current year the work on the correction of FTIP indices proceeded. For instance, changes were made into distribution of funds among the objects of the Federal Road Agency (Rosavtodor), that are financed within the FTP “Modernization of Russia's transportation system (2002-2010)”. Besides, in the second half of the year the limitations for financing of measures by the superintendent of the budget funds Russian Information Technologies (Rosinfotech) included in the FTP “Electronic Russia (2002-2010)”, at the total amount of RUR 1210.0 mln are lifted.

According to the account of the Federal State Statistics Service, the level of year limit financing of public investments in FTIP construction sights and objects in January-July 2008 was equal to RUR 185.7 bln, not taking into account construction sights and objects included in the government defense

order. Financing of the year limit from the budgets of subjects of the Russian Federation and other sources of financing in January-July 2008 was RUR 20.2 bln.

It was the earlier dates of approval for the List of construction sights and objects for the current year that had positive influence on the financing processes and use of funds. Whereas over January-July 2007 the limit of the budget allotments for construction sights and objects, included in the List, was financed at the rate of 34.1%, this year the figure was 51.3%. The year limit of public investments within the framework of production complexes (77.9%) is financed at the level considerably higher than the average for construction sights and objects, while the investments within the framework of special (30.9%) and social (33.5%) are finance below the average.

Table 3

Objects Envisaged by Targeted Investment Program for 2008

	Units				As RUR bln			
	Number of objects		Put into commission in January-July 2008		Limit of public investments		Financed from the federal budget in January-July 2008	Investments used at the expense of all the sources of financing*
	total	Including with the date of commissioning in 2008	fully	partially	total	Including from the federal budget		
Total	2346	1084	43	4	389.3	361.8	185.7	89.7
Including:								
Transportation complex	354	110	2	-	132.8	130.3	105.6	37.1
Agriculture complex	355	213	1	1	11.3	9.3	6.2	2.2
Special complex	163	37	-	-	79.6	64.2	19.8	13.4
Social complex	1392	691	40	3	152.8	148.7	49.8	34.8
Other objects	82	33	-	-	12.8	9.3	4.3	2.2

* Excluding investments allocated from the federal budget for purchase of the equipment and for design and survey works for construction sights and objects included in the Federal targeted investment program for 2008 and held on the books of the government customers (builders), managers of the investments mentioned

Source: Federal State Statistics Service

On average over January-July in Russia there was 43.6% used of the total amount of funds financed at the expense of all the financing sources. The government customers used RUR 89.7 bln of public investments or 24.8% of the year limit of funds envisaged for their construction.

As broken by territories, the limit of funds for FTIP construction sights and objects financing is used at the level above the average for Russia in Northwestern, Southern, Far-Eastern and Privolzhsky federal okrugs (districts) (table 4).

Table 4

Limit of Public Investments and Their Real Use at the Expense of All Financing Sources As Broken by Federal Okrugs

Federal Okrug	Limit of public investments for 2008	Really used at the expense of all of the financing sources, January-July 2008	
	As RUR bln	As RUR bln	As percentage of the year limit
Russian Federation – total	361.8	89.7	24.8
Central	145.9	22.9	36.6
Northwestern	79.2	29.0	39.8
Southern	39.4	15.7	22.7
Privolzhsky	21.1	4.8	13.2
Ural	20.4	2.7	21.6
Siberian	26.4	5.7	30.5
Far-Eastern	29.5	9.0	26.8

Source: Federal State Statistics Service

Foreign Investments in Russian Economy

E. Ilukhina

In the first half of 2008 foreign investments received by the non-finance sector of the Russian economy were 22.9% below the corresponding index of the previous year. The same as in 2007, in the first half of 2008 direct foreign investments growth rates lagged behind the corresponding figures for other and total foreign investments, which resulted in the decrease in the share of the direct investments. The structure of foreign investments attracted to the Russian economy by branches is characterized by the drop in investments into the industry, as well as into trade and catering, while investments in the sphere of real estate operations, rent and service rendering increased considerably. In the first half of 2008 USD 36.4 bln flowed out of the country in the form of the foreign investors profits transferred abroad as well as in the form of the interests for credit use and credit repayments, the figure being by 36.0% above that of the corresponding period of 2007.

Over the first half of 2008 foreign investments in the Russian economy reduced by 22.9% as compared with the first half of the previous year and were equal approximately to USD 46.5 bln (in the first half of 2007 they went up by 2.6 times as compared with the first half of 2006). The level of the foreign investments inflow as GDP percentage remains rather low.

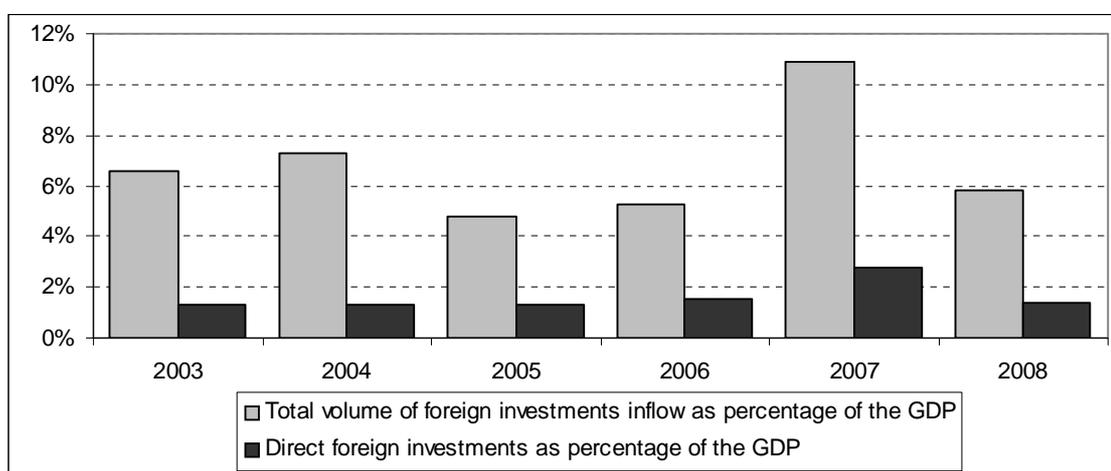


Fig. 1. Level of Foreign Investments Inflow in Russian Economy in the First Half of 2003-2008 (as percentage of the GDP)

Source: Federal State Statistics Service

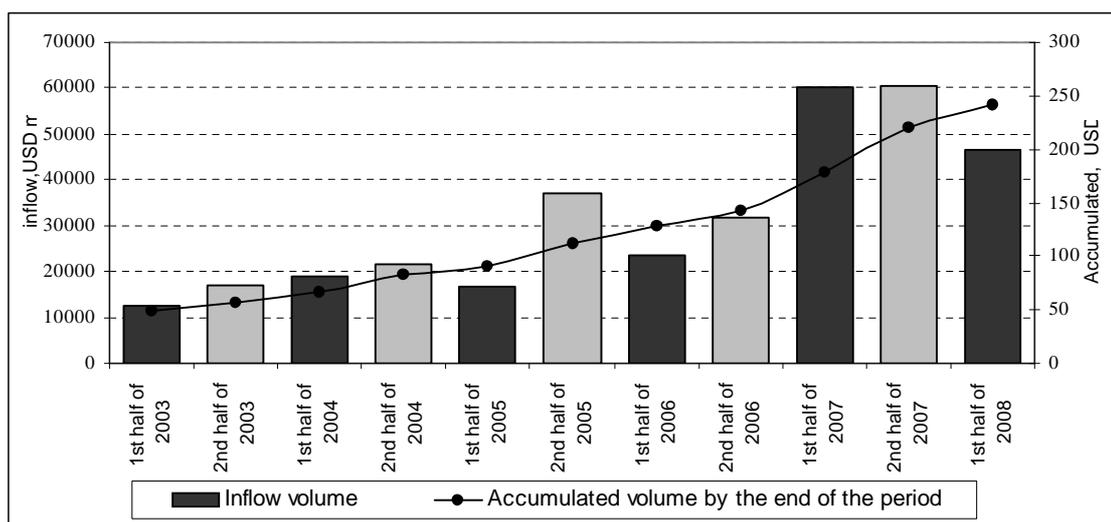


Fig. 2. Dynamics of Foreign Investments Volume in Russia (not taking into account the monetary and credit regulation and banking sector)

Source: Federal State Statistics Service

As on July 1, 2008 the accumulated foreign investments in the Russian economy, including the investments from CIS-countries, are estimated to be USD 242.1 bln, which is by 9.8% more than the figure of the beginning of the current year and exceeds the level of 1 July 2007 by 35.6%.

In the first half of 2008 USD 36.4 bln flowed out of the country in the form of the foreign investors profits transferred abroad as well as in the form of the interests for credit use and credit repayments, the figure being by 36.0% above that of the corresponding period of 2007. It should be noted that over the first half of 2008 it was 73.6% of the received foreign investments that was withdrawn (76.1% and 41.7% in the first half of 2006-2007, correspondingly).

The same as in the preceding years, it is the other investments that steadily hold the leading position in the structure of foreign investments, flowing into the Russian economy.

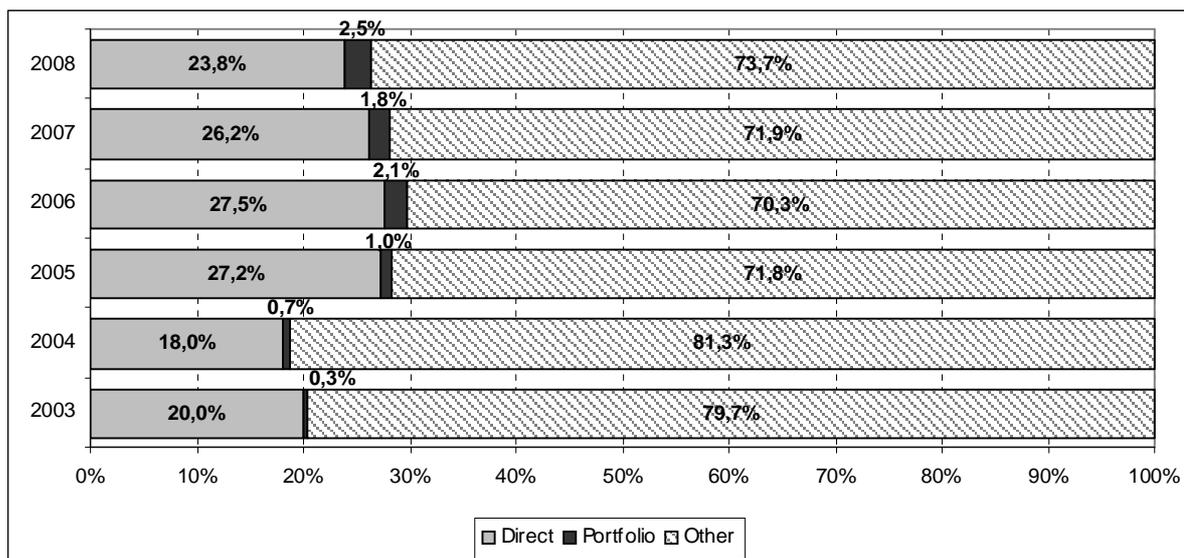


Fig. 3 Structure of Foreign Investments into the Russian Economy in the First Half of 2003-2008

Source: Federal State Statistics Service

The same as in 2007, in the first half of 2008 direct foreign investments growth rates lagged behind the corresponding figures for other and total foreign investments, which resulted in the decrease in the share of the direct investments. Despite that fact the share of the direct investments in the second quarter 2008 increased as compared with the corresponding period of 2007 by 18.8% (second quarter 2007 – 17.0%).

The structure of foreign investments attracted to the Russian economy by branches is characterized by the drop in investments into the industry, as well as into trade and catering, while investments in the sphere of real estate operations, rent and service rendering increased considerably.

Table 1

**Structure of Foreign Investments into the Russian Economy
in the First Half of 2005-2008 by Branches**

	As USD mln.				As percentage to the total			
	2005	2006	2007	2008	2005	2006	2007	2008
Industry	8 026	11 353	26 295	21 078	48.6	48.5	43.6	45.3
Transportation and communication	1 677	3 946	3 550	1 096	10.2	16.9	5.9	2.4
Trade and catering	4 917	5 092	25 973	13 479	29.8	21.8	43.0	29.0
Operations with real estate, rent and service rendering	1 153	1 240	2 071	7 101	7.0	5.3	3.4	15.3
Finance, credits, insurance, pensions provision	526	1 387	1 232	1 672	3.2	5.9	2.0	3.6
Other sectors	204	3 892	1 222	2 104	1.2	1.6	2.1	4.4

Source: Federal State Statistics Service

As compared with the first half of 2007, in the first half of the current year the volumes of foreign investments in the sphere of communication and transportation reduced by 3.2 times, and the foreign investments in trade and catering diminished by nearly 2 times, investments in industry decreased by 19.8%. Against the background of lower rates of the total investments slow-down, the proportion of transportation and communication spheres, as well as trade and catering reduced down to 2.4% and 29.0% (5.9% and 43.0% in the first half of 2007).

The same as in the previous year, in the first half of 2008 the most attractive branches of industry were processing ones, where USD 13.3 bln or 63.3% of the total investments directed to the industry was invested (USD 13.5 bln or 51.3% in the first half of 2007). Investments in minerals extraction over the period under examination reduced by 2.8 times down to USD 4.6 bln? in metallurgy – by 27.1%, in foodstuffs industry – by 28.1%. Foreign investments in chemistry and petrochemistry industry increased by 40.3% in the first half of 2008 as compared with the corresponding period of 2007. Thus, the structure of the foreign investments in industry has suffered considerable changes this year.

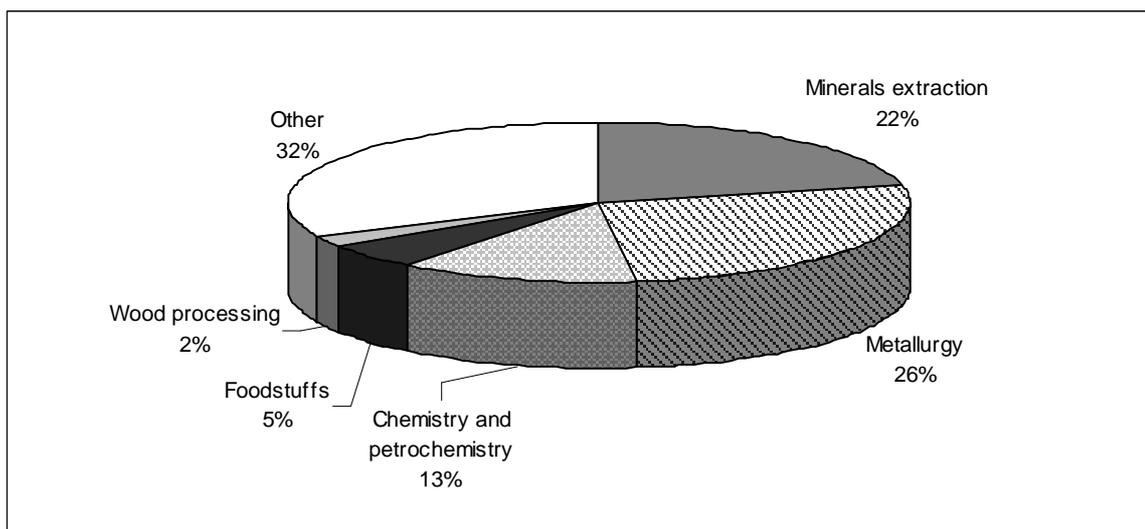


Fig. 4 Structure of Foreign Investments in Industry in the First Half of 2008

Source: Federal State Statistics Service

Table 2

Structure of Foreign Investments into Industry in First Half of 2008

	As USD mln			Change as to 1 half of 2005		
	Direct	Portfolio	Other	Direct	Portfolio	Other
Industry	6998	987	13093	54.0	156.2	103.1
Including:						
Minerals extraction	2823	28	1706	25.3	155.6	117.0
Metallurgy	165	44	5349	126.0	112.8	71.7
Chemistry and petrochemistry	64	26.5	2564	54.7	5.7	196.0
Foodstuffs	213	1	875	26.4	4.5	127.6
Other branches	3733	887.5	2599	by 5.1 times	by 10.3 times	by 1.5 times

Source: Federal State Statistics Service

The trend for the increase in the share of other investments and the decrease in the proportion of the direct investments is characteristic both for the structure of total volume of foreign investments and for the structure of the foreign investments in the industry. In the first half of the current year the share of the direct investments in the structure of investments into the industry decreased down to 33.2% (in the first half year of 2007 – 49.3%). The share of portfolio and other investments in the industry over the period of the current year under examination is estimated at 62.1% and 4.7% (in the first half of 2007 – 48.3% and 2.4%).

In the first half of 2008 63.2% of the direct, 85.6% of the portfolio and 38.2% of other foreign investments in the Russian economy flowed into the industry.

Whereas in the first half of 2007 there was about 70% of the direct foreign investments assigned to the extractive industry, this year the corresponding figure reduced to the level of 25.5%. There was 18.7% of total direct foreign investments in the Russian economy sank to the processing industry (11.0% in the first half of 2007), 9.6% in trade and catering (4.0% in the first half of 2007), 14.2% in the operations with the real estate and service rendering (5.2% in the first half of 2007).

This year a sharp shift in portfolio investors' priorities is observed. The biggest part of the portfolio investments was directed into electricity, gas and water production and distribution – it made 74.8\$ of the total amount of the portfolio investments in the Russian economy (6.6% in the first half of 2007). Investments in the operation with the real estate, rent and services rendering was another priority sphere for portfolio investors – there 11.8% of the total amount of the portfolio investments was directed (2.5% in the first half of 2007).

It was the sphere of trade and catering that accounted for the major part of the other investments in the first half of 2008 and made 36.2% of the total amount of other investments in the Russian economy. The sphere of operations with the real estate, rent and services rendering comprised 15.7% of the total amount of other investments (2.8% in the first half of 2007).

As compared to the previous year some changes were also observed in the geographic structure of the foreign investments attracted in the first half of 2008. As a result of the first half of 2008 the leading position among the countries exporting capital in the Russian economy is held by the Cyprus, which increased its investments in the Russian Federation up to USD 10.8 bln, which is by 34.8% more than the corresponding figure of the first half of 2007 (in the first half of 2007 there were USD 8.0 bln or 13.3% of the total foreign investments in the Russian Federation invested from the Cyprus).

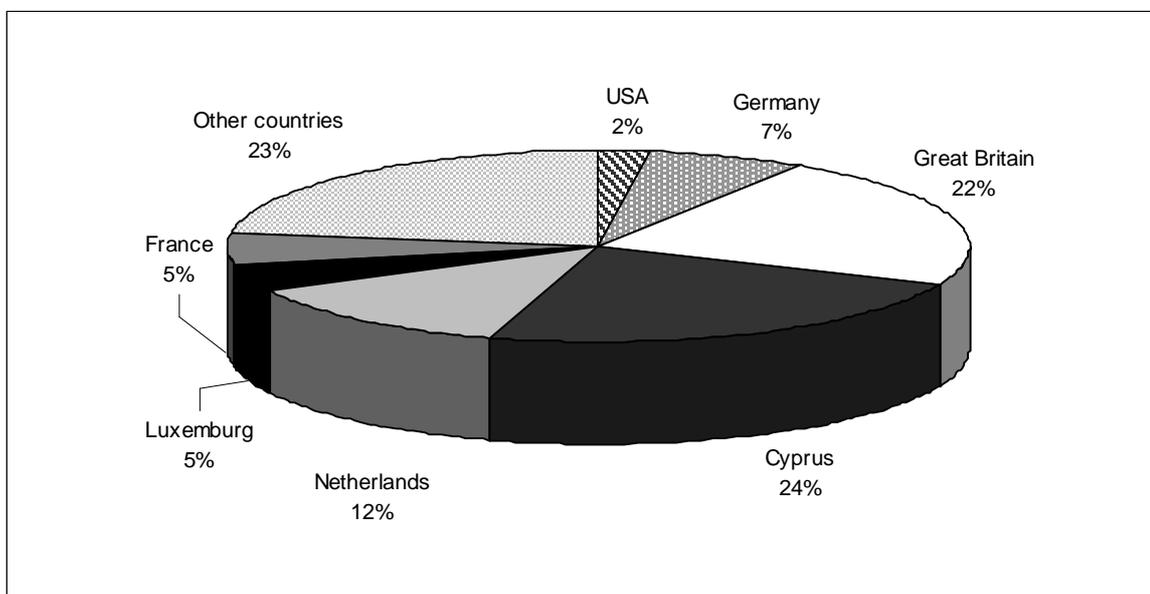


Fig. 5 Geographic Structure of Foreign Investments Received by Russian Economy in the First Half of 2008

Source: Federal State Statistics Service

Last year leader, the Great Britain, whose share in the first half of 2007 accounted for 24.9% of all the foreign investments receiver by the Russian Federation, reduced its investments in the Russian economy as a result of the first half of the current year by 31.4% down to USD 10.3 bln as compared with the corresponding period of the previous year.

In the first half of 2008 the investments from the Netherlands in the Russian Federation reduced more than by half (down to USD 5.7 bln), from Luxemburg and Switzerland – by three times (down to USD 2.3 bln and USD 1.2 bln), from France – by 32.7%, which resulted in the decrease in the share of the countries mentioned in the geographic structure of the foreign investments in the Russian economy this year.

The structure of investments of three leading countries, whose investors placed the biggest amount of the capital into the Russian economy broken by branches of the industry can be represented as the following:

Table 3

**Structure of Foreign Investments for the Leading Countries,
Exporting Capital to the Russian Federation in the First Half of 2008
(data for the first half of 2007 are given in parentheses)**

	Great Britain		Netherlands		Cyprus	
	As percentage to the total	As percentage to the total investments into the branch	As percentage to the total	As percentage to the total investments into the branch	As percentage to the total	As percentage to the total
Processing industry	36.8 (2.6)	28.4 (2.9)	8.4 (5.1)	3.6 (4.5)	11.0 (13.3)	8.9 (7.9)
Trade and catering	38.2 (93.3)	29.2 (54.0)	No data	No data	34.0 (48.5)	27.3 (15.0)
Transportation and communication	No data	No data	No data	No data	1.5 (3.8)	15.1 (8.5)
Minerals extraction	No data	No data	29.5 (91.0)	37.0 (84.9)	6.7 (4.9)	16.0 (3.1)
Operations with real estate, rent and service rendering	18.5 (0.8)	26.8(5.8)	No data	No data	25.4 (15.6)	38.7 (60.4)
Financial activity	No data	No data	No data	No data	6.8 (No data)	44.0 (No data)

Source: Federal State Statistics Service

Table 4

**Changes in Accumulated Volumes of Foreign Investments
As Broken by Leading Investing Countries as on 01.07.2008**

	As percentage on 01.07.2007				As percentage on 01.01.2008			
	Total	Direct	Portfolio	Others	Total	Direct	Portfolio	Others
USA	126.9	89.7	109.4	180.7	109.8	89.8	86.8	136.6
Germany	130.8	148.8	65.9	121.2	112.3	118.6	27.6	109.5
France	100.8	181.5	by 15 times	87.5	112.8	108.9	19.4	114.8
Great Britain	163.6	148.5	by 13.2 times	152.8	107.3	118.9	106.6	105.6
Cyprus	151.3	172.2	143.4	109.3	114.5	117.7	131.4	103.1
Netherlands	130.1	128.4	103.3	147.0	113.5	112.5	121.2	123.3
Luxemburg	104.7	104.9	152.7	104.3	104.7	104.2	153.4	104.3
Other countries	144.8	149.5	117.9	142.4	105.4	111.9	65.2	102.7
Total	135.6	145.4	189.7	125.2	109.8	113.7	102.6	106.5

Source: Federal State Statistics Service

In the first half of 2008 the share of 10 countries that are the leading investors in the Russian economy accounted for 86.6% of the total volume of the foreign investments accumulated by 1 July (in the first half of 2007 – 88.5%), including: 86.9% (in the first half of 2007 – 87.8%) of the direct investments accumulated, 92.6% (88.8%) and 86.0% (89.0%) – of portfolio and other investments accumulated, correspondingly.

As compared with the data for the end of June 2007, the biggest growth of the accumulated foreign investments is observed for Ireland (by two times), and the most significant drop – for Switzerland (by 38.2%). As on the beginning of the current year the accumulated investments from Ireland increased by 13.2%, and from Switzerland – reduced by 23.8%.

Foreign Trade

N. Volovik

In contrast to the previous year, when import increased at anticipating rates as compared with export, this year, despite a considerable growth in import supplies, it is export that is growing faster. On the whole, in July 2008 Russian indices of the foreign trade again reached the record level. The Government of the Russian Federation approved the decree on cancellation of the import duties for componentry for production of plasma and LCD television sets.

The slow-down of the world economy growth has not been reflected in the dynamics of the foreign trade indices of the Russian Federation yet. In July Russia's foreign trade turnover calculated on the basis of the balance-of-payments methodology increased by 54.9% as compared with July 2007 and was equal to USD 76.5 bln. Over the same period the volume of Russian export reached USD 47.8 bln, which exceeds the figure of July 2007 by 59.7%. Export to non-CIS countries made USD 40.8 bln, that is by 61.4% more than in July 2007, and to CIS countries – USD 7 bln (growth by 50.4%). The volume of import into the Russian Federation reached USD 28.7 bln in July 2008, which is by 47.4% more than in July 2007. Import from non-CIS countries went up by 46.8% (USD 24.6 bln), and from CIS countries – by 51.1% (USD 4.1 bln). In July 2008 foreign trade balance of the Russian Federation was positive and equal to USD 19.1 bln, exceeding by USD 8.4 bln the positive balance of the corresponding period of the previous year.

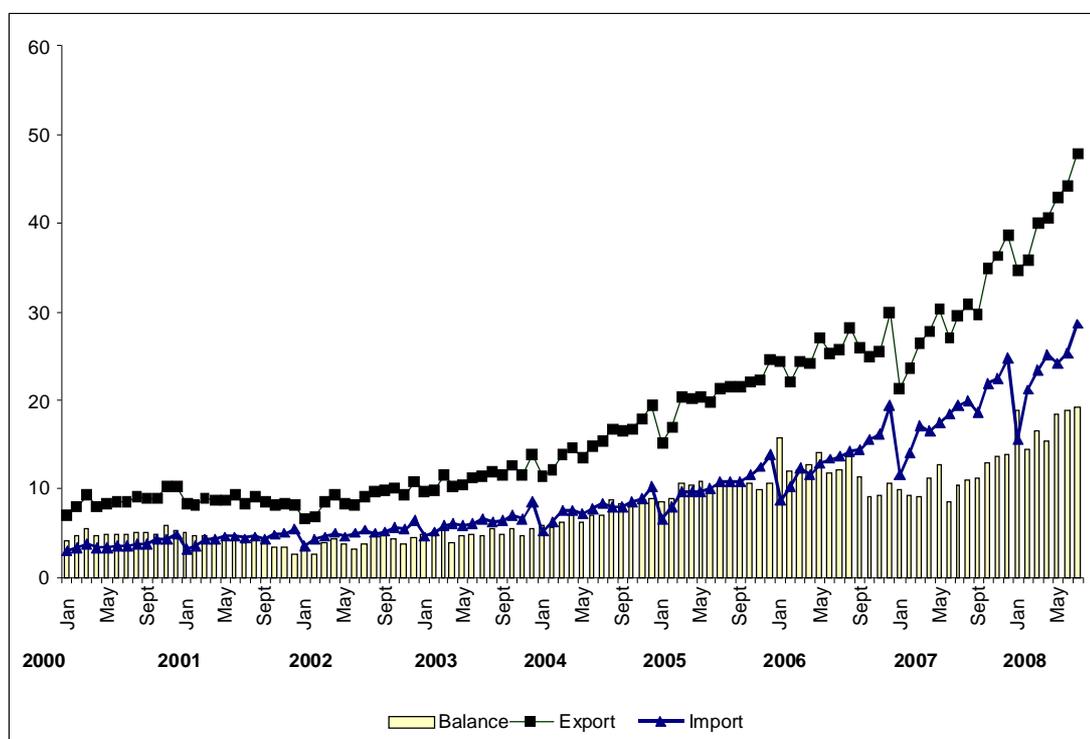


Figure 1 Main Indices of Russia's Foreign Trade (as USD bln)

Source: Central Bank of the Russian Federation

The same as in the preceding months, in July the main factor for record-breaking export growth rates was favorable situation at the world markets.

In July 2008 the price for the barrel of oil set a new record of USD 146.93 per barrel of oil grade Brent, after which the prices start to decrease. In July 2008 average world price for oil grade Urals was equal to USD 130 per barrel and increased by 1.9% as compared with June 2008 and by 24.3% as compared with July 2007. Nonetheless, in connection with the drop in prices in September 2008, from 1 October 2008 the Government of the Russian Federation decreased export duties for oil from USD 495.9 per ton earlier in effect to USD 372.2 per ton, for light oil products – from USD 346.4 per ton to USD 263.1 per ton, for dark oil products – from USD 186.6 per ton to 141.7 per ton. New duty rates are calculated not on the basis of two-month monitoring of oil price, as it had been done before, but

basing on the world prices for oil from September 1 to 17, 2008 (average price for this period bring USD 97.3 per barrel). This is connected with a considerable drop in oil prices at the world markets. Over the last two months it went down by USD 50 (more than 30%). Thus, export duty rates were decreased to a larger extent than they should have been if the Government acted on the basis of the existing rules. This measure will provide support for oil companies and adds liquidity to the Russian financial market.

In July 2008 price for non-ferrous metal also reached record levels (*table 1*). Thus prices for copper and aluminum reached historical maximums, while price for nickel – two-year minimum.

This year prices for aluminum set new records three times: in March – USD 3 227 per ton, on July, 7 – USD 3 308 per ton, on July, 10 – USD 3 380 per ton. It should be taken into account that there is no acute deficit in metal observed in the world. International aluminum institute records the growth of aluminum production by 7% in the first half of 2008 as compared with the corresponding period of 2007.

Copper prices sustain at high levels: on July, 3 2008 the price maximum for the last 11 years was observed, USD 8985 per ton. After natural disasters in China, reconstruction of the country's infrastructure requires big volumes of copper and raises the prices level. The information on the decrease in USA economy growth rates and demand in EU countries damps the market a bit.

In July 2008 average prices for copper and aluminum increased as compared with the corresponding period of the previous year by 28.9% and 27.7%, correspondingly.

In July 2008 prices for nickel dropped to the two-year minimum. The drop in prices is connected with the sharp decrease in metal consumption by the stainless steel producers that use alternative materials.

TABLE 1

Average World Prices in July of the Corresponding Year

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Oil (Brent), USD/bbl	12.96	18.8	28.4	24.62	25.7	28.25	38.2	56.4	72.5	75.09	139.23
Natural gas, USD/1 mln BTU	1.983	2.363	4.01	3.15	2.94	5.021	6.034	7.554	6.305	6.539	11.22
Petrol, USD/gallon	0.423	0.6	0.935	0.732	0.804	0.896	1.306	1.601	2.271	2.182	3.313
Copper, USD/ton	1754.3	1744.8	1864.2	1541.4	1589.0	1730.3	2813.0	3614.0	7712	7962.7	8415.3
Aluminum, USD/ ton	1377.7	1403.5	1565.9	1412.2	1338.4	1434.9	1710.0	1779.0	2513	2730.7	3071.2
Nickel, USD/ ton	4620	5273	8202.0	5956.8	7143.1	8790.6	15038	14581	26585	33373	20160

Source: calculated on the basis of the London Metal Exchange (Great Britain, London), International oil exchange (London).

In July 2008 price for wheat (American No 2) made USD 245.4 per ton, which is 3.6% below the figure of the previous month. Since the beginning of 2008 price for wheat went down by 28.9%.

In July 2008 price for corn reduced by USD 20.2 per ton as compared with the previous month and was equal to USD 266.9 per ton. Nonetheless the price for corn remains at quite a high level. Thus, over the period from the beginning of the year, corn became more expensive by 48.1%, and average price for corn in July 2008 exceeded that of 2007 by USD 63.5 per ton.

According to the data of the International Grains Council, decrease in rice prices in July 2008 was connected with better situation with rice export supplies from Vietnam. In July price for rice dropped by USD 25.3 per ton and was equal to USD 731.8 per ton.

As compared with June, in July prices for sunflower seed (American), soybean (Dutch) and palm-tree (Malaysian) oil reduced by 1.4%, 1.7% and 7%, correspondingly.

According to the data of the Central Bank of the Russian Federation, over seven months of 2008 Russian export was equal to USD 285.8 bln, and exceeded by 54.2% the figure of January-July of the previous year.

High export growth rates are accounted for by increase in prices for the main goods of the Russian export. It should be noted that the year index of average prices growth for export to non-CIS countries was ahead of the prices growth for export to CIS countries (160.7% and 137.0%, correspondingly). However physical volumes of export to non-CIS countries, in contrast to CIS countries virtually did not grow (99.6 % against 109.2%).

Among fuel and raw materials goods it is the physical volumes of natural gas and aluminum export that grow at the fastest rates. As compared with seven months of 2007, in January-July 2008 natural gas export extended by 12.8%, and there was 10.9% more aluminum exported. The expansion of other fuel and raw materials export in terms of physical volume did not exceed 7% over the period concerned.

Physical volumes of oil export from Russia decreased by 4.9% down to 142.7 mln of tons in January-July 2008 as compared with the corresponding period of the previous year. The proportion of oil export in the total volume of the Russian export was equal to 36.7% in January-July of the current year, and in the export of fuel and energy goods – to 52.6%. In January-July 2007 these figures were, correspondingly, 34% and 53.6%.

Table 2

Goods Export Indices in July 2008 (Figures of July 2007 taken as 100)

	Value index	Physical volume index	Price index
Total	158,4	101,1	156,8
To non-CIS countries	161,0	99,6	160,7
To CIS countries	149,5	109,2	137,0

Source: Ministry for Economic Development and Trade

Export of some kind of machine-building industry goods is expanding at by far faster rates. For instance, as compared with the corresponding period of the previous year in January-July 2008 passenger cars export in natural terms went up by 19.2%, tractors export – by 18.9%, metal-working machine tools - by 10.4%. However despite high growth rates of some kinds of machine-building industry goods, the proportion of machine-building industry goods in the total volume of export remains quite low. In January-July 2008, the proportion of machinery, equipment and transport vehicles in the total amount of Russian export decreased down to 4.7% against 5.3% in January-July 2007.

Over seven months of 2008 import went up by 42.3% as compared with January-July 2008 and reached the level of USD 164.6 bln. In July 2008 import growth was mainly due to the increase in physical volumes of supplies from non-CIS countries, contract prices growing but moderately (*tabl 3*).

Table 3

**Goods Import Indices in July 2008
(Figures of July 2007 taken as 100)**

	Value index	Physical volume index	Price index
Total	154.0	134.7	114.4
From non-CIS countries	154.3	138.5	111.4
From CIS countries	152.4	112.2	135.8

Source: Ministry for Economic Development and Trade

Import from CIS countries became significantly more expensive – by 35.8%, and import supplies from these countries grew at considerably lower rates than those from non-CIS countries.

High import growth rates were mainly accounted for by the increase in machinery, equipment and transport vehicles import both from non-CIS countries (growth by 59.9%) and from CIS-countries (growth by 46.9%). The share of this goods group in the structure of the Russian import reached 53% in January-July 2008 as compared with 49.5% in January-July 2007.

In January-July 2008 value of foodstuffs and agriculture raw materials import exceeded their import value in January-July 2007 by 32%, foodstuffs import from non-CIS countries increasing by 29.4 per cent, and from CIS countries – by 47.8 per cent.

Value indices for textile, clothing and footwear went up by 1.5 times, for chemistry industry production – by 1.4 times.

According to the Decree of the Government from 11 September 2008 No659 “On making changes to the Customs tariff of the Russian Federation with regard to plasma panels (screens) and liquid crystal devises” import duty rates for componentry for plasma and LCD television sets production were nullified. Earlier only the companies operation in Kaliningrad special economic zone had the privileges for preferential import duties.

In Russia the segment of plasma and LCD equipment production was practically missing and the custom rate of 10% was only an additional limitation for the development. Before the duties were abandoned the production of television sets with such components was 25-30% more expensive in Russia than in Japan or China. LCD and plasma panels account for up to 60% of the finished goods prime cost. It is assumed that duties abolition will enable Russian enterprises to become more com-

petitive with regard to Asian and East European producers. In those countries duties for componentry were abolished a few years ago.

According to the Russian Association of Trading Companies and Manufacturers of Consumer Electronic and Computer Equipment (RATEK) forecast, in 2008 in Russia there will be 3.5 mln of LCD television sets (worth Euro 2.5 bln) and 450 thousand of plasma ones (worth Euro 580 mln) sold, the share of LCD television sets produced in Russia (taking into account production in Kaliningrad) will make 8-9%, and not taking Kaliningrad production into account – only 1%, and of plasma television sets- 1-2%.

Meetings of the Government of the Russian Federation in September 2008

M. Goldin

The meetings of the Presidium of the RF Government, among the most important issues, addressed the results of the execution of the federal budget in the first half-year 2008, the process of implementing federal target programs (FTP), and the implementation of the Federal Targeted Investment Program. The previously observed lagging behind in the financing of FTPs became far less pronounced.

At the meeting of the Presidium of the RF Government on 15 September 2008, among the most important issues, the report of the Deputy Chairman of the Government - Minister of Finance – was heard, which described the results of the implementation of the federal budget in the first half-year 2008. The report covered the following aspects:

1. Revenue of the federal budget (including the single social tax (SST) – 240.9 billion rubles) during the reporting period amounted to 4,370.7 billion rubles (or 23.2% of the preliminarily estimated volume of GDP in the first half-year 2008 – 18,858.0 billion rubles). Revenue of the federal budget (without the SST) amounted to 4,129.8 billion rubles (or 21.9% of GDP). Expenditure of the federal budget in cash terms was 2,995.6 billion rubles (or 15.9% of GDP), or 40.4% by the verified sum of budget revenue and expenditure. Federal budget surplus in the first half-year was 1,375.1 billion rubles (or 7.3 % of GDP).

2. By the results of the first half-year 2008 the revenue of the RF consolidated budget and the budgets of state off-budget funds amounted to 7,543.7 billion rubles (or 40.0 % of GDP), the corresponding expenditure – to 5,515.5 billion rubles (or 29.2 % of GDP). The surplus of the consolidated budget of the Russian Federation and the budgets of state off-budget funds was 2,028.1 billion rubles, including federal budget surplus – 1,375.1 billion rubles, the surplus of the consolidated budgets of RF subjects – 473.2 billion rubles, the surplus of the state off-budget funds – 164.4 billion rubles, and the surplus of the budgets of territorial state off-budget funds – 15.4 billion rubles.

3. The volume of government debt as of 1 July 2008 was 2,362.4 billion rubles (or 12.5 % of GDP), having decreased from 1 January 2008 by 40.4 billion rubles.

4. As of 1 July 2008 the aggregate ruble-denominated volume of the resources of the Reserve Fund amounted to 3,056.5 billion rubles, that of the National Welfare Fund – to 770.6 billion rubles.

The Government's Presidium approved the report of the execution of the federal budget in the first half-year 2008 and decided that it should be submitted to the State Duma, the Council of the Federation and the RF Audit Chamber.

Besides, at the Government's Presidium's meeting on 13 September the RF Minister of Economic Development delivered the report "On the process of implementing federal target programs and the implementation of the Federal Targeted Investment Program in the first half-year 2008".

In the report it was noted that, by the results of implementing the FTPs in the first half-year 2008, the lagging behind in meeting their main target parameters that occurred in Q I 2008 by comparison with the preceding years had been largely overcome.

Thus, as of 1 July 2008, the execution of the federal budget in cash terms in the part relating to the financing 45 FTPs amounted to 206.8 billion rubles, or to 30.3 % of the volumes of financing envisaged in the amended Federal Law "On the federal budget for the year 2008 and the planned period through the years 2009 and 2010", including state capital investments – 120.4 billion rubles (or 28.9 %), research and development – 23.5 billion rubles (or 40.1 %), and expenditures allocated to "other needs" – 62.9 billion rubles (or 30.3 %).

In the first half-year 2008 the level of financing allocated to FTPs from the federal budget rose by 4.1 p.p., or by 73.4 billion rubles, on the corresponding period of last year, and nearly by 24 p.p. on Q I 2008.

At the same time, the levels of financing across individual programs vary considerably. No financing at all was allocated to 4 programs in the first half-year 2008. The level of financing allocated to 15 programs did not exceed 10 %. The level of financing was over 50 % only in respect of 2 programs.

Thus, despite the increased financing allocated to FTPs, the planned volumes were not achieved in the first half-year 2008.

Among the main factors that had a negative impact on the implementation of FTPs, the Ministry of Economic Development, as before, pointed to the untimely conclusion of state contracts, delays in the distribution of budget allocations among state customers and capital construction projects, and incomplete co-financing of the programs by subjects of the Russian Federation and from off-budget sources.

As for work under contracts, in the first half-year 2008 state customers had to finish the placement of orders and to conclude, in the main, state contracts for the implementation of the measures listed in the programs.

According to the state customers, during the reporting period 3,407 long-term contracts and 9,324 annual contracts, in the sum of 536,35 billion rubles, or 78.6% of per annum budget allocations (including the contracts of previous years), were concluded, which is by 3.9 p.p. ofr by 156.3 billion rubles more than in the corresponding period of last year.

Besides, 292 agreements with RF subjects were concluded, which envisaged the granting of subsidies with regard to objects of capital investments in the form of government property of RF subjects in the amount of 68.67 billion rubles, or 10.1% of per annum allocations.

Although by comparison with the indices of Q I 2008 there had occurred a significant growth (from 9.1 % to 25.2 %) in the level of actual co-financing of the programs from the budgets of subjects of the Russian Federation and local budgets, as well as from off-budget sources, the volumes of resources allocated to these purposes remained insufficient for ensuring an even distribution in the financing of the program over time.

In the first half-year 2008, only 93.17 billion rubles (or 28.8% of planned per annum allocations) was spent on the financing of FTPs from the budgets of subjects of the Russian Federation and local budgets, and 176.22 billion rubles (or 23,7% of planned per annum allocations) - from off-budget sources.

An analysis of the changes in legislation aimed at the development of small and medium-sized businesses

A. Kireeva

In July 2008 two laws were adopted in order to improve the legal position of small and medium-sized businesses. In September 2008 the State Duma was considering a number of draft laws designed to diminish administrative pressure on business, and in particular on small and medium-sized businesses. Taken as a whole, both the adopted laws and the draft laws currently being discussed by parliament have made it possible to speak of an attempt to devise a new approach to legal regulation of small-scale entrepreneurship which, if implemented, will make it possible to reduce the risks of violations. However, the measures designed to support small businesses cannot, regretfully, be recognized as complete and systematic.

During last quarter, some important changes took place in legal regulation of the activity of small businesses. The main purpose of these innovations, as well as of the planned amendments that have been submitted for the consideration of parliament, is to lower the administrative barriers that usually emerge between small businesses and the State during the former's interaction with controlling bodies.

Firstly, in July amendments were made to Federal Law "On the development of small and medium-scale entrepreneurship in the Russian Federation" of 24 July 2007, No 209-FZ, aimed at a better regulation of the process of alienation of state and municipal property leased by small and medium-sized businesses.

In Federal Law "On the specific features of the alienation of the immovable property belonging by right of state ownership to subjects of the Russian Federation, or that in municipal ownership, and

leased by subjects of small and medium-scale entrepreneurship, and on the introduction of changes into some legislative acts of the Russian Federation” of 22 July 2008, No 159-FZ, whereby the aforesaid amendments were made, it is stipulated, in particular, that subjects of small entrepreneurship should enjoy preferential right to acquire the ownership of the state and municipal property leased by them:

In accordance with Article 2 of this Law, in order to exercise this right, a subject of small or medium-scale entrepreneurship must submit two applications to an empowered body:

- concerning it meeting the requirements established for being placed into the category of subjects of medium-scale entrepreneurship;
- concerning the intended realization of the right to become the owner of the leased property⁹.

On receiving the applications, the empowered bodies are obliged to do the following:

1) ensure that an agreement be concluded concerning the assessment of the leased property’s market value in the procedure established by Federal Law “On the evaluation activity in the Russian Federation” within two months from the date of receiving the applications;

2) make the decision concerning the terms of privatization of the leased property within two weeks from the date of receiving the report on its evaluation;

3) send to the applicant a draft of the purchase and sale contract in respect of the leased property and the contract of its mortgage within ten days from the date of making the decision concerning the terms of privatization of the leased property.

Secondly, in July Federal Law “On the introduction of changes into Part Two of the Tax Code of the Russian Federation” of 22 July 2008, No 155-FZ, was adopted, which also granted a number of privileges to small businesses. Thus, eight new items were added to the list of types of activity, consolidated by Article 346.25 of the RF Tax Code, on which tax can be levied on the basis of a patent. After the introduction of these amendments, this list now covers a total of 69 types of activity, with regard to which an individual entrepreneur may apply the simplified taxation system (STS). Besides, the entrepreneurs applying the patent-based form of taxation, are not allowed to attract employees, including on the basis of contacts based on civil law, the average number of which during one tax period should not exceed five persons. It should be noted that previously, according to experts, the patent-based form of STS was almost never made use of specifically because of the impossibility to use hired labor¹⁰.

An important step toward simplifying the tax administration of small companies was the abolition of quarterly reports for the taxpayers applying the simplified taxation system. In particular, in Item 1 of Article 346.23 of the RF TC the clause “taxpayers - organizations *after the end of a tax (or reporting) period* shall submit tax declarations to the tax bodies at the place of their location” was replaced by the following one: “taxpayers - organizations *after the end of a tax period* shall submit a tax declaration to the tax bodies at the place of their location”. This has made it possible for taxpayers to substantially lower their costs related to the submission of reports and to interact more rarely with auditing bodies.

Besides, Law No 155-FZ envisaged some other improvements in the operation of small businesses. In particular, it specified the conditions for a switchover to the payment of the single agricultural tax, expanded the list of expenditure items to be recognized as costs for purposes of taxation for the organizations that had switched over to the payment of that tax, and introduced some other specific features of the procedure for applying the single agricultural tax, the simplified taxation system and the single tax on presumptive income.

In addition to these two Laws that have already been passed, in August yet another draft law was submitted for the consideration of the State Duma, which is essential for the interests of small and medium-sized businesses, - the draft law “On the protection of the rights of juridical persons and individual entrepreneurs while executing state and municipal control”, No 92975-5. This draft law in Sep-

⁹ This provision is applied only to property not included in the list, approved in accordance with Part 4 of Article 18 of the Federal Law “On the development of small and medium-scale entrepreneurship in the Russian Federation”, of state or municipal property earmarked for transfer into ownership and (or) use of subjects of small and medium-scale entrepreneurship.

¹⁰ <http://www.opora.ru/press/lenta/2008/07/24/prezident-rf-podpisal-zakon-po-sovershenstvovaniyu-spetsialny>

tember was discussed in the first reading and approved at the session of the State Duma on 17 September 2008¹¹.

The draft law envisages a number of important innovations, designed to reduce opportunities for arbitrary decisions and corruption in the course of auditing measures. Thus, it effectively unifies the procedure for the conduction of audits by different controlling and supervisory bodies of all levels (federal, regional and local). While previously the procedure for conducting an audit was established, as a rule, by those same auditing bodies within the framework of bylaws (by issuing internal regulations, orders and instructions), now, in case the draft law is adopted, the following components will become comprehensively applied:

- the classification of the types of audits (it is suggested that audits should be subdivided into planned and unplanned, as well documentation-based and on-site);
- the general timelines for conducting an audit (in Article 15 of the draft law it is suggested that a single period should be established for in-house and on-site audits – twenty days, which in exceptional cases may be extended by another twenty days¹²);
- the maximum periods for conducting on-site audits by supervisory bodies in respect of small-sized companies (seventy hours per year) and microcompanies (15 hours per year);
- the grounds for temporary suspension of audits (in accordance with Article 14 of the draft law, an audit may be suspended for purposes of obtaining information from abroad, conducting experts' estimations, or translating into the Russian language; in this connection, the overall period of suspension cannot exceed three months);
- the periods for conducting planned audits (once in three years, and also after the expiry of the period established for complying with a prescription issued by a controlling or supervisory body);
- the grounds for conducting unplanned audits (these grounds seem to be formulated in a rather vague manner; nevertheless, they make it possible, at least, to establish certain restrictions against the violation of controlling powers; in Article 12 of the draft law the grounds for conducting unplanned audits are formulated as follows: the receipt of information from organizations, citizens and the mass media concerning the emergence of a threat to the life or health of people, to the environment, or [the emergence of] disaster-related situations, or the infliction of damage on them);
- the necessity to coordinate with a public prosecutor any unplanned control measures undertaken in respect of subjects of small and medium-scale entrepreneurship;
- the procedure for conducting unplanned audits (in accordance with Article 13 of the draft law, audits must be conducted at the place of location of a given control (or supervisory) body, by decision of the body's head; this represents a direct reference to the fact that the officials working at the controlling bodies are deprived of opportunities for initiating audits on their own, without the permission of their supervisors; this can result in a markedly improved protection of the interests of the organizations being audited; in conjunction with the norm stipulating the necessity for each organization to keep a journal of their audits, the risk of being subjected to unauthorized unplanned audits conducted by the officials of supervisory bodies becomes much lower);
- the procedure for requesting additional information during the conduction of in-house audits (in this case, however, virtually any kind of information may be requested "relating to the subject of an audit", and the person being audited is allotted fifteen days for submitting such information);
- the formalization of the results of audits (the conducted audits must be formalized by an act, a copy of which should be handed to the person being audited; the person being audited is granted the right to submit, within fifteen days, objections against the act);
- the obligation of organizations and individual entrepreneurs to keep a journal for registering audits, wherein the auditing officials must make entries concerning the conduction of controlling and auditing measures,
- other specific features of the controlling measures applied to economic subjects.

The majority of the innovations suggested in draft law No 92975-5 are to be applied not only to small and medium-sized businesses, but also to all the other types of entrepreneurship, however, it is

¹¹ <http://www.akdi.ru/gd/NEW07/504.htm>

¹² If the person being audited has affiliations in different regions, the audit may be conducted for a period of twenty days in respect of each affiliation.

specifically with regard to small and medium-sized companies that additional preferential and legal guarantees are established by this draft law.

Besides, in the draft law it is suggested that the licensing mandatory for a number of types of activity specific of small and medium-sized businesses should be replaced by an advising procedure. It is intended that, instead of obtaining a license, a newly created organization (or a registered individual entrepreneur) should simply advise the empowered supervisory body concerning the fact that the person in question is planning to operate in one of the following spheres:

- the provision of hotel services and the services relating for temporary lodging and housing;
- the provision of public services to the population (regretfully it is not specified in the draft law which specific public services are implied, and this may give rise to complications in case the draft law is actually implemented. It should be specified which normative acts should be referred to when establishing the list of such services. For example, it should be known whether this norm should be applied to all the types of public services listed in the All-Russian Classifier of Services Provided to the Population (OKUN) OK 002-93¹³);
- the provision of public catering services;
- retail and wholesale trade;
- commercial transportation of passengers by motor vehicles with no more than 20 seats;
- commercial cargo shipments of up to 2.5 tons.

On the whole, the draft law may substantially lower the risks of arbitrary actions and violations of the law on the part of controlling bodies, and in particular law enforcement agencies. However, it also has a number of limitations, which are fraught with additional difficulties that may emerge in actual practice.

Thus, in the draft law the presumption of “honesty” of the person being audited is mentioned, without specifying what exactly should be understood as honesty. This term, in contrast to presumption of innocence, is not applied in legislation. In the late 1990s it was “put into circulation” by the RF Constitutional Court with regard to legal relations in the taxation sphere, but has never been interpreted in normative acts.

As is stated earlier, the draft law does not offer an interpretation of the notion of “public services” that should not be subject to licensing, either. By way of comparison it should be noted that previously the lawmakers have already made an attempt to provide support to the organizations providing “public services” to the population by means of freeing them from the obligation to use cash registers¹⁴. However, due to the absence of any clear reference to any specific list of types of services that may be provided without the use of cash registers, public services were relieved from compulsory use of cash registers on a selective basis. The problem was that Federal Law “On the use of cash registers when executing cash settlements and (or) settlements with the use of payment cards” of 22 May 2003, No 54-FZ, makes a reference in connection with this issue to the RF Government, which in its Decree of 31 March 2005, No 171,¹⁵ referred, in its turn, to the RF Ministry of Finance, which approved the use of registered forms only in respect of some public services, “having forgotten” about all the others. As a result, the services in respect of which the use of registered forms had not been established were provided with the compulsory use of cash registers.

However, the main problem inherent in this draft law is that, in case it is adopted, the sphere of its application will be very limited. In particular, it is supposed that it should not be applied to the sphere of taxation and finance taken as a whole; the sphere of customs and tariff relations; and also a number of areas of control that are essential for small and medium-sized businesses. Of course, it would be impossible to directly apply it to tax relations – among other things, also because the procedure for conducting tax audits is currently subject for much more detailed regulation, with differently established timelines, etc. Nevertheless, it would be feasible to properly coordinate the actions aimed at providing additional protection of subjects of small entrepreneurship during the conduction of tax and “other” audits. For example, it now happens so that, while establishing shorter periods for conducting “other” audits in respect of small businesses and microcompanies, the lawmakers have neglected to accordingly shorten the periods of in-house and on-site tax audits of these economic subjects.

¹³ Introduced by Decree of the Gosstandart of Russia, issued on 28 June 1993, No 163.

¹⁴ The application of KKT was replaced by the right to apply registered forms.

¹⁵ By this Decree the Provision “On the execution of cash settlements and (or) settlements with the use of payment cards without the use of controlling and cash registers”.

It is by no means obvious that this draft law makes it possible to extend the aforementioned procedure to *all* the control measures executed in respect of taxpayers by law enforcement bodies. In particular, Item 2 of Article 1 contains the following wording: “this Law is not applicable to the actions relating to the conduct of investigation and search operations, inquiry, preliminary investigation, supervision by a public prosecutor’s office, serving of justice, and of tax, budget and currency control...”. In fact, this clause can be interpreted as follows:

- any controlling measures with regard to taxpayers applied by either tax or law enforcement agencies may be executed in accordance with norms other than those stipulated in this draft law;

- in order to “bypass” the rules established by this draft law it would be sufficient for law enforcement agencies to initiate a criminal case against the person being audited¹⁶, to undertake any kind of auditing measures in respect of any activity of a small business, and then simply to terminate the proceedings. Since the RF CCP establishes a rather wide range of grounds for initiating criminal cases, an investigation of the activity of a taxpayer can be initiated by a law enforcement agency on the basis of, for example, the information of the existence of big arrears of taxes sent by a tax inspectorate, or information submitted by a company’s competitors, etc.

In September 2008 one more draft law was submitted to the consideration of the State Duma, designed to improve the situation faced by small businesses. This is draft law No 100239-5 “On making changes to Articles 346.12 and 346.13 of part two of the Tax Code of the Russian Federation”, whereby it is intended to substantially raise the upper limit of gross income allowing an organization to switch over to the simplified taxation system (STS), as well as the upper limit of the income of such an organization on achieving which it is no more allowed to apply the STS.

Thus, in the draft law it is envisaged that the right to switch over to the simplified taxation system should be enjoyed by economic subjects in case their gross proceeds from sales during nine months of the preceding year did not exceed 45 million rubles, instead of the currently established threshold of 15 million rubles. The abolition of this right will occur if the income exceeds the sum of 60 million rubles.¹⁷

This draft law, if adopted, will make it possible to somewhat broaden the range of organizations applying the STS. However, in our opinion, its feasibility for small businesses proper is by no means evident. In fact, the tax privileges granted to truly small companies may also be made use of by their bigger-sized rivals. And, in view of the fact that tax bodies so far have failed to efficiently prove the instances of this right being violated by big companies, when they switch over to the SST through their division or separation in order to create the illusion of complying with the criteria established by Articles 346.12 and 346.13, the degree of competition for small businesses can only become greater.

The feasibility of adopting this draft law might have been justified by the argument that the threshold indices have become senseless due to inflation, but this also appears to be unsubstantiated. In fact, they are subject to periodic indexation. As a result, in 2008 the marginal size of income enabling a taxpayer to enjoy the right to apply STS amounts to 26,800 rubles, and not to 20,000 rubles.¹⁸

All this has led us to the conclusion that legislation on small entrepreneurship is developing towards providing additional legal guarantees to small and medium-sized businesses. However, this process is as yet by no means completed, and the measures that are currently being applied or planned for the nearest future with the purpose of relieving the administrative burden imposed on small businesses should be properly systematized and implemented comprehensively. In particular, it is necessary to apply a uniform approach to the issue of establishing shorter periods for the conduct of tax and “other” audits of small businesses; to the taxation of the organizations providing public services and to the execution of different types of control over their activity; and to the use of cash registers by the organizations switched over to the payment of a single tax on presumptive income, etc.

¹⁶ In accordance with Item 1 of Article 146 of the RF Code of Criminal Procedure (CCP), in the presence of an occasion and grounds envisaged in Article 140 of the RF CCP, an inquiry body, inquirer or investigator should, within the limits of their competence established by the Code, initiate a criminal case, to which effect the corresponding decree is issued.

¹⁷ See, e. g., http://taxhelp.ru/new/view_article.php?article_id=19033

¹⁸ See Letter of the RF Ministry of Finance of 31 January, No 03-11-04/2/22

An overview of economic legislation

I. Tolmacheva

In September, the following changes were introduced in existing legislation: additional indices were determined for estimating the performance level of bodies of local self-government; a special provision was approved concerning the licensing of foreign trade transactions with the goods and services that are subject to export control; and the adjustment coefficient applicable to the rate of the tax on extraction mineral resources with regard to oil was lowered for August 2008.

I. Regulations issued by the Government of the Russian Federation

‘ON THE IMPLEMENTATION OF EDICT OF THE RF PRESIDENT OF 28 APRIL 2008, No 607, “ON ESTIMATING THE PERFORMANCE LEVEL OF BODIES OF LOCAL SELF-GOVERNMENT OF CITY DISTRICTS AND MUNICIPAL RAIONS”’ of 11 September 2008, No 1313-р.

In accordance with the RF President’s Decree, the RF Government approved the list of additional indices (31 items) for assessing the performance of bodies of local self-government, in particular in the spheres of public health care, education, culture, capital construction, public road systems, etc. For example, the list includes: the average monthly wage in nominal terms charged to employees; volume of medical care and cost of one unit of medical care provided to the population; the average annual occupancy of one hospital bed; hospitalization level; the average length of patient hospital stay per bed; the percentage of children aged 5 to 7 years receiving pre-school education services; number of students per employee of comprehensive educational establishments; the average number of students per class at comprehensive educational establishments; the share of the length of local public motor roads with hard surface in the overall length of public motor roads of local importance; etc.

Besides, the following documents were approved: the model report of heads of bodies of local self-government on the achieved values of reporting indices; the methodology for monitoring the performance level of bodies of local self-government (for determining priority areas); methodological recommendations concerning the procedure for allocating grants from the budget of a RF subject to municipal formations, for purposes of promoting the achievement of best performance indices by bodies of local self-government, and of rewarding such achievements.

II. Decrees of the Government of the Russian Federation

“ON APPROVING THE PROVISION CONCERNING THE LICENSING OF PF FOREIGN TRADE TRANSACTIONS WITH THE GOODS, INFORMATION, WORKS, SERVICES, RESULTS OF INTELLECTUAL ACTIVITY (OR THE RIGHTS THERETO), WHICH ARE SUBJECT TO EXPORT CONTROL” of 15 September 2008, No 691.

The Decree is to come into force on 25 October 2008.

The approved Provision establishes the rules for issuing licenses to carry out foreign trade transactions with goods and technologies that can be applied in the production of mass destruction weapons, means for delivering such weapons, or other types of armaments and military technologies, or those that can be applied in the preparation for and (or) execution of acts of terrorism, which are subject to export control (or belong to the category of “controlled products”). Foreign trade transactions in this Provision are understood as the export and import, as well as other forms of transfer (or international exchange) of “controlled products” carried out on the basis of agreements (or contracts, or treaties) concluded between Russian and foreign persons.

The licenses (single or general) for the execution of foreign trade transactions with controlled products are to be issued by the Federal Service for Technical and Expert’s Control on the basis of applications submitted by Russian participants in foreign trade. The list of the foreign states and types of controlled products in respect of which general licenses are issued are to be determined by the RF Government.

The Decree establishes the list of documents necessary for obtaining a license and the list of grounds for denying a license. A license can be suspended or annulled. Attached are the application form for a license and the license form.

III. Letters, orders, regulations

Letter of the RF Federal Tax Service (FTS) “ON THE INFORMATION NEEDED FOR CALCULATING THE TAX ON EXTRACTION OF MINERAL RESOURCES WITH REGARD TO OIL, FOR AUGUST 2008”, of 18 September 2008, No ShS-6-3/656@.

The Federal Tax Service published the information to be applied for calculating the tax on the extraction of mineral resources with regard to oil for August 2008. Thus, the adjustment coefficient for the rate of this tax for August 2008 is established as 9.4609 (in July it was 10.7763). The downward change in the coefficient is associated with the corresponding change in the indices on the basis of which it has been computed: the average level of prices of Urals decreased from 129.45 to 111.31 USD per barrel; and the mean USD/ruble exchange rate over that tax period displayed a slight change – from 23.3508 to 24.1354.

An overview of the normative documents regulating the issues of taxation, issued in August - September 2008

L. Anisimova

1. By letter of the RF Ministry of Finance of 20 August 2008, No 03-07-08/202, the absence of any grounds for applying the zero rate of VAT to the services provided by Russian carriers in the form of cargo shipment by motor transport from the territory of the Russian Federation into the territory of the Republic of Belarus was confirmed.

The place of the realization of shipments from the RF into Belarus, in accordance with the Protocol between the parties, is recognized as the territory of the RF in the event of such services being provided by RF taxpayers. Therefore the services in the form of shipment and (or) transportation of commodities from the territory of the Russian Federation into the territory of the Republic of Belarus, when provided by Russian organizations, are recognized as an object for levying the value added tax in the territory of the RF.

On the basis of Article 165 of the RF Tax Code (TC RF) the rate of VAT in the amount of 0 % is granted only on condition that the documents listed in that Article are provided, including shipping (or transportation) or other documents with the notes made by customs agencies in confirmation of the export of the commodities out of the territory of the Russian Federation. Since the customs control between the RF and Belarus has been abolished, the services provided by Russian carriers in the form of shipments of commodities by motor transport from the territory of the RF into the territory of the Republic of Belarus, in accordance with Item 3 of Article 164 of the TC RF, are subject to the levying of the value added tax at the rate of 18 %.

2. By letter of the RF Ministry of Finance of 20 August 2008, No 03-11-02/93, it is explained that when calculating the tax base for the tax payable under the simplified taxation system, a taxpayer should not take into account the cost of acquisition of (or payment for) the commodities for subsequent realization purchased during the period of applying the system of taxation in the form of the single tax on presumptive income established for some specified types of activity. The sums of proceeds from the sale of these commodities, received during the period of applying the simplified taxation system, are to be taken into account as incomes from realization when calculating the tax base.

3. By letter of the RF Ministry of Finance of 21 August 2008, No 03-03-06/1/478, the issue of the conditions for using electronic digital signatures in primary accounting documents that serve as a basis for accounting and tax records is explained.

According to the RF Ministry of Finance, for this purpose it will be necessary to introduce changes into the special legislation on accounting procedures (Federal Law of 21.11.1996, No 129-FZ) and into tax legislation. In accordance with the law on accounting procedures, primary and summary accounting documents may be drawn as hard and electronic copies. However, the invoices the details of which are envisaged by Items 5 and 6 of Article 169 of the TC RF cannot be recognized as primary documents for the purposes of applying Law No 129-FZ, and instead are applied as the grounds for accepting the declared tax sums for deduction or refund in the procedure envisaged by Chapter 21 “Value Added Tax” of the TC RF. The Tax Code does not envisage the possibility for using the electronic signatures of the director and chief accountant of an organization.

The rules for the keeping of the journals of invoices received and submitted for payment, the ledgers of sales and the ledgers of purchases used in the settlements relating to the value added tax, ap-

proved by Decree of the RF Government of 02 December 2000, No 914, do not envisage the procedure whereby the electronic signatures of the director and chief accountant of an organization may be used, either.

4. By letter of the RF Federal Tax Service (FTS) of 25 August 2008, No ShS-6-3/603@, explanations are provided with regard to the set of tax exemptions in respect of VAT in connection with the preparations to the Olympic Games in Sochi, including the exclusion from the lists of objects of taxation of the transactions involving the realization of the goods (or work, or services, or property rights), executed by agreement with the persons who are the foreign organizers of the Olympic and Paralympic Games in accordance with Article 3 of the Federal Law "On the organization and conduct of the XXII Winter Olympic Games and the XI Winter Paralympic Games in 2014 in the city of Sochi, and the development of the city of Sochi as a mountain climatic health resort", as well as the works and services produced by the residents of the special port economic zone.

5. By letter of the RF Ministry of Finance of 27 August 2008, No 03-05-05-05/17, the standpoint of the RF Ministry of Finance concerning the procedure for registering gambling machines in the event of an organization's reorganization in the form of accession to another organization is explained. More specifically, it has to do with the procedure for applying the two-day timeline established for the re-registration of objects of taxation by Article 366 of the TC RF.

In accordance with the stipulations of the Resolution of the Constitutional Court of the Russian Federation of 16 October 2007, No 648-O-O, a taxpayer is obliged to register an object of taxation (a gambling machine) not only before beginning to use it for the organization of gambling games, but also prior to installing it at a gambling establishment in the territory accessible for gamblers.

Thus, as explained by the RF Ministry of Finance, the procedure for registering gambling machines envisaged by Article 366 of the Tax Code is established for purposes of executing tax control over the total number of the objects of taxation. In an event of reorganization of a juridical person, the tax liabilities of the juridical person being merged should be transferred to its legal successor. If reorganization in the form of accession does not result in any change in the number of objects of taxation (withdrawal or installation of new objects of taxation), the tax base does not change either; also, in an event when the gambling establishments transferred to a legal successor were not closed for the period of reorganization, according to the Ministry of Finance, when the objects of taxation are re-registered, the provision concerning the two-day timeline should be applied.

6. By letter of the RF Ministry of Finance of 26 August 2008 the issue of recording in the accounting documents of the cost of purchased electronic passenger tickets for purposes of levying the profits tax is explained. If an employee of an organization has purchased an electronic ticket in order to go on a business trip in the territory of the RF or abroad, the documents confirming the cost can be the itinerary/receipt formalized as a registered passenger ticket form, check or other document confirming the fact of payment for transportation, formalized as a registered form.

At the same time, in the opinion of the RF Ministry of Finance, such expenditures can also be accepted for purposes of diminishing the tax base for the profits tax, if they can be confirmed indirectly, in particular by the order concerning the sending of an employee on a business trip, documents confirming the lodging abroad, or other documents, formalized as unified forms for primary accounting records and confirming the fact of an employee being on a business trip, and the printouts of electronic tickets or boarding passes with the specification of details that make it possible to identify the fact of an employee traveling abroad (in particular, the passenger's surname, route, ticket price, and date of travel).

7. By letter of the RF Ministry of Finance of 28 August 2008, No 03-01-15/10-317, it is explained that, in an event of any model being excluded from the State Register of Models of Cash Registers, taxpayers have the right to continue to exploit it until the expiry the standard period of that model's depreciation. Cash registers are depreciated in accordance with the procedure established as of the moment of the putting in operation of a given model, until its initial cost is fully redeemed.

Therefore, as explained by the RF Ministry of Finance, the changes relating to the recognition of the depreciation of such property, in cases when its initial cost is in excess of 20,000 rubles, are applicable only to the capital assets put in operation after 1 January 2008.

8. By letter of 29 August 2008, No 03-07-11/290, of the RF Ministry of Finance it is explained that when a lessee transfers to the lessor, by way of paying rent, the cost of inalienable improvements made to the leased property by means of attracting contractors, such improvements are subject to VAT.

It seems that an important substantiation of this standpoint of the RF Ministry of Finance is the consent, on the part of a lessor, to receive as rent the cost of improvements made to immovable property. In fact, a lessee may not make any changes to leased property without the lessor's consent. The cost of inalienable improvements made by a lessee without the lessor's consent are not subject to refund. In accordance with Item 5 of Article 270 of the TC RF, a lessee's capital expenditures on the inalienable improvements made to the leased property without the lessor's consent and not refunded by him should not be recorded for the purpose of the taxation of profit. And in the case of a lessor, in accordance with Item 32 of Article 251 of the TC RF, the capital investments in the form of inalienable improvements made by a lessee to the leased property should not be recorded as part of the incomes levied by the profits tax (Note: in this connection it is not specified whether such improvements have been made with or without the owner's consent). As for VAT, for purposes of applying Chapter 21 of the TC RF the transfer of the ownership right to the goods, results of works, or services provided on a gratis basis is recognized as realization of goods (or works, or services). Besides, according to Item 1.1 of Article 148, the services relating to lease should be recognized as an object of VAT taxation. However, in an event of inalienable improvements being made by lessee without the consent of the property's owner it is impossible to prove the fact of realization on a gratis basis. The Judicial instances are guided by Item 1 of Article 616 of the RF Civil Code, according to which a lessor is obliged to perform, at his own expense, capital repairs of leased property, if not provided otherwise by the law, or other legal acts, of by a lease contract. In such a situation to provide the proof of the fact of a realization on a gratis basis represents an unsolvable problem for a tax agency.

9. By letter of the RF Ministry of Finance of 29 August 2008, No 03-04-05-02/14, it is explained that for private entrepreneurs and other independent professionals, including privately practicing notaries, Article 237 of the TC RF establishes similar rules for recording costs for purposes of forming a taxation base for levying the single social tax (SST) both for the profits tax and the personal income tax (PIT). On the basis of this similarity, the RF Ministry of Finance RF believes that, exactly as in the event of costs recorded for the purposes of paying the profits tax, the payment of the personal income tax should not be taken into account as costs when determining the base for levying the single social tax on privately practicing notaries.

10. By Decree of the RF Government of 15 September 2008, No 688 changes were made to the list of medical goods taxable by VAT at a rate of 10 %.

An overview of budget legislation

M. Goldin

In September, the following changes occurred in the sphere of budget legislation: by Decrees of the RF Government, the Provision on the Federal Register of municipal normative legal acts was approved; changes were introduced in the Rules for restructuring the monetary liabilities to the Russian Federation assumed by subjects of the Russian Federation; RF subjects were provided with opportunities for making a choice between two variants of obtaining a federal subsidy for covering, in the year 2008, the expenditures related to the provision of hi-tech medical care to citizens; by a Regulation of the RF Government, additional indices were determined for estimating the performance of bodies of local self-government.

By Decree of the RF Government of 10 September 2008, No 657, "On the keeping of the Federal Register of municipal normative legal acts", the Provision concerning the keeping of the corresponding Federal Register was approved. The Provision was developed in compliance with Article 43.1 of the Federal Law "On the general principles of the organization of local self-government in the Russian Federation".

The purposes of keeping the Register is the registration and systematization of municipal normative legal acts and the exercise of the right of citizens to receive reliable information concerning municipal normative legal acts. It is established that the federal body of executive authority empowered to keep the Register and to provide methodological backing thereto shall be the RF Ministry of Justice. The access of citizens and organizations to the information contained in the Register will be achieved through a single portal for providing government services through the Internet. The Decree is to come into force from 1 January 2009.

By Decree of the Government of 12 September 2008, No 672, “On introducing changes in Decree of the Government of the Russian Federation of 21 July 2004, No 366”, appropriate changes were made to “The Rules for restructuring the monetary liabilities to the Russian Federation assumed by subjects of the Russian Federation”. By these Rules it is established that the restructuring of liabilities is to be effectuated by means of their consolidation, with simultaneous writing-off of accrued penalties and fines. Since the previous Rules granted the right to redeem the consolidated debt by installment payments until 1 January 2012 if the restructuring was carried out in the period of 2004 – 2007, the Rules were augmented by a provision whereby an evenly distributed installment plan for the payment of consolidated debt was to be granted until 1 January 2013, in case the restructuring took place in 2008 – 2010.

By Decree of the RF Government of 16 September 2008, No 698, “On introducing changes in Decree of the Government of the Russian Federation of 5 May 2007, No 266”, RF subjects were granted an opportunity to choose between two variants of obtaining from the federal budget the subsidies for financing in the year 2008 their expenditures associated with the provision, by medical institutions, of hi-tech medical care to citizens.

In accordance with the amendments introduced to “The Rules of co-financing, in the year 2008, of the state assignment for providing hi-tech medical care to the citizens of the Russian Federation by the medical institutions in the jurisdiction of subjects of the Russian Federation and municipal formations”, the supreme body of executive authority of a RF subject has the right to determine the possibility for obtaining a subsidy both in the procedure envisaging the keeping of such monies on individual accounts opened with bodies of the Federal Treasury, and in the procedure of compensating for the actual cash expenditures from the budget of a RF subject.

Besides, the procedure for transferring a subsidy to the budgets of RF subjects and the procedure for using the resources of the federal budget that are not executed during a current financial year, were established.

When the supreme body of executive authority of a Federation’s subject selects the variant that envisages obtaining a subsidy by way of compensating for actual cash expenditures, the aforesaid compensation is to be effectuated by the RF Ministry of Public Health Care and Social Development on the basis of the reports listed in Section 9 of the Rules (in this connection, the Q IV report should be submitted no later than on 15 December of a current financial year).

By Regulation of the RF Government of 11 September 2008, No 1313-r, additional indices were determined for estimating the performance of bodies of local self-government of city districts and municipal raions. In accordance with RF President’s Edict of 28 April 2008, No 607, “On estimating the performance level of bodies of local self-government of city districts and municipal raions”, the RF Government approved the list of additional indices) for assessing their performance, in particular in the spheres of public health care, education, culture, capital construction, public road systems, etc.

Some aspects of Russia’s policy with regard to military technologies

V. Zatsepin

An analysis of the Russian policy with regard to military technologies, as pursued by the government formed in May 2008, has demonstrated that it is fully derived, in terms of its goals and means, from that of the previous cabinet. This implies that, as before, the pronounced asymmetry of information across the key institutions of this sphere will be resulting in uncontrolled growth of prices of the products of the defense industry, which is becoming an increasingly prominent factor triggering further inflation. Higher transparency of the military budget remains a key factor in increasing the efficiency of expenditures in this sphere.

In June – September the leadership of the new RF government formed in May 2008 once again confirmed the unchanging and continuous character of the Russian policy with regard to military technologies in terms of both its goals and the means applied in achieving these goals.

Thus, when opening the government meeting on 30 June 2008, at which the draft federal budget for the years 2009 – 2011 was to be discussed, Chairman of the RF Government V. Putin declared that the

share of expenditure allocated to the development of the Armed Forces in the military budget would begin to increase in 2009 and would become in 2015 as high as 70%¹⁹; that is, he confirmed the course adopted in the years of his Presidency. In this connection, he once again reproached the Armed Forces for “gobbling up” budget resources. Judging from the simplistic interpretation of the problems involved in the financing the defense sphere demonstrated by the Russian Prime Minister, understood solely as a ratio between the shares of expenditure allocated to upkeep and development, one begins to feel that the true goal of the current Russian leadership’s policy with regard to military technologies is not to ensure an adequate level of this country’s defense potential, but to mechanically pump money into the military-industrial complex. To rely on such simplistic visions would be dangerous in any field²⁰, but such an approach is totally unacceptable for a Prime Minister and former Commander-in-Chief of the Armed Forces. Unfortunately, in Russia there has not always been a clear understanding of this point²¹.

No doubt that the new Prime Minister is familiar with the existing bottlenecks in the implementation of the Russian policy in the sphere of military technologies. Thus, when speaking three weeks prior to the government meeting at another caucus addressing the issues involved in the planning of state military orders in the draft federal budget for the years 2009 – 2011, V. Putin set before its participants the task of a switchover to serial supplies of new military technologies and the concentration of resources needed for completing prospective development projects, on condition that proper order should be established in the timelines for their implementation and pricing²². In this connection he emphasized both the dangers associated with inflation and the hopes that Rosoboronpostavka (the Federal Agency for Supplies of Armaments, Military and Specialized Equipment, and Material Means)²³ would undertake active measures designed to stabilize prices of military products.

In this connection, of great interest is one of the latest interviews with another key player on the field where the Russian policy involving military technologies is being played – Chairman of the Military – Industrial Commission and Vice Prime Minister S. Ivanov, published on 9 July²⁴. If one makes judgments only on the basis of the published text²⁵, the main efforts in the government’s policy in this sphere are focused on implementing the tasks set by the State Armaments Program for the Years 2007 – 2015, resulting from which the state defense order in 2007 received financing in the amount of 100%, was actually fulfilled by 98%, and once again the army was equipped with more than 200 new models of armaments and military equipment. At the same time S. Ivanov admitted that such a high degree of the actual implementation of the 2007 program had been achieved only because the state defense order was adjusted by the RF Ministry of Defense *seven times*, with reallocation of 7 billion rubles.

As the main problems hindering the implementation of the state policy with regard to military technologies, Ivanov pointed to anarchy in pricing, weak substantiation of the tactic requirements to technologies by the customers, and failure to comply with the two-month deadline established for the placement of state defense orders – by the end of April of this year contracts had been concluded only in respect of 65% of the total volume of budget allocations earmarked for this purpose. A growing number of enterprises are refusing to participate in

¹⁹ The figure 70% is mentioned only in the text posted to the website <http://www.government.ru/content/rfgovernment/rfgovernmentchairman/chronicle/archive/2008/06/30/1884577.htm>. In the video footage accompanying this text V. Putin speaks about 50%.

²⁰ “[The] main goal in the sphere of state defense orders is to create appropriate conditions for the development of the technological base of military – industrial enterprises”. Head of Rosoboronzakaz (the Federal Service for Defense Orders) S. Maev, “Voенно – promyshlennyyi kur’er” [“The Military – Industrial Courier”]. 2008. 24–30 September (No 38). P. 7.

²¹ “For example, the Prime Minister spoke of defense expenditures, which is very correct, because presently these are mainly being spent on “gobbling”. And expenditures allocated to defense must go to development. This implies entirely different methods and approaches to this sphere, which is very delicate and very important”. From: *Gontmakher Ye.* Inhaling on inflation // “Rossiiskaia gazeta” [“The Russian Gazette”. 2008. 7 July (No 143p).

²² See the full text at : <http://www.government.ru/content/rfgovernment/rfgovernmentchairman/chronicle/archive/2008/06/10/7048457.htm>.

²³ The Federal Agency for Supplies of Armaments, Military and Specialized Equipment, and Material Means.

²⁴ Zakaz na oboronu [Defense order] // Rossiiskaia gazeta [The Russian Gazette]. 2008. 9 July (No 146).

²⁵ Which reproduces, in part, the information already made known by press releases after the meetings of the Military-Industrial Commission on 29 April and 16 May 2008.

the tenders for receiving a state defense order. The main reason for such a situation as stated by Ivanov, who in this respect shares the opinion of the Government's Chairman, is the overpricing of products by their producers, which is against the stipulations of Decree No 549, "On approving the Rules for developing and implementing state armaments programs", adopted by the Government in August 2007.

So what is happening in Russia with regard to prices of armaments? It is rather difficult to assess correctly the random facts of sharply increased prices of military products referred to by the mass media without following up statistics over several years. Thus, in early 2007 the price of T-90A tank supplied to the Russian Armed Forces increased from 42 to 58 million rubles, or by 38 %; and that of a BTR-80 [APC-80] – from 5.3 to 7.1 million rubles, or by 34 %²⁶. However, nothing new in principle has actually happened – if one assumes that deflator of the end-product expenditures of the state administration adequately reflects growth in armaments prices, such a picture would be typical for Russia's economy as a whole throughout the eight previous years (*Table 1*).

Table 1

Changes in deflators of end-product expenditures of the state administration and GDP in Russia, %

	2000	2001	2002	2003	2004	2005	2006	2007	Average in 2000 – 2007
Growth of expenditure deflator for end-product of state administration	53.6	34.4	26.9	19.2	19.7	23.6	25.3	29.6	29.6
Growth of GDP deflator	37.6	16.5	15.5	14.0	20.1	19.2	15.7	13.5	25.0
Difference, p.p.	16.0	17.9	11.4	5.2	-0.4	4.4	9.6	11.8	4.7

Source: Russian economy in 2007. Trends and prospects. (Issue 29). – M.: IET, 2008. – P. 592.

The difference, as calculated in *Table 1*, between the expenditure deflator for end-product of state administration (essentially the growth of armaments prices) and the GDP deflator has demonstrated a positive correlation between the overall inflation rate and the rate of inflation in terms of state (or military) expenditures. But, generally speaking, can the situation ever be different? As a matter of fact, it can.

Table 2 shows changes in armaments prices and growth of the GDP deflator in 2000 – 2004 in France. In this case, the growth rate of armaments prices, in addition to considerably falling behind the general inflation rate in that country, is more than by one order lower than the corresponding index in Russia. As for this country, the average difference here during the same period (2000 – 2004) between the expenditure deflator for the end-product of state administration and growth of the GDP deflator was 10 p. p.

Table 2

Changes in armaments prices and GDP deflator index in France, %

	2000	2001	2002	2003	2004	Average in 2000 – 2004
Growth of armaments prices	2.6	0.0	0.8	-1.0	0.2	0.5
Growth of GDP deflator	1.4	1.8	2.2	2.4	1.7	1.9
Difference	1.3	-1.7	-1.4	-3.4	-1.6	-1.4

Source: L'économie de la défense 2006. – [Paris]: Conseil économique de la défense, [2006]. – P.108.

However, despite all, the domestic price of the tank T-90A, contrary to the common opinion, still falls behind the price of its exported version T-90S by more than 1 million USD, the latter amounting on the average to 3.59 million USD in the transaction with India, when 347 such items were sold in late 2007 (considering that the greater part of the consignment will be supplied in the form of assembly sets)²⁷. Thus is it not surprising that Rosoboronzakaz's head²⁸ S. Maev²⁹ and Deputy Minister of Defense General-Colonel V. Popovkin, who in early July was appointed head of armaments of the

²⁶ Krasnaia Zvezda ["The Red Star"]. 2007. 9 June (No 99).

²⁷ Rossiiskie tanki dvinulis' na Indii. [Russian tanks started moving towards India.] // Kommersant. 2007. 4 December (No 223).

²⁸ The Federal Service for Defense Order under the RF Ministry of Defense.

²⁹ Krasnaia Zvezda ["The Red Star"]. 2008. 11 July (No 120).

Armed Forces³⁰ have made declarations from which it follows that supplies of new tanks to the RF Armed Forces will be discontinued until the Indian order is fulfilled in 2010, and until then their additional necessary tests will be carried out. It is difficult to make any judgments as to why such tests had not been completed earlier, before the onset of the first serial production of such machines in 1992, let alone the second one started in 2004. It seems that here we are faced with an attempt to get, in three leaps, over an abyss that opened up in the post-Soviet period “between those who were using armaments and those who were determining the purchasing policy”³¹.

In this light last, year’s result of the activity of the Military-Industrial Commission headed by S. Ivanov, in the form of the 98 % fulfillment of the state defense order and the putting into service of 200 new models of military equipment, appears rather dubious and is indicative of an asymmetry in the availability of information concerning the Russian policy with regard to military technologies. It should be remembered that even in countries with highly developed economies delays in the completion of assignments and growth of contractual prices are a common phenomenon: thus, in the USA only one-third of all programs are fulfilled within the initially established timelines³². It is understandable that this habitual asymmetry is very convenient for the Russian military-industrial complex, because it allows state officials to feel that they are indispensable no matter what their level of performance might be, the producers - to maintain their monopoly on the market, and the top military commanders – to build their careers on adopting and putting into service “raw” or indeed unnecessary armaments, if these are liked by their superiors.

And so far any hopes as to the efficient role of Rosoboronpostavka, whose beginning of operation has been delayed until January 2009, that is, for one more year, appear ungrounded. One should simply point to the disastrous shortage of proper cadres: although 1100 military posts were switched over to it from all the other “power” ministries, no specialists have been found so far. Besides, the preliminarily established overall staff number of this body may prove to be insufficient – its counterparts in France and the UK, which manage volumes of purchases comparable to those handled in Russia, are manned by 18,500³³ and 5,594³⁴ persons, respectively.

The negative trend of the more and more noticeable “deadening” of the budget resources allocated to defense can hardly be overcome by simply increasing the volume and share of expenditures on development projects, while keeping intact the inefficient institutions for implementing the armaments program and state defense orders inherited from the USSR. The chairman of the Military – Industrial Commission may complain as much as he likes of prices being increased by dishonest producers, but until, for example, last year’s Decree No 549 remains unpublished in the open press the rules of game (as well as the prices) on the domestic market of military products will be determined not by him personally, but by the parties to contracts at their free will.

Our analysis of the Russian policy with regard to military technologies, regretfully, has provided no grounds for optimism: it reveals the same bad institutions, ideas turned upside down, and vague goals. The five-days-long military conflict with Georgia in August, which once again confirmed the existence of serious problems, among other things, with the technological equipment of the Russian Armed Forces, may, unfortunately, serve as a reason for further distortion in the structure of military expenditures in favor of the military-industrial complex.

The only recently observed positive development does not relate directly to the sphere of military technologies and follows from the speech of RF President D. Medvedev at the meeting of the Presidium of the State Council on 17 July, when it was admitted, however indirectly – and maybe for the first time at this high level in this country’s history, - that state administration in Russia is subject to

³⁰ <http://www.rosprom.org/inf2.php3?id=3793>.

³¹ Quoted from an interview with Head of the Main Administration for Combat Readiness and Service of the Troops of the RF Armed Forces, General Lieutenant V. Shamanov. *Krasnaia Zvezda* [“The Red Star”]. 2008. 24 June (No 107).

³² Defense Acquisitions. Assessments of Selected Weapon Programs: Report to Congressional Committees / U.S. Government Accountability Office; GAO-08-467SP. – March 2008. – P.9.

³³ La DGA, partenaire des armées pour bâtir la défense de demain. – [Paris]: Délégation Général pour l’Armement, [2007]. – P.2.

³⁴ Defence Procurement Agency: Annual Report and Accounts 2006/2007. – London: The Stationery Office, 2007. – P.17.

too much secrecy³⁵. The understanding of this problem by the head of the State is of great value – one should like to believe that Russia will thus have a chance for introducing changes aimed at achieving a higher transparency and efficiency of the federal budget, as well as for having a responsible government.

It would be impossible to improve budget efficiency without adopting urgent *political decisions*, designed to dramatically reduce the share of “classified items” of budget expenditure, exclude such classified items of expenditure, which have nothing to do with state defense and security, from the sections of the budget already being considered by the State Duma, lifting the secrecy and publication of normative methodological documents, including the state armaments program, as well as information concerning all the contracts being concluded (both within and outside of the framework of the state defense order).

³⁵ *Medvedev D. A.* Summing-up speech at the meeting of the Presidium of the State Council “On the implementation of the Strategy for the Development of Information Society in the Russian Federation”. – Petrozavodsk, 17 July 2008. <http://www.kremlin.ru/text/appears/2008/07/204258.shtml>.