

RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES
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Main events

By the results of the general election, four parties got access to the Duma. The outcome of the Duma elections can be summarized as a successful “referendum to test confidence in Putin”, which yielded a positive result, although the methodology of its actual implementation has cast doubt as to its legitimacy. The candidate to succeed to the post of this country’s president has been determined. As to V. Putin, he himself was offered the post of Prime Minister by D. Medvedev, in the event of the latter’s very likely victory in the presidential election. Such developments may give rise to the emergence of an institute of co-rulers, wherein Medvedev’s role will be eventually becoming more prominent, while that of Putin will diminish. The stability of this dual power will depend, most importantly, on adequacy of the levels of political ambitions of them both..

Inflation in November remained high, CPI amounted to 1.2 % against 0.6 % in November 2006. At the same time, international reserve assets continued to grow, their volume in this country by mid-December having become more than \$ 467 billion. In November – December the situation on RF interbank market was stabilized both due to the appearance on the market of the funds allocated by the Government in order to finance development institutions, and to the measures undertaken by the Bank of Russia.

Federal budget expenditure in November was much higher than revenue. This had to do both with the uneven spending of budget resources throughout the year and with the considerable softening of budgeting policy within the political cycle’s framework. Growth of budget expenditure directly resulted in the enhanced inflation rate observed toward the year’s end.

In October 2007 the volumes of exports and imports reached their historic high of the last 17 years. The second half-year was characterized by an increased role of the price factor in the formation of external trade aggregates. The exports growth rate in October, for the first time during the year, became higher than that of imports. At the same time, the number of countries with which Russia has a negative balance of trade is also growing. Russia and Poland signed a memorandum lifting the more than two-year-long ban on supplies of Polish meat to Russia, which should help in providing solutions to a number of strategic issues of foreign trade integration.

Another record of 2007 was an increase in the share of investments in fixed assets up to 19.4 % of GDP. In 2007 the volume of investments, according to preliminary estimations, rose by 18.8 % against 13.7 % in 2006 and against the average 12.1 % observed in 2000 - 2005. The high rate of investment demand was sustained by an increasing role of the domestic market in the shaping of the economy’s dynamics.

As estimated by directors of enterprises, the year 2007 was rounding up in a situation of a noticeable slowdown in demand throughout industry, which prompted enterprises to suppress their output growth. The output growth forecasts for early 2008 are less optimistic than similar forecasts made in late 2006. In Q IV the financial and economic status of enterprises was no longer improving, while at the same time approximately 90 % of enterprises are assessing their financial situation as good or satisfactory.

In December the Russian stock market demonstrated growth of quotations on the share market, which was associated with more positive global expectations concerning investments. Investor activity on the market of derivative financial instruments displayed a stable growth rate.

At the RF Government meeting the implementation of federal target programs and the federal targeted investment program during the first 9 months of 2007 was discussed in detail. On the basis of a newly adopted federal law, one more big state-owned corporation – “Rostekhnologia” – will be created. Besides, several important economic laws were approved, including the Laws “On mutual insurance” and “On self-regulating organizations”.

The political and economic results of December 2007

S. Zhavoronkov

By the general election’s results, four parties got access to the State Duma. The outcome of the Duma elections can be summarized as follows: United Russia has managed to keep its constitutional majority in parliament, the “referendum to test confidence in Putin” has indeed taken place and yielded a positive result, although the methodology of its actual conduct casts doubts as to its legitimacy. The candidate to succeed to the post of this country’s president has been determined. As for V. Putin, he was offered the post of Prime Minister by D. Medvedev, in the event of the latter’s very likely victory in the forthcoming presidential election. Such developments create opportunities for the emergence of an institute of co-rulers, wherein

Medvedev's role will, in time, become more prominent, while that of Putin will diminish. The stability of this dual power will depend, most importantly, on adequacy of the levels of political ambitions of them both.

December, as expected, has provided answers to several vital questions concerning the impending transfer of power. Besides, the completed elections to the Duma have also given food to much thought.

First of all, one should speak of the official results of the parliamentary elections. The voter turnout at the polls was 63.78 % (higher than that at the previous parliamentary elections but lower than at the presidential election in 2004). Four parties entered parliament: *United Russia* with 64.3 % of votes, the Communist Party of the Russian Federation (*CPRF*) with 11.57 %, the Liberal Democratic Party of Russia (*LDPR*) with 8.14 %, and *A Just Russia* with 7.74 %. Thus, just as we expected, the forecasts of a “two-party Duma” turned out to be groundless – both the *LDPR* and *A Just Russia* have passed the threshold although, similarly to the other rivals of *United Russia*, they were victims of abuse. In fact, this can be translated as obvious success for these two parties, especially for *A Just Russia* – a new party in Russia's politics, which has confirmed the current popularity of “the New Left” ideas, and which stands for a fundamental redistribution of public benefits, purified of Marxist dogmas and Soviet nostalgia. The election also turned out to be a success for the *LDPR*, whose losses as compared to the previous election were negligible, despite the fears that *United Russia's* aggressively populist campaign would win some of its former votes. However, it should also be pointed out that the results achieved by these two parties also reflect their endowment with resources – they both launched impressive newspaper campaigns and invested in surveillance of the election's conduct (which is particularly true of *A Just Russia*).

The results achieved by the *CPRF* invite rather skeptical comments. Firstly, their percentage of the vote is even lower than that at the 2003 election, especially if one considers the fact that this time the conditions for their campaigning were incomparably more favorable: during the previous election, the Communists were subjected to total ostracism by the state-owned TV channels, but now there was no counter-propaganda. Secondly, their most recent campaign was funded much more generously than in 2003 – the level of *CPRF's* expenditures was second only to that of *United Russia*, and they covered the cost of numerous large-scale handouts of printed matter and of a similarly large-scale observation at the election polls. At the same time, the Communists have certainly confirmed their parliamentary potential.

The other parties were featuring rather bleakly. The Agrarians gained 2.3 %, *Yabloko* -1.59 %, *Civil Force* - 1.05 %, the Union of Right Forces (*SPS*) - 0.96%, *Patriots of Russia* - 0.89 %, the list being bottomed by the “spoiler” *DPR* with its 0.13 %. Among these results, the old parties aspiring to represent the democratic voter – *SPS* and *Yabloko* – deserve a special commentary. The election has proved to be their ultimate failure as political subjects – considering, moreover, that the leaderships of them both have announced their “victories” and refused, in categorical terms, to resign. Of course, to be just, it should be said that *Yabloko* had practically no financial resources, while *SPS* was subjected to a massive denigrating campaign on the state-owned TV channels and confiscations of promotion printed matter (which indeed seems to be the real reason for their results being so oppressively low). However, the fact remains that *SPS* and *Yabloko* failed to approach the election threshold even in Moscow and St. Petersburg, their maximum gains in Moscow being 2.8 % and 5.6 %, respectively. Thus, the liberal flank of Russia's politics produced an empty space, which in a truly democratic situation would have certainly be filled. The same, by the way, can be said about the nationalists, whose votes were partly absorbed by the *LDPR* (although it would be a gross exaggeration to call the present-day the *LDPR* a nationalist organization¹), and partly, quite simply, fell outside of the election ballot (the list of the last moderately nationalist party, S. Baburin's *People's Union*, was not registered by the Elections Commission which had found their submitted signatures to be invalid).

A separate comment should be offered concerning *United Russia's* results. This is due in part to the fact that this party's vote was claimed to be a “referendum to test confidence in Putin” and in Putin's policy in a broader sense, and in part because such a result was achieved through large-scale direct falsifications, which had also been observed during the previous election cycle, but this time were even more open and numerous. Thus, in some Republics with totalitarian regimes (Chechnya, Ingushetia), where the poll turnouts were 99 % and 98 %, respectively, the party in power gained the same 99 % and 98 %². In Khabez raion of Karachaevo - Cherkessia both indices were even more brilliant – as high as 100 %. The party in power enjoyed

¹ In our opinion, the *LDPR* can be described as a structure of the populist-xenophobic type, whose principal message is that of the existence, within society, of numerous external and internal enemies, and the readiness of a charismatic leader to fight these enemies.

² In Ingushetia, during the action of protest “I Have Not Voted!”, statements from more than 20 % of the electorate have been collected in confirmation of the fact of their non-participation in the elections, with their full personal data.

fantastic success in the Republics of Kabardino – Balkaria, Mordovia, Karachaevo – Cherkessia, Dagestan and Tyva, as well as in the rural areas of Tatarstan, Bashkortostan and Kemerovo Oblast. Gross fraud was applied in the drawing of protocols, when observers received one protocol from a district elections commission (DEC), and then it was redrawn by the territorial elections commission (TEC), the results being entered in the State Automated System “Elections” in a considerably changed version (as a rule, for lack of time, the quantitative data of other parties were left unchanged or were changed only slightly, while the total poll turnout index was increased, and all the “imaginary” votes were added up for the benefit of the party in power). The discrepancies of this sort, registered and published by the observers for *the CPRF*, *SPS* and *A Just Russia*, have shown that in rural areas, by applying this simple technique alone, the party in power gained additional 10 – 15 % of votes, the geography of such tricks being very wide, including even Moscow Oblast. In big cities, with their mass media on the alert, more subtle technologies were applied – “merry-go-rounds” with the certificates issued to voters of their having been struck off the voters’ lists³, ballot-stuffing, and removal of observers.

The worst results were achieved by *United Russia* in Nenets Okrug (48.7 %), St. Petersburg (50.3 %), Yaroslavl Oblast (53.1 %), Smolensk Oblast (53.9 %), and Moscow (54.1 %). After that, the governors of Yaroslavl and Smolensk Oblast were made to submit their resignation⁴, while the heads of Chechnya and Ingushetia, on the contrary, were rewarded by membership in the Bureau of *United Russia*’s Supreme Council. The majority of developed countries, as well as pan-European institutions (OBSE, PACE) either ignored the elections in Russia, or estimated them negatively. However, there were some exceptions. Thus, France’s President N. Sarkozy congratulated Putin with the victory of *United Russia*.

On the whole, the outcome of the elections to the Duma can be summarized as follows: *United Russia* has kept its constitutional majority in parliament, and the “referendum to test confidence in Putin” has indeed taken place with a positive result, although the methodology of its actual conduct has given grounds to doubts as to its legitimacy.

The elections’ outcome, just as it had been expected, did not produce any immediate constitutional developments. However, one week after the parliamentary elections, V. Putin made his long-awaited announcement – namely, appointed his successor. Putin’s choice, while it can hardly be regarded as original, was to a certain degree unexpected – he named as his successor First Vice Prime Minister of the RF Government D. Medvedev. For a while in 2006, he was being enthusiastically displayed to public as a possible successor, but in 2007 his media coverage practically ceased, and in the last months forecasts pointed to V. Zubkov as the most likely candidate, closely followed by S. Ivanov and B. Gryzlov.

Medvedev graduated from the Department of Law of Leningrad State University, in the early 1990s joined the team of A. Sobchak, then Chairman of Leningrad City Soviet and later Mayor of the City of St. Petersburg. From 1991 to 1996 he worked under Putin at the Committee for External Relations of St. Petersburg. After a short interlude in business, in 1999 Medvedev, together with his boss, resumed his career in civil service and became Deputy Head of the RF President’s Administration. In 2003 he moved on to the post of Head of the RF President’s Administration, and from late 2005 – to that of First Vice Prime Minister of the RF Government supervising national projects. Since 2000, he has simultaneously been working as Chairman of the Board of Directors of *Gazprom*⁵. During his civil service, Medvedev showed himself as a not very brilliant, without a desire for global influence, but sometimes rather efficient lobbyist. Thus, for example, he helped to fight off the raider-type takeover of the timber holding “Ilim Pulp” engineered by the “forces” of a powerful oligarch O. Deripaska and his partners from the power structures. Besides, Medvedev won several other victories within the state apparatus in connection with appointments of governors or government officials. The results of Medvedev’s constructive activity are controversial: on the one hand, there was noticeable progress in the implementation of a number of “priority national projects”, in particular with the development of appropriate infrastructure and the granting of awards in the spheres of public education and public health care. But his failures are no less obvious, the most serious among these being the national

³ Having issued a ballot paper against the certificate, the member of the election commission, in violation of the law, does not take the certificate, leaving it instead at the voter’s disposal, after which the “merry-go-rounder” goes to vote in the next electoral district.

⁴ The heads of Moscow and St. Petersburg are too prominent figures to be removed in a moment, while Nenets Okrug, where the last governor elected by popular vote had been arrested and replaced by an appointed “outsider” from St. Petersburg, has long been known for its inclination to opposition.

⁵ This post is important, but not the key one – main powers belong to the company’s managerial board, since 2001 headed by A. Miller.

project “Affordable Housing” – in the course of its implementation housing, instead of becoming more affordable, became much less so due to an upsurge of housing prices.

When speaking of Medvedev, politologists emphasize several aspects. First of all, Medvedev is characterized as a liberal – at least to the extent possible within Putin’s circle. Secondly, Medvedev is considered to represent “the *Gazprom* group” within the fuel and energy complex, which competes both with its main state-owned rival – I. Sechin’s *Rosneft* – and with private companies. Thirdly, Medvedev features as a representative of a certain community of “St. Petersburg lawyers” (RF Minister of Regional Development D. Kozak, Chairman of the Supreme Arbitration Court A. Ivanov), and sometimes – even of the so-called “family” (R. Abramovich, A. Voloshin, etc.)

In this connection, the following can be said. The greatest liberal among Putin’s circle is Putin himself, if “liberalism” is to be estimated by appropriately demonstrated rhetoric. However, essentially the policies of either Putin or Medvedev can hardly be described as liberalism – be it in the economic or in the political sense. It would be enough to recall *Gazprom*’s audacious takeovers in recent years (“Sakhalin-2”, Kovykta, “Nortgaz”, legislation on gas export monopoly, etc.), let alone the whole recent Russian history of private property’s transformation into a semblance of feudal “fiefs” held from the “king” on certain conditions. At the same time, in contrast to some of his colleagues in Putin’s circle (e. g., например, S. Ivanov, V. Surkov, or former Procurator General V. Ustinov), Medvedev never attempted to resort to theoretic discourse in order to provide substantiation for Russia’s “special way” of development, preferring to speak of a “democratic version” of such development, according to which, in fact, this country’s political life is quite compatible with universally recognized democratic norms.

While speaking of *Gazprom* (where Medvedev is closer to Executive Director of *Rosukrenergo* K. Chuchenko, head of *Mezhregiongaz* K. Seleznev, and A. Usmanov who has grown, inside *Gazprom*, to its top ranks, rather than to A. Miller), one cannot but agree that the company’s evident striving to acquire assets in the territories of countries where rule of law is in full force is to a certain extent a guarantee against Russia’s ultimate descent into totalitarianism. It is also true that Medvedev’s relations with the group of officials within Putin’s circle most closely identifiable as the embodiment of the economic or political lawlessness of the last few years (I. Sechin, N. Partushev, V. Surkov, R. Kadyrov) are far from perfect – no matter whether it all has to do with different candidates to the post of president, or with purely business controversies. As for the version of Medvedev being supported by the “family”, we believe it to be quite groundless. Firstly, D. Medvedev replaced A. Voloshin in a situation that was far from being friendly, and secondly, all those who in 2006 were identified as Medvedev’s “support group” in 2007 already joined the “support group of Sergei Ivanov”, that is, were simply going with the flow of Kremlin gossip.

One important circumstance, by the way, could have been the easy-going way in which Medvedev survived the temporary exclusion from the ranks of “successors” – this lack of ambition could be visualized as a valuable trait by V. Putin who wanted to keep, in some or other form, the status of “co-ruler”.

As for Putin himself, he was offered by Medvedev – evidently by a previous agreement – the post of Prime Minister in the event of the later’s very likely victory in the presidential election. Putin acted very simply – not being impressed by the dubious speculations of him becoming a “national leader” without any official status, he secured for himself the second constitutionally important post, which, no doubt, he is going to fill with the second-in-importance financial and symbolic content. At the same time, it would be wrong to say that Putin actually is going to remain the country’s leader, considering the once again confirmed policy of the Constitution’s unchangeability – one simply has to bear in mind that, according to the Constitution, a Prime Minister can be dismissed from his post by a president’s edict alone, without any need for parliament’s approval. It would be correct to speak of an institute of co-rulers where, no doubt, Medvedev’s role will be growing in prominence, and that of Putin – diminishing. As for the stability of such dual power, it will primarily depend on the adequacy of the ambitions of both these figures, and especially Putin’s, whose main guarantee under conditions of a non-ideological regime will be unofficial human friendliness and his successor’s gratitude.

After the successor’s candidacy was finally determined, he received support from *United Russia* and *A Just Russia*, while from the formal point of view Medvedev had been nominated at the party in power’s congress. On the other hand, the manner in which the party in power silently sealed V. Putin’s choice, is by no means an evidence, in our opinion, of any strengthening of “party trends” in the activity of Russian bureaucracy.

The “commander” of D. Medvedev’s headquarters became Head of the RF President’s Administration S. Sobianin, and not the actual “director of policies” V. Surkov. This is yet another confirmation of the doubtful political future of Kremlin’s “chief technologist” V. Surkov, who was too obviously in favor of the scenario involving S. Ivanov’s “successorship”.

As for the presidential election itself and the authorities' goals, the answer will become evident in a month's time. The main issue, in brief, is this: whether V. Putin truly needs the highest vote for his "successor" and, consequently, the highest legitimacy of the election, or, on the contrary, both the vote and legitimacy should feature far less prominently. However, even if the latter is true, it would be technically very difficult to ensure a "limited vote" during the election.

From the point of view of the election's legitimacy, the issue of access to it of a democratic candidate – M. Kasianov (beside G. Ziuganov and V. Zhirinovskiy who, as candidates from parliamentary parties, are registered automatically) - remains no less important.

Budgetary and Tax Policy

O.B. Kirillov

In November, the growth in federal budget expenditures has expressly exceeded the revenues. The increase in expenditures happened largely due to the two factors: the reduced backlog versus the estimated budget and the forthcoming elections of the Deputies to the State Duma and the RF President. This was also based on the significant irregularity in revenues, administered by the Federal Tax Service. As a result, the share of this category of revenues in GDP has exceeded for the first time in 2007 the relevant indicator of preceding year. In November, the Central Bank of Russia has proposed to perform the exchange operations with the RUR portion of the Stabilization Fund in foreign currency in the open market. This is explained by irregular budget spending during the year, by the elections to the State Duma and the approaching elections of the RF President. It should be noted that a significant mitigation of fiscal policy in view of general political trend has accelerated the growth of prices at the end of the year.

A remarkable event in November 2007 in the budgetary sphere was a significant excess of federal expenditures (31.31 per cent of GDP) over the revenues (22.36 per cent of GDP), resulting in a substantial deficit (8.96 per cent of GDP) (see Figure 1). Such a significant deficit is unusual to the Russian federal budget, but we have predicted the substantial increase in budget expenditures at the end of the year in the previous survey. A similar situation was observed in 2005. In that year, in September and December the federal budget deficit amounted to 0.29 per cent and 0.99 per cent of GDP respectively. However, it is worth noting, that the share of deficit in GDP was significantly lower than in November 2007.

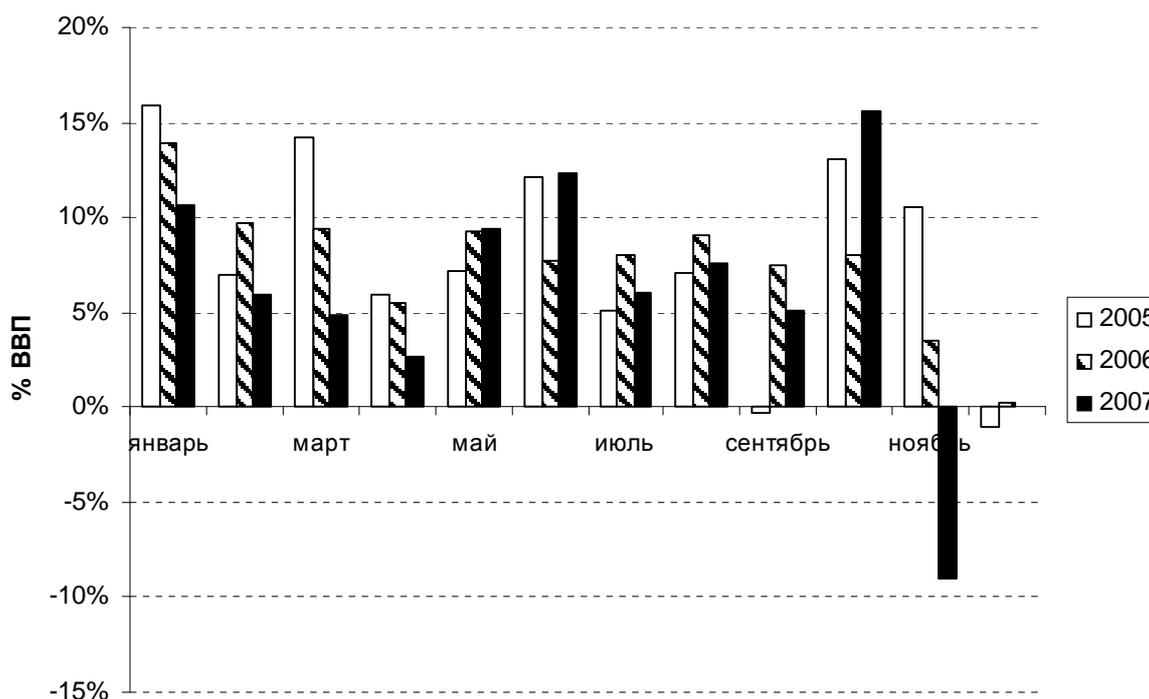


Fig. 1. Deficit(-)/Surplus(+) of the RF Federal Budget in 2005-2007 (per cent in GDP)

Despite the explicit growth of expenditures of the RF budget in November⁶, in general, within January-November of 2007 revenues have still exceeded the expenditures (See *Table 1*).

Table 1.

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

	2005	January- November 06	2006	January- November 07
Revenues	23,7%	23,12%	23,5%	23,67%
Expenditures	16,2%	15,09%	16,2%	17,47%
Deficit (-)/ Surplus (+)	7,5%	8,02%	7,4%	6,20%

Source: RF Ministry of Finance, RF Treasury, IET estimates.

There are two major reasons for dramatic growth in federal expenditures at the end of 2007. First, the mitigation of fiscal policy in the framework of the current political cycle in anticipation of the parliamentary and presidential elections. Second, the irregular budget expenditures during the fiscal year and as a consequence, the growth of expenditures at the end of the year.

We have considered the execution of the federal budget on cash basis as compared with the budget estimates for the first three quarters of 2007 in detail in the preceding survey. Now we would like to note again, that in general, the execution of the federal budget on cash basis, in terms of revenues, as well as expenditures, in the course of the year has gradually approached the budget estimates for the relevant period. At the same time, while the revenues in the third quarter of the year have exceeded the budget estimates, the expenditures fell behind the planned value by 16.2 per cent. It is worth saying, that the explicit growth of national budget expenditures has boosted up the inflation rate at the end of 2007.

Attention should be paid to the comments of Alexei Kudrin, the Minister of Finance, on the irregular execution of the federal budget in terms of targeted programs and national projects. He has stated, that the quotas of the federal funds for the government authorities were disclosed for the period after January 1, 2007. The problem is in untimely decisions on financing some projects, as well as delays in development of design documentation for eighty objects of targeted federal investment program. An important factor was the entry into force of the new City Planning Code. A series of regulatory documents should have been worked out for its implementation, which appeared only in April.

The data on financing of federal budget expenditures in January-October 2007, provided by the RF Ministry of Finance, can be seen below

Table 1.

**Amount of Revenues to the RF Federal Budget in 2005-2007
(% in GDP)**

	2005	January- November 06	2006	January- November 07
Federal issues	2,58%	2,31%	2,19%	2,67%
Including expenditures associated with the servicing of federal and municipal debt	1,06%	0,70%	0,65%	0,50%
National defense	2,71%	2,68%	2,57%	2,79%
National security and law enforcement	2,05%	2,20%	2,08%	2,23%
National Economy	1,17%	1,25%	1,31%	2,17%
Housing and public utilities	0,04%	0,19%	0,20%	1,00%
Environmental protection	0,02%	0,03%	0,03%	0,03%
Education	0,73%	0,82%	0,78%	0,96%
Culture, cinematography and mass media	0,22%	0,20%	0,21%	0,23%
Health care and sports	0,42%	0,58%	0,56%	0,67%
Social policy	0,88%	0,86%	0,81%	0,78%
Interbudgetary transfers	5,77%	5,92%	5,68%	6,48%
Total expenditures	16,58%	17,05%	16,40%	20,01%

Source: RF Ministry of Finance, IET estimates.

⁶ Expenditures of the federal budget have accounted to RUR 618.2 bln in October and RUR 984.5 bln in November 2007. Thus, the monthly growth has approached 60 %.

There were no significant changes in the revenue portion of the federal budget within the past month. The structure of tax revenues of the federal budget for the period under review as broken by individual federal administrative bodies is presented in *Table 3*.

Table 3.

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

	2005	January- November 2006	2006	January- November 2007
Taxes and other payments administered by the Federal Tax Service	12,33%	11,17%	11,27%	11,67%
Taxes and other payments administered by the Federal Customs Service	9,73%	10,58%	10,76%	9,96%
Receipts administered by the Federal Agency for Management of Federal Property	0,27%	0,26%	0,26%	0,27%
Revenues of the federal budget administered by other federal structures	1,35%	1,11%	1,25%	1,77%
Total revenues	23,67%	23,12%	23,54%	23,67%
<i>Reference: an average price for Urals oil for the period (USD per barrel)⁷</i>	50,20	61,12	60,89	67,75

Source: RF Ministry of Finance, IET estimates



*Fig. 2. Oil and gas revenue and other than oil-and-gas deficit of the federal budget in 2006-2007.
(in % of GDP)*

Within January-November 2007, there is observed some access in the revenue, raised by all federal administrative bodies as compared with the relevant indicators of preceding year, except for the Federal Tax Service (the reduction in revenues of this administrative body made 0,62 % of GDP). The decline is largely based on the reduction of export customs duties by 1.53 per cent of GDP versus the level of preceding year.

Monthly dynamics of oil and gas revenues and the federal budget deficit thereof are presented in Fig. 2. Other than oil deficit is one of the key indicators for external economic risks estimation in terms of national reserve stability. As can be seen from the graphs below, the re is a trend to reduction of the share of oil and

⁷ These prices are calculated as a simple average monthly price used for tax purposes

gas revenues in the federal budget and GDP. This is a sign of some decrease in the budget dependence on the commodity sector in the Russian economy. At the same time, the share of oil and gas revenues, despite a slight decline, remains rather high. The average non-oil deficit of the federal budget for the period under review remained within 2-6 per cent of GDP. This reflects the sustained risks to the stability of public finance and requires prevention from excessive mitigation of fiscal policy on the part of the government.

As of December 1, 2007 the cumulative volume of the RF Stabilization Fund in the Russian ruble equivalent amounted to RUR 3517.05 billion, or 11.1 per cent of GDP (in annual terms). Fig. 3 presents monthly dynamics of the Stabilization Fund (in per cent of GDP). It is worth noting, that Stabilization Fund share in GDP in the current year has substantially exceeded the indicators, observed in preceding year.

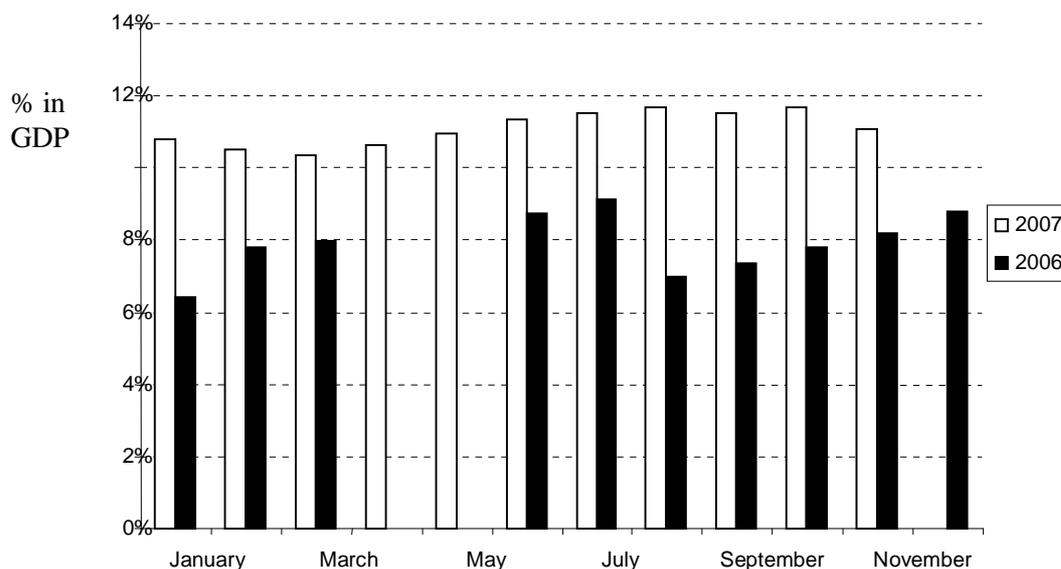


Fig. 3. The RF Stabilization Fund in 2006-2007 (in % of GDP)

Note: Data for April and May is not available.

Proceeds from the placement of the Stabilization Fund assets of the Russian Federation in 2007 amounted to RUR 151.89 billion. Those revenues include the ruble equivalent of USD 6.20 billion, transferred by the Bank of Russia in the form of interest for the usage of the Stabilization Fund assets in foreign currency, placed in the accounts with the Bank of Russia as of December 15, 2007. The estimated return on the Stabilization Fund placement for the period from December 15, 2006 to December 15, 2007, has amounted to 10.94 per cent per annum (in USD). The exchange rate differences from the revaluation of balances in the account of the Stabilization Fund in foreign currency for the period under review has amounted to – RUR 58.59 billion.

Inflation, Monetary and Credit Policy

P. Trunin

In November the inflation continued in the Russian Federation, having made 1.3 per cent as compared with 0.6 per cent in the relevant period of the preceding year. Herewith, foreign currency assets were being accumulated in the country, having exceeded USD 467 bln. Significant reduction of commercial banks' reserves with the RF Central Bank was noted in October due to unfavorable situation in the interbanking credit market. In November - December, the situation in the Russian interbanking market has been stabilized both, due to the funds, allocated by the government of Russia to finance development institutions, and as a result of the measures of the Bank of Russia to increase the liquidity reserves, available to the Russian banks.

The consumer price index in November made 1.2 per cent (against 0.6 per cent in November 2006 (see Fig. 1.). Such high rates of consumer prices growth in November were observed for the last time only in 2002, when monthly CPI has exceeded 1.6 per cent. The utmost contribution to the prices growth, like in preceding month, was caused by foodstuffs (+ 1.9 per cent). It is worth noting, that in November the upsurge of those products reached 1.5 per cent, regardless fruit and vegetables. The utmost growth was observed in

fruit and vegetables (+6.2 per cent), milk and dairy products (+3.7 per cent), pasta (+3.3 per cent), cereals and beans (+ 2.9 per cent), oil (+2.3per cent). Sugar was downgraded by 1.6 per cent in November.

In November, high rates of growth were observed in regard to non-food items, which average nation-wide prices have increased during the month by 0,9per cent (versus + 0,6per cent in November 2006). The highest growth rates were noted in November for petrol (+2.3 per cent), footwear (+ 1.2 per cent), knitwear (+ 1.3 per cent), clothes and underwear (+ 1.2 per cent), detergents and cleaning agents (+ 1 per cent) and medical supplies (+ 1.1per cent). Downgrading was not observed in any type of non-food items.

Commercial public services have grown in price in November by 0.6 per cent (+ 0.5 per cent in November 2006). The utmost growth was observed in regard to preschool and school education (+ 1.4 per cent), culture organizations (+ 1.5 per cent), housing utilities (+ 1.2 per cent), public transportation (1.2 per cent), health-care services (+ 1.1 per cent). Downgrading was noted in November were observed for health-care and resort services (– 0.2 per cent).

Thus, in November the growth rates of consumer prices fell down in comparison with October, but still remained significantly higher than in the year of 2006. On 13 December, the RF Ministry of Economic Development ha submitted a plan to reduce the rate of consumer prices for 2007-2008. First of all, it is worth noting that most of the activities set forth in the Plan, are medium and long-term measures. In other words, the plan, submitted by the RF Ministry of Economic Development, will not reduce the inflation rate in the short term. Apparently, in the first half of next year, the inflation rate in Russia will remain rather high. The proposals, outlined in the Plan, are aimed at the development of trade infrastructure, improvement of prices for the products of mineral resource monopolies, encouragement of competition. Undoubtedly, such proposals are sound and able to provide a positive impact over inflation rate in the country. However, it remains unclear to what extent the proposed measures will be implemented, taking into account the slow progress on these trends in structural reforms within the recent years.

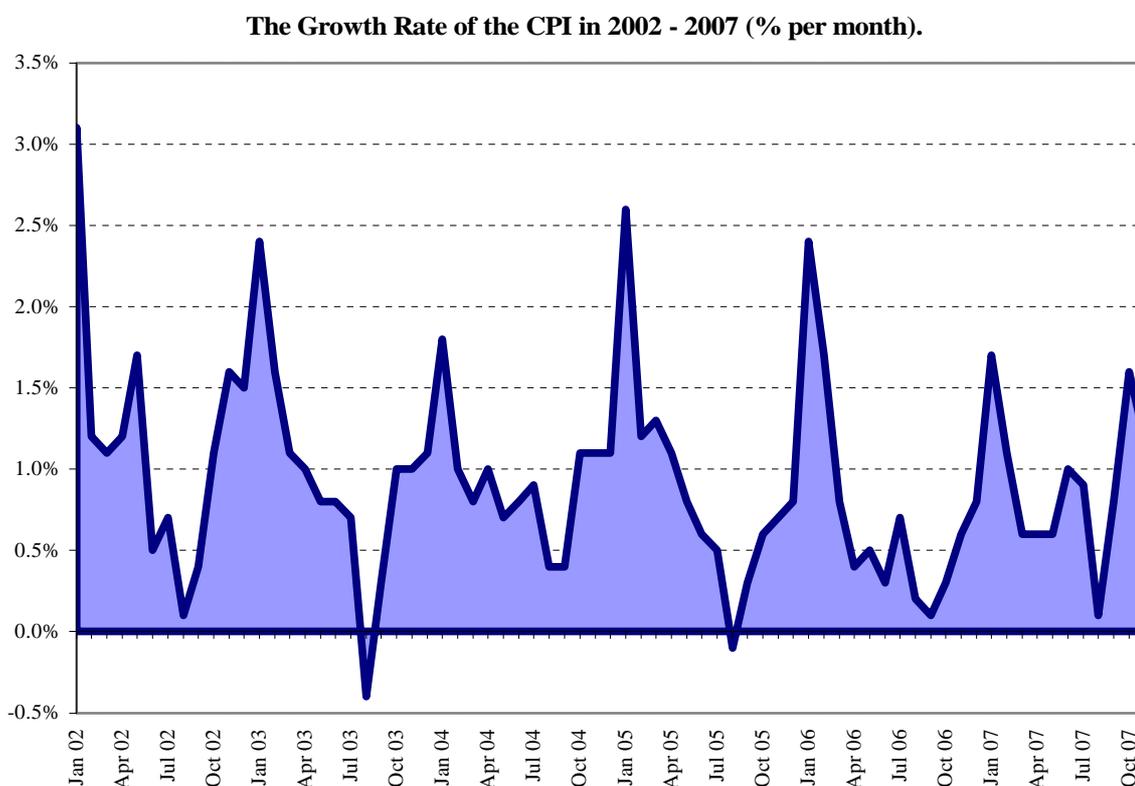


Fig. 1. Source: RF Statistical Service

Finally, it was not clear, what steps should be taken in fiscal policy, which are also mentioned in the Plan, to reduce the inflation in the short term. Apparently, the reduction of public spending is problematic on the eve of the presidential elections, and high oil prices and a possible inflow of capital create the circumstances for the further expansion of monetary supply and support inflation. In such a situation, according to our estimates, the CPI will reach 4.5-5per cent as a result of the first quarter of 2008.

Consumer price index⁸ in November made 1.1 per cent (– 0.6 per cent against the relevant period of preceding year). In our view, this fact is quite natural result of expressed extension of monetary offer in the current year, as well as the growth of foodstuffs prices in autumn.

Within November 2007 the volume of monetary base (in broad definition⁹) has been increased by RUR 245.3 bln to the amount of RUR 4650.4 bln (– 5.6 per cent). The volume of monetary base in broad definition as of November 1, 2007 was RUR 4405.1 bln. Let us consider the dynamics of monetary base in broad definition by components. The volume of cash in circulation, including the cash balances of credit institutions, as of December 1, 2007 was RUR 3,64 trillion (+ 3.7 per cent as compared with November 1), the correspondent accounts of credit institutions with the Bank of Russia made RUR 677,4 bln (+ 32,7 per cent), mandatory reserves – RUR 222.8 bln (–14.5 per cent), credit organizations' deposits with the Bank of Russia – RUR 87.5 bln (–14.5 per cent), the value of the Bank of Russia's bonds held by credit institutions – RUR 20.5 bln (+ 6.2 per cent). Therefore, further growth of commercial bank's reserves with the RF Central Bank took place in October, based on reduction of liquidity problem. At the same time, before the assets, allocated by the government to the development institutions, were available at the market, credit organizations were using the Central Bank credits under securities: at the end of November, the volume of direct daily REPO transactions reached RUR 300 billion, what is higher than the peak value of the August of this year. Here-with, the volume of those transactions remained at a rather high level throughout November, indicating preservation of tension in the Russian financial market. At the same time, by mid-December, the volume of REPO transactions has decreased, and the rates at the interbank market have come back to the range of 3 – 4 per cent per annum. Sustainability in the interbank market in the next year will be largely determined by the dynamics of the budget expenditures, as well as income of private capital and export duties to the country.

The growth of cash in circulation in November of the current year (by 3.7 per cent) at the background of increased mandatory reserves (by 14.5 per cent) has resulted in extension of the monetary base in narrow definition (cash + mandatory reserves)¹⁰ by 1.4 per cent (*see Fig.2*). At the same time, the gold and foreign currency reserves of the RF Central Bank also grew by 3.7 per cent and amounted, as of November 1, to USD 463.5 bln. Within the first two weeks of December they have increased by 0.8 per cent more and reached the level of USD 467.4 bln. A greater portion of the national liquidity inflow was accumulated in the RF Stabilization Fund, which volume as of December 1, 2007 amounted to RUR 3517.1 bln, or 11.1 per cent of GDP (– RUR 132.2 bln against November 1 of 2006). The volume of the RF Stabilization Fund has grown by RUR 140.2 bln within the relevant period of preceding year. The reduction of the RF Stabilization Fund was caused by the transfer of some part of the assets to the Bank of Development, the Government Nanotechnology Corporation and the RF Investment Fund.

Therefore, in November-December, the inflow of currency into the country has renewed as a result of sustained oil price growth, as well as due to resumed capital inflow from private sector. As a result, the real effective exchange rate of the ruble started to grow again: while in August-September it practically stayed at the same level of 129.4 – 129.6¹¹, in November it has grown to 130.6 (*see Fig. 3*).

In November there was noted further USD downgrading in the world currency market, causing its further weakening in the RF: by the end of the month the dollar rate RUR 24.35. Despite the significant strengthening of the ruble against USD, the Bank of Russia has maintained the value of bi-currency basket¹². As a result, the EURO has grown to RUR 36.04 by the end of November.

⁸ Basic index of consumer prices is an indicator of the inflation level without regard to seasonal price reduction (fruit and vegetable products) and to administrative measures (tariffs for government-regulated services, etc.). It is estimated by the RF Statistics Service.

⁹ 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.

¹⁰ Monetary base in a narrow definition is a monetary instrument (an indicator of monetary supply volume), which is fully controlled by the RF Central Bank. The Monetary base in narrow definition includes the cash in circulation, issued by the Bank of Russia (and the balance on the accounts of credit organizations), balances on the accounts of mandatory reserves of the funds in the national currency attracted by credit institutions in national currency, deposited with the Bank of Russia.

¹¹ The level of 2002 is accepted as 100 per cent.

¹² Bi-currency market is an operational index, used by the RF Central Bank in foreign currency policy. Currently, the share of EURO makes 45 %, USD share is 55 % in the basket.

Changes in the Monetary Base and in the Gold and Foreign Currency Reserves in 2006 - 2007.

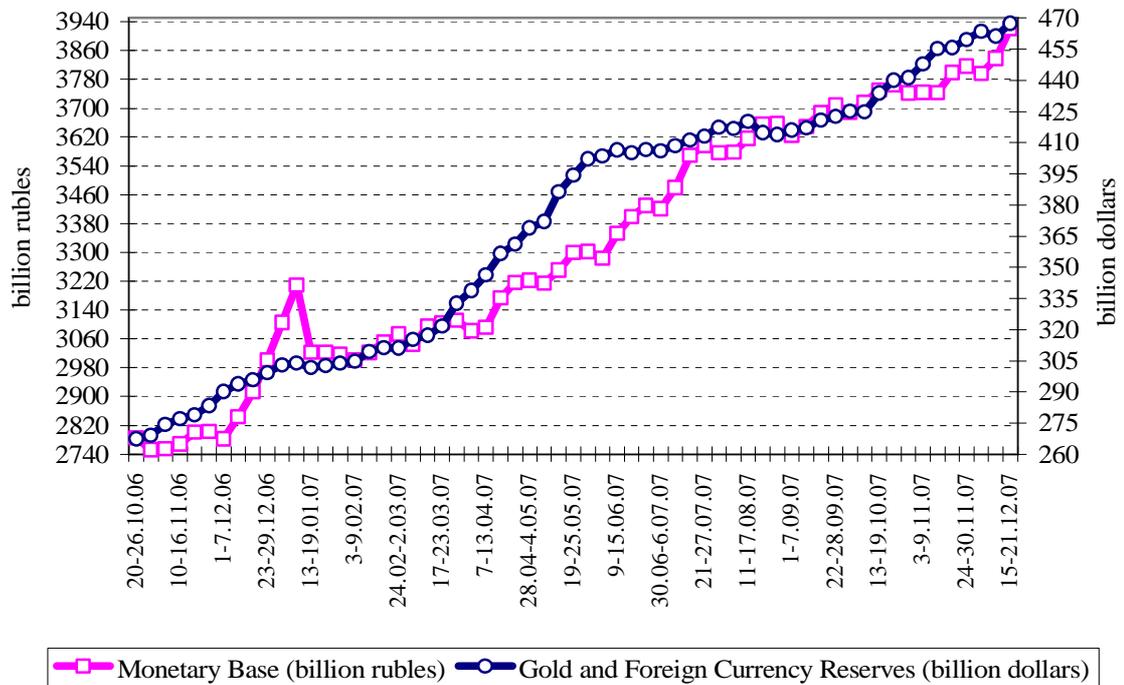


Fig. 2.

Source: RF Central Bank

Indicators of Ruble's Exchange Rate Dynamics

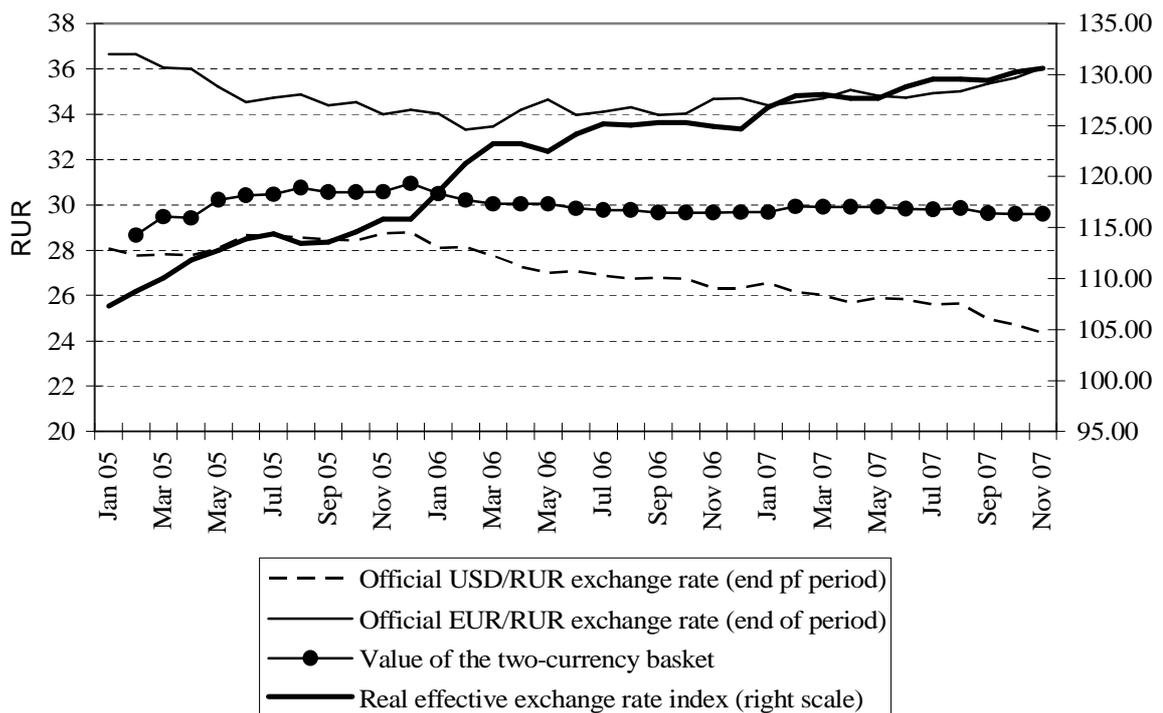


Fig. 3. Indicators of RUR Exchange Rate Dynamics in January 2002 - November 2007 rr.

Source: RF Central Bank, authors' estimates.

According to the information of the Federal Treasury, payments under external debt in November of the current year have made USD 1248 million. The amount of USD 1060.1 million was addressed to repayment of the external debt and USD 187.9 million was paid for the services thereof. Herewith, USD 632.4 million was million was spent to cover the debt of Russia, 90.2 million for the World Bank and EBRD loans, USD 451.3 million for loans raised upon bonds and USD 74.1 million under intergovernmental agreements.

To reduce tension in the banking system, the Central Bank of Russia has taken a series of measures, aimed at increasing liquidity resources in November-December, governed by the Russian credit organizations.

First, from November 28, the Central Bank of Russia has started to make lombard loans for the term of one day at a fixed rate of 8 per cent per annum. Moreover, in addition to the existing direct REPO auctions, the banks have got an opportunity to take credits from the Central Bank under securities for one day at a fixed rate of 8 per cent and for one week at a fixed rate of 7 per cent. This measure has allowed to limit the rates in the interbank market to eight per cent, as the excess of this value makes it more profitable to commercial banks to take credits from other credit institutions, rather than the Central Bank of Russia.

Secondly, on the fifth of December, the Bank of Russia has published a list of 24 issues of Eurobonds, under the security of which the banks can be able to attract credits of the Central Bank of Russia. In December, the information was disclosed, that the Bank of Russia intends to enter the stock exchange market to provide funds to the banks under stock bonds.

Third, from December 27, the Central Bank of Russia started to provide credits to the banks under the loans and promissory notes of reliability categories I and II. However, those guarantees will be accepted only from the companies, engaged in mineral resource extraction, manufacturing, production and distribution of electricity, gas and water, construction, transportation and communications, have a business record over three years and a share in the bank capital at least by 20 per cent (or the bank shares in the company).

Those measures will make for extension of the amount of funds, available to commercial banks in the event of deterioration of the situation in financial market. At the same time, after allocation of the funds, dedicated by the government to development institutions, the Bank of Russia has placed the bonds worth about RUR 60 billion to reduce excessive liquidity funds.

Financial Markets¹³

N. Burkova

In December, a number of measures, taken by the United States have inspired positive expectations of the investors worldwide, as compared with November situation, including the Russian stock market, where the growth of the stock market quotations was observed. MICEX and the RTS indices have also increased. The steady growth in the activity of investors was noted in the market of financial derivatives, in particular in the RTS.

Government securities market

Despite the increase in liquidity, the situation in the Russian market of government securities in December was characterized by persistent dynamics of investment activity and smooth decrease of secondary markets growth.

As of December 21, the Russian Eurobonds' RUS 30 yield to maturity made 5.54 per cent per annum, RUS-18 – 5.60 per cent per annum. As of the same date, the yield to redemption of the Russian Eurobonds made: for the seventh tranche of external currency debt bonds – 5.45 per cent, the fifth tranche of external currency debt bonds 5.31 per cent (See Figs 1 and 2).

¹³ In the course of preparation of the survey, there were used analytical materials and surveys published by the Zenith Bank, investment company ATON, MICEX, and the materials presented at web sites of Russian issuing companies.

FIG. 1.

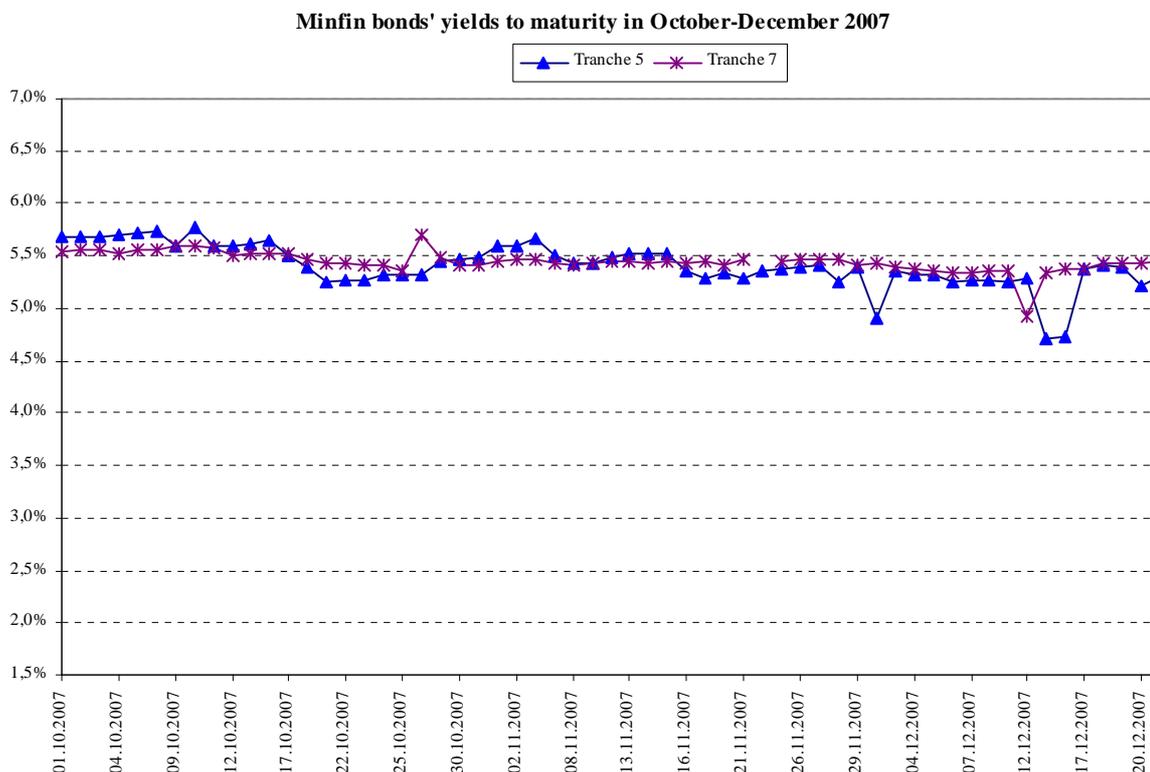
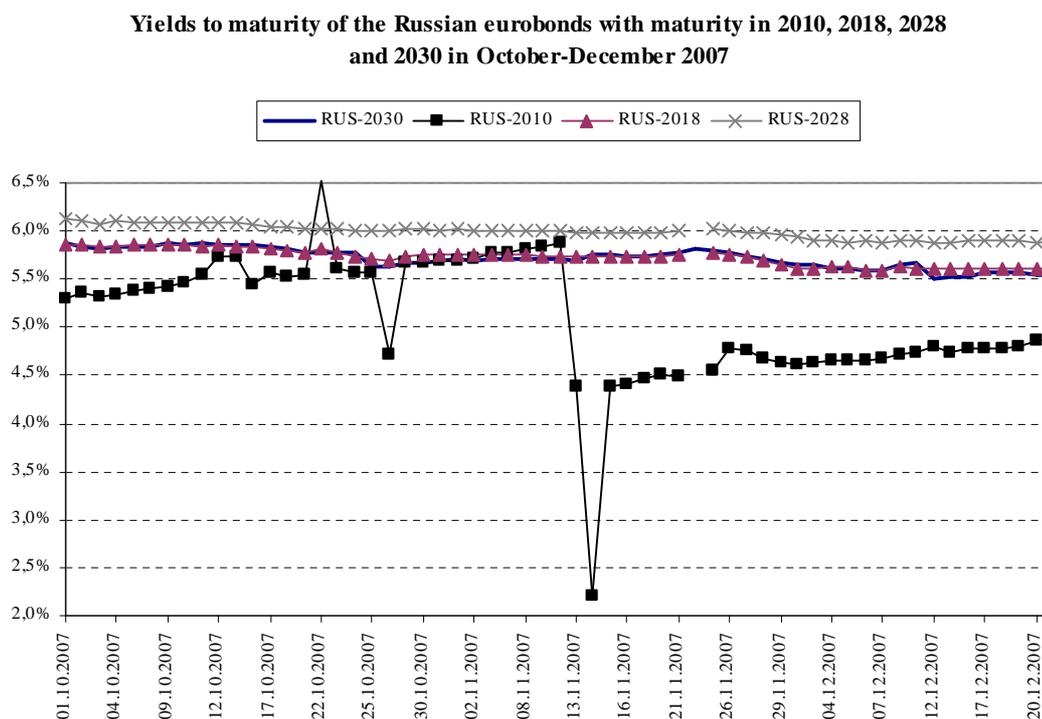


FIG. 2.



A smooth decline in yields to redemption was observed within the month in the ruble debt market as well. However, the activity in the debt market has been increased by several times, what is largely based on the measures taken by the RF Central Bank on attraction of additional funds to cover the deficit of liquidity, including daily measures.

Within the period from November 24 to December 21 the total turnover of GKO- OFZ secondary market amounted to approximately RUR 99.81 billion with an average daily turnover of RUR 4.99 billion. (About RUR 33.84 billion with an average daily turnover of RUR 1.69 billion in November). Two auctions on addi-

tional OFZ placement were arranged in December. Thus, the auction on placement of OFZ series 46018 was held on December 12 for the amount of RUR 4 billion, actual placement made RUR 3.8 billion with an average weighted yield of RUR 6.49 per cent per annum. Another auction on placement of OFZ series 26199 was held on December 18 for the amount of RUR 0.3 billion, with an average weighted yield of RUR 6.29 per cent per annum.

As of December 24, the GKO-OFZ market amounted to RUR 1047.4 bln at face value and to RUR 1053.3 bln at market value. The duration of the GKO-OFZ market portfolio was 2104.28 days, having decreased by 13.34 days as apposed to the preceding month, when that value made 2117.62 days (as of October 26).

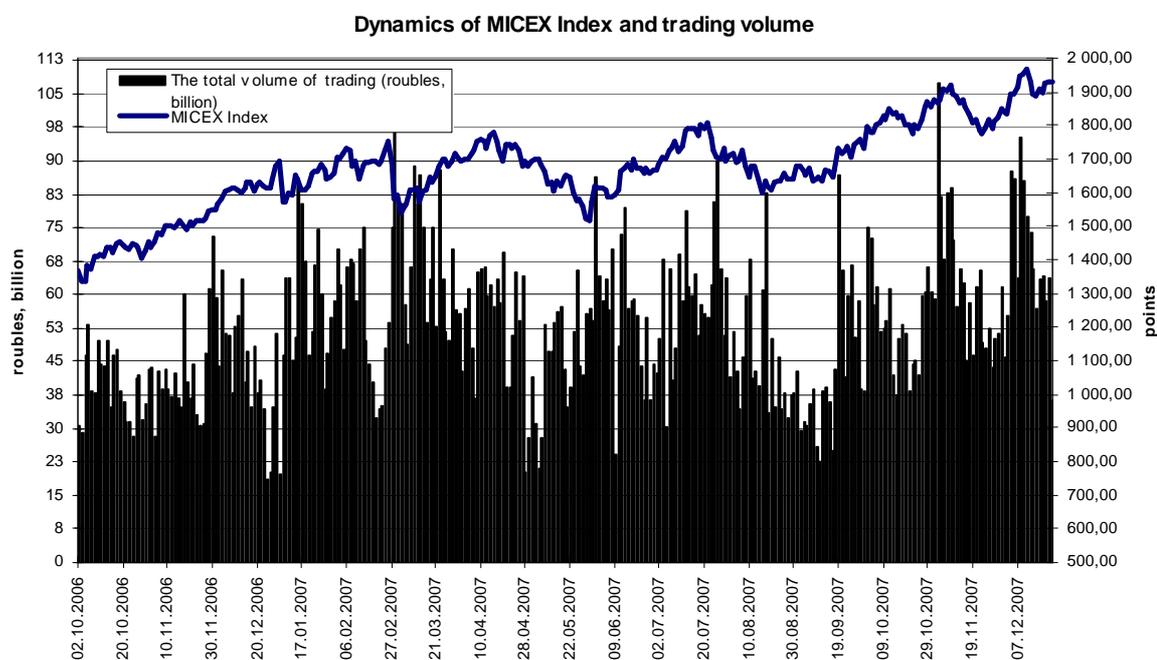
Equity Market

Stock market situation

Reduction of the key interest rate by a quarter of the percentage point by the USA Federal Reserve System has affected positive expectations of the Russian stock market participants. Throughout December, there was observed a strong and continuous price growth in the Russian stock market.

However, positive impact on the overall dynamics of the market was provided by growing activity in the oil and gas sector in view of the decision of the Central Bank to support the ruble liquidity, as well as a number of positive corporate news. As a result, the MICEX index has reached a new its historical peak of 1969.91 points, having grown as of December 12 by 16.42 per cent since the beginning of 2007. Earlier peak of MICEX index was recorded on December 11, 2007 at the level of 1951.38 points. The MICEX index growth in December has reflected the general trend of the growth of the Russian companies quotations (See Fig. 3).

FIG. 3



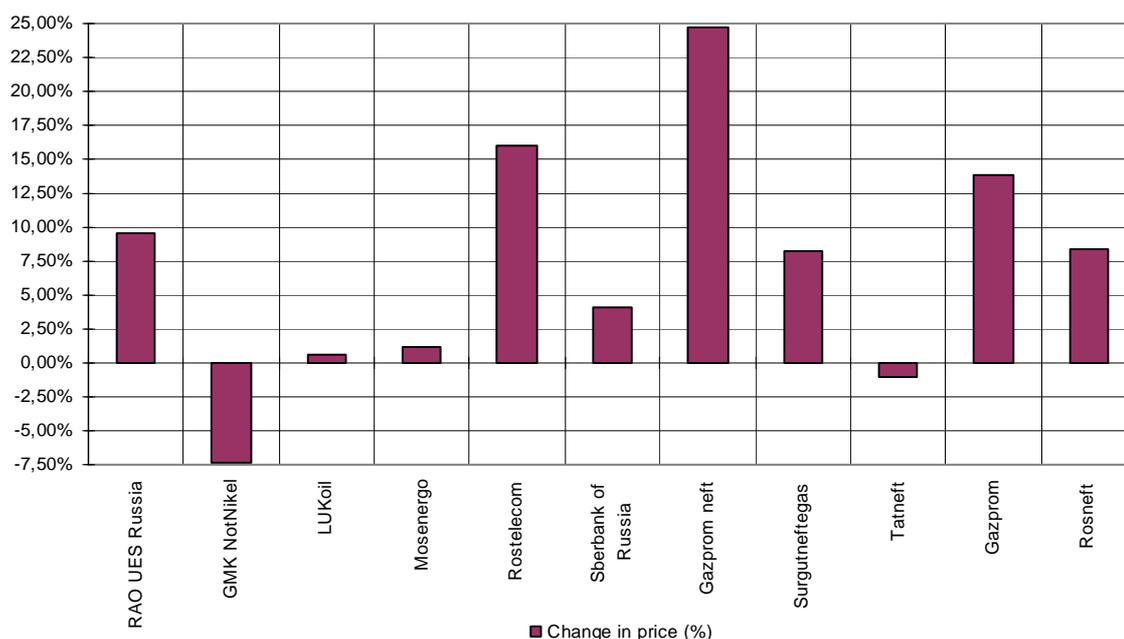
In general, within the period from November 24 through December 24, the MICEX index has decreased by 7.6 per cent, i.e., by 136 points in absolute terms. Within the same period, the turnover of trades on shares, included in the MICEX index, made about RUR 1338 bln at an average daily turnover at the level of RUR 63.71 bln (as compared with about RUR 1301.41 bln at an average daily turnover at the level of RUR 65.07 bln within October 26-November 23). Therefore, the investors' activity in the stock market in December has implicitly downgraded as compared with the preceding month. The indicators of maximum and minimum turnover in the market trades in December made RUR 95.2 bln (as of December 10) and RUR 36.5 bln (as of December 24), accordingly.

As of monthly results (from November 24 through December 24), practically all "blue chips" have shown a steady growth in their market values, except for "Nornickel" and "Tatneft", whose shares have been downgraded in December by 7.4 per cent and 1.09 per cent accordingly. The leaders in terms of growth rates were "Gasprom Neft", whose shares have grown by 24.72 per cent, "Rostelecom" (16.10 per cent), "Gasprom" (13.83 per cent), RAO "UES of Russia" (by 9.55 per cent). Some lower rates of growth were recorded in the

shares of “Rosneft” (by 8.43 per cent), “Surgutneftegas” (by 8.25 per cent), “Sberbank of Russia” (by 4.14 per cent), Mosenergo” (by 1.23 per cent), “LUKOIL” (by 0.66 per cent) (See Fig. 4).

FIG. 4.

Dynamics of the Russian Blue Chips from November 24 to December 24, 2007



In December the MICEX turnover leaders¹⁴ were: “Gazprom”(37.4 per cent), “Nornickel” (14.2 per cent), “LUKOIL” (9.3 per cent), “Sberbank of Russia” (8.2 per cent) and RAO “UES of Russia” 97.2 per cent). The total share of transactions with the above companies’ shares made 87 per cent of the gross turnover in the traditional MICEX stock market.

In terms of capitalization, as of December 24, the top five leaders of the domestic stock market were¹⁵: “Gazprom” (RUR 7448 bln), “Sberbank of Russia” Russia (RUR 2161 bln), “Rosneft” (2067 bln), “LUKOIL” (RUR 1883 bln), GMK “Norilsk Nickel”(RUR 1362 bln).

Futures and options market

In December the investors’ activity in the MICES futures and options market has expressly decreased as compared with the preceding month. Thus, in that period the total turnover in the MICEX futures and options market amounted to approximately RUR 132.5 bln (322 transactions, 5.28 mln of contracts) against about RUR 132.5 bln (335 transactions, 5.84 mln of contracts) in November.

An adverse situation was observed in the RTS futures and options market, where the investors’ activity in December has expressly increased as compared with the preceding month. Thus, in the period from November 24 through December 24 the total turnover in the RTS futures and options market amounted to approximately RUR 1399.3 bln (1.704 thousand of transactions, 21 mln of contracts) against about RUR 1155.63 bln (1519 thousand of transactions, 16.74 mln of contracts) in November.

The greatest demand, as before, was for futures: the volume of trading in futures in the period under review was RUR 1099.3 bln (1659 thousand of transactions, 16.6 mln of contracts). Options enjoyed a far lower demand, with the volume of trading at about RUR 300 bln (45 thousand of transactions and 4.41 mln of contracts). The highest level of trading in the futures market was RUR 126.8 bln (as of December 13), the lowest was RUR 17.9 bln (as of December 28).

Corporate bond market

As of December results, an explicit growth was observed in the total volume of trading in corporate bonds (about 30 per cent) as compared with the preceding month.

From November 24 through December 24 the price index of corporate bonds traded on MICEX¹⁶ has grown by 0.06 points (- 0.05 per cent), as well as the index of the ten most liquid corporate bonds, which

¹⁴ At the classical stock market.

¹⁵ According to RTS data.

have grown by 0.48 points (- 0.41 per cent) (See Fig. 5). In December, a significant growth was recorded in the market of corporate bonds (over 30 per cent) as compared with preceding month.

Within that period the total turnover in MICEX corporate bond sector amounted to nearly RUR 58.6 bln with an average daily turnover of RUR 2.79 bln (about RUR 44.35 bln with an average daily turnover of RUR 2.22 bln in the relevant period of September). Therefore, the investors' activity has noticeably increased within the month.

FIG. 5

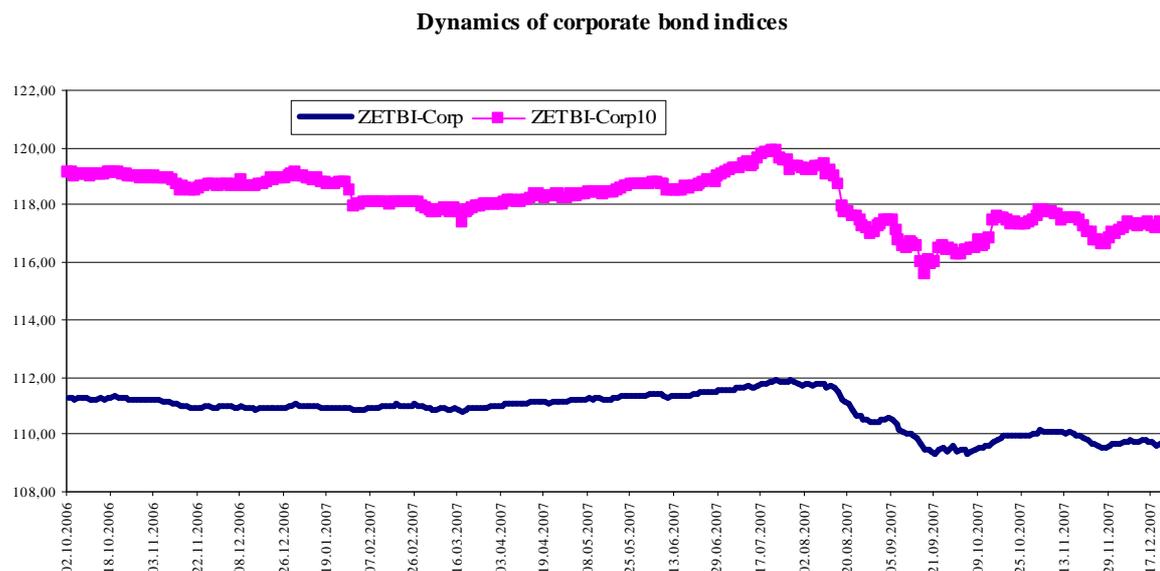


Table 1.

Dynamics of international stock market indices

Data as of December 24, 2007	Ticket	Value	Dynamics within the month (%) ¹⁷	Dynamics from the beginning of the year (%)
MICEX (Russia)	MICEXINDEXCF	1929.31	7.67%	13.93%
RTS (Russia)	RTSI	2303.28	6.86%	19.84%
Dow Jones Industrial Average (USA)	DJI	13549.33	4.56%	8.72%
Nasdaq Composite (USA)	NASD	2713.5	5.14%	12.35%
S&P 500 (USA)	SPX	1496.45	4.78%	5.51%
FTSE 100 (UK)	FTSE	6479.3	5.51%	4.16%
DAX-30 (Germany)	DAX	8002.67	6.26%	21.31%
CAC-40 (France)	CAC	5614.28	3.31%	1.31%
Swiss Market (Switzerland)	SSMI	8468.37	0.44%	-3.61%
Nikkei-225 (Japan)	NIKKEI	15257	0.22%	-11.43%
Bovespa (Brazil)	BUSP	63097.71	6.17%	41.88%
IPC (Mexico)	IPC	29853.77	6.15%	12.88%
IPSA (Chile)	IPSA	3079.97	0.76%	14.35%
Straits Times (Singapore)	STI	3434.53	1.84%	15.03%
Seoul Composite (South Korea)	KS11	1919.47	3.21%	33.81%
ISE National-100 (Turkey)	XU100	55510.46	7.89%	41.91%
Morgan Stanley Emerging Markets Free Index	EMF	997.9	-16.00%	9.34%

External factors behind Russian stock market dynamics

One of the basic factors, supporting the Russian stock market during the month, was again the world oil market, where prices in December have reached the peak values once again. It can be largely explained, among other factors, by the report of the US Ministry of Energy on further reduction of "black gold" reserves. An important factor was also the agreement between the US FRS and other central banks to coordinate measures on prevention credit crisis. The quotations were affected by oil leakage from the Norwegian

¹⁶ The calculation was based on indices of corporate bonds traded on MICEX. The indices were produced by the Zenit bank.

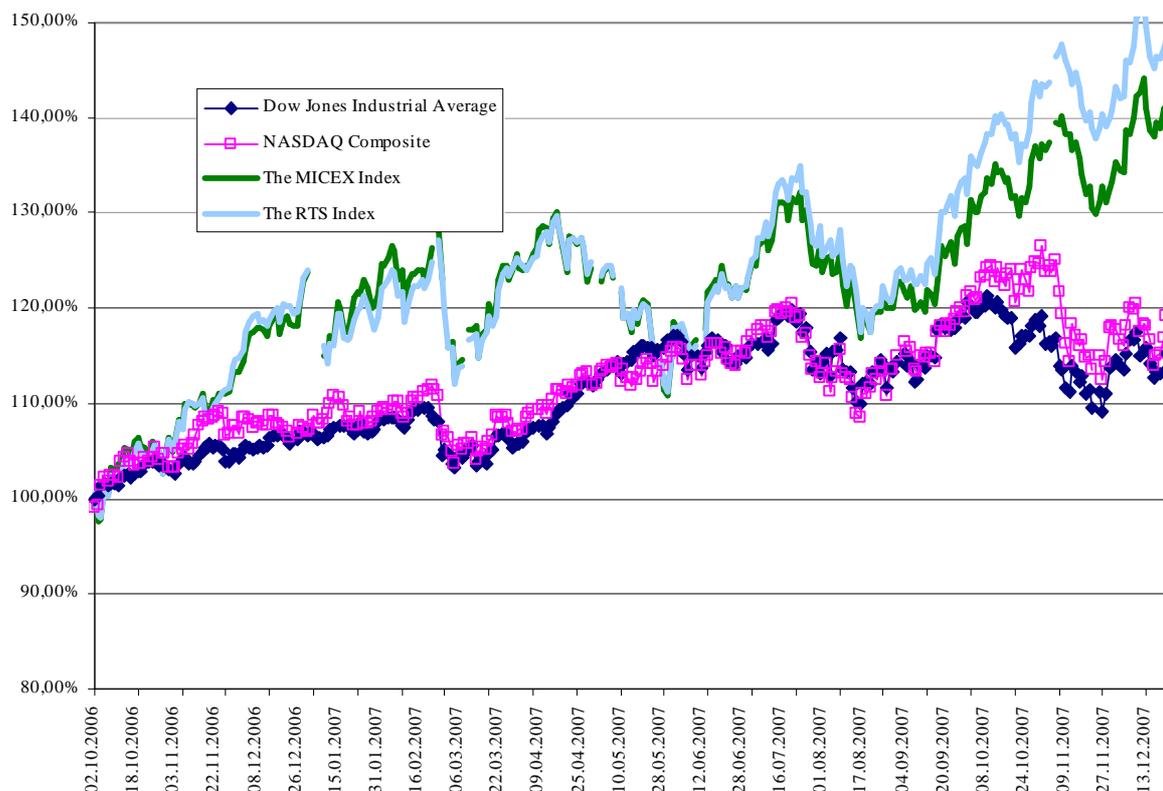
¹⁷ Against indices of November 2007.

oil platform in the North Sea. Moreover, the dynamics of the Russian oil market was influenced by the reduced interest rate by a quarter of per cent point, made by the USA FRS.

All external factors have led to the growth of the majority of stock indices (See Table 1 and Fig. 6).

FIG. 6.

Dynamics of the main USA and Russian stock indexes (in % to the date 01.09.2006)



Corporate News

OAO «Gasprom»

On December 5, 2007 OAO “Gasprom” has disclosed non-audited intermediary consolidated reporting for the first six months of 2007, prepared in accordance with IAS 34 (“Intermediary Financial Reporting” 34).

Within six months of 2007 proceeds from sales (after excise tax, VAT and customs duties) has increased by RUR 52,470 million, or by 5 per cent as compared with the same period of 2006 and amounted to RUR 1,143,894 million. During the same period, net proceeds from the sales of gas increased by RUR 36,408 million, or 5 per cent against the same period of 2006 and amounted to RUR 758,293 million.

OAO «Gasprom Neft»

OAO “Gasprom Neft” has disclosed for the first time consolidated reporting for the third quarter and nine months of 2007, prepared in accordance with US GAAP.

According to the financial results, revenues of OAO “Gazprom Neft” for the third quarter of 2007 have grown as compared with the figures of preceding year by 0.5 per cent and amounted to USD 5434 million. Profit before interest payments, profit tax and amortization (EBITDA) made USD 1449 million, which is by 7.2 per cent more than in the third quarter of 2006. Revenue of OAO “Gazprom Neft” for the first nine months of 2007 amounted to USD 14,677 million, which is by 5.5 per cent less than the relevant indicator of preceding year. Net profit for the first nine months of 2007 amounted to USD 2819 million, which corresponds to the level of the past year.

OAO «LUKOIL»

OAO “LUKOIL” has disclosed consolidated financial reporting for the third quarter and nine months of 2007, prepared in accordance with the USA principles of financial reporting US GAAP. Net profit in the third quarter and nine months of 2007 amounted to USD 2482 million, what is by 2.1 per cent more than in the third quarter of 2006. Herewith, the net profit of the company within 9 months of 2007 has amounted to USD 6298 million, the EBITDA (earnings before deducting interest, the profit tax, depreciation and amortization) made USD 10370 million (by 1.9 per cent more than in the 9 months of 2006), sales profit amounted

to USD 57096 million, which is by 11.0 per cent more than in the 9 months of 2006. The total volume of oil sales and oil products reached 98.8 million tons, which is 4.6 per cent more than in the nine months of 2006.

ОАО «ГМК «Norilsk Nickel»

On December 14, 2007 ОАО "ГМК Норильск Никел" ("Norilsk Nickel", the "Company") held an extraordinary general meeting of shareholders summoned on the issue of reorganization of the Company in the form of allocation of non-targeted energy assets. According to preliminary results of voting on the allocation of non-energy assets has not received the required number of votes of the company shareholders. The final results of the voting will be disclosed in accordance with the current legislation of the Russian Federation.

In December 2007, the Government Committee on mineral reserves "Rosnedra" has approved the reserves of the group "Norilsk Nickel" deposit "Bugdainskoye", located in Chita region. The approved category of the deposit is B + C1, the volumes are: 436.2 million tones of ore, 347.5 thousand tones of molybdenum, 11.2 tons of gold, 193.5 tons of silver, 41.4 thousand tons of lead. Category C2: ore - 376.3 million tones, molybdenum - 252, 2 thousand tons. The reserves of molybdenum and ore, are increased by 40.9 per cent and 44.5 per cent as compared with the previously approved rating.

The deposit is regarded as a major field in terms of its reserves. Bugdainskoye reserves contain various components: molybdenum, gold, silver, lead. The ore bedding allows for open-cut mining at the estimated volume of 16 million tons per year. Meanwhile, the international audit company Micon International Co Limited has performed an independent audit of reserves and resources of Bugdainskoye deposit, and generally confirmed the findings of geologists of ООО "Vostokgeologiya" (a subsidiary of Norilsk Nickel, created for the exploration works in the eastern regions of Russia). Micon Indicated: ore - 383.7 million tonnes, molybdenum - 335, 8 thousand tonnes, gold - 5 tons. As per Inferred: ore - 233.2 million tonnes, molybdenum - 175.5 thousand tons.

«Sberbank of Russia»

On the 7th of December 2007, the international credit rating agency Fitch Ratings has confirmed the ratings of Sberbank of Russia:

- Long-term issuer default rating at "BBB +" with "Stable" forecast,
- Short-term issuer default rating "F2"
- Individual rating "C"
- Approval rating "2"

The level of support for long-term issuer default rating is "BBB +".

ОАО «Surgutneftegas»

A new Chairman of the Board of Directors was elected by meeting of the Board of Directors "Surgutneftegas" on December 19.

ОАО «Tatneft»

ОАО "Tatneft" basic has disclosed basic results of operational and financial performance under the U.S. GAAP for the nine months through September 30, 2007. During the first nine months of 2007, the sales profit amounted to RUR 258436 million. During the same period, the net profit amounted to RUR 29531 million.

In November Tatneft extracted 2055889 tons of oil in excess of the planned amount of 30299 tons (the plan is performed by 101.5per cent).

Real sector: trends and factors

O. Izryadnova

Considerable growth of construction and processing industries in 2007 allows making the conclusion that investment character of economic growth sustains. One of the main problems of the second half of 2007 was sustention of the growing dynamics of consumption against the intensifying inflation.

Characteristic feature of 2007 was acceleration of economic growth by nearly all kinds of economic activities. Increase in business activity in 2007 was based on anticipating growth of investments against the dynamics of final consumption and had the biggest impact on the character of structural shifts in produced and used GDP. GDP increasing by 7.8% over January-September 2007, real final consumption of households increased by 13.3% and investments in fixed assets – by 21.2%.

The positive dynamics of final consumption was one of the main factors of internal market development in 2001-2007. Increase of inflation level influenced substantially the dynamics of final households' consumption in 3 and 4 quarters of 2007. Consumer prices index was equal to 110.6% over January-November 2007, exceeding by 1.6 p.p. the year figure of 2006. As a result in January-November 2007 growth rates of

population's real incomes slowed down to 10.1% against 13.2% in the corresponding period of the previous year. At the same time the structure of population's real incomes changed against the background of acceleration of real wages growth rates by 16.0% (13.4% in 2006) real pensions and social payments growing quite moderately. The expected level of inflation for 2007, the existing trend sustaining, is in the range of 112.0-112.3%.

Table 1

Structure of Population's Cash Incomes 1999–2007, as percentage to the total

	2004	2005	2006	3 quarter	
				2006	2007
Cash incomes - total	100	100	100	100	100
Labor remuneration, including hidden wages	64.9	64.8	66.4	66.6	69.1
Profits from entrepreneurial activity	11.7	11.4	11.2	11.7	10.2
Profits from property	8.3	8.9	7.2	7.3	6.7
Social payments	12.9	12.9	13.2	14.8	12.0
Other incomes	2.2	2.0	2.0	1.7	2.0

Source: Federal State Statistics Service

Structural changes in population's cash incomes formation were accompanied by the change in population distribution as to the value of average incomes per capita. In January-September 2007 average nominal incomes per capita growing by 121.7% and nominal wages – by 125.8% the share of population with average per capita income of more than RUR 12000 increased by nearly 9.2 p.p., and with the incomes below RUR 6000 decreased by nearly 8.0 p.p. This however has not relaxed social and economic differentiation of the population as to incomes.

Dynamic growth of investments, construction work and processing industries in 2007 allows making conclusion that investment character of economic growth sustained. As compared with January-November 2006 increase in industrial production was 6.3%, workload in construction – 22.4%, retail trade turnover – 15.0%. In 2007 economic growth was defined by anticipating development rates of processing industries, although in the second half of the year a gradual slackening of the dynamics from 14.5% in 1 quarter to 9.5% in 2 quarter and 7.2% in 3 quarter was observed. However on the whole over January-November 2007 output growth rates of processing industries exceeded the figure of the corresponding period of the previous year by 5. p.p. and were equal to 9.4%, minerals extraction increasing by 2.0% and electricity, gas and water production and distribution reducing by 1.3%. Under existing dynamics of the production the Ministry of Economic Development and Trade raised the expected estimation for the GDP growth in 2007 up to 7.6% and for investments in fixed assets – to 20.5%.

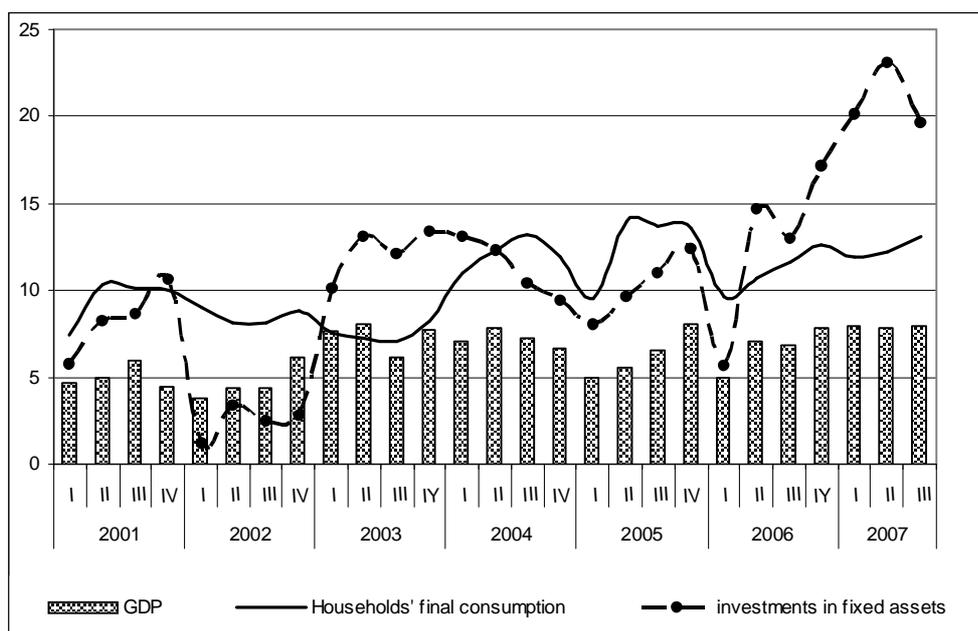


Fig. 1 Changes in GDP Dynamics by Components of Final Demand in 2001–2007, as percentage to the corresponding quarter of the previous year

Source: Federal State Statistics Service

However it should be taken into account that since the second half of 2007 a slight slowdown of investments growth rates has been observed, which is connected with exhaustion of the low base effect of the beginning of the year, limitations of enterprises and population's incomes growth as well as availability of necessary production and construction resources.

Stirring up of construction activity has led to acceleration of investment goods production rates. Over January-November 2007 machinery and equipment production increased by 20.5% against 1.6% in the corresponding period of 2006, transport vehicles and equipment production – by 15.1% as compared with 3.5%. Electric, electronic and optic equipment production growth recovered by 12.7% in 2007 as compared with reduction in production by 3.6% in the corresponding period of the previous year. Against the background of unsteady dynamics of domestic machine-building production development in 2005-2006 the share of investments in purchase of import equipment was equal to 18.6% in January-September 2007.

At the market of machine-building investment goods increase in import is one of the main factors of investment projects fulfillment, production modernization and technological innovations introduction. It should be noted that investment activity being traditionally low, fixed assets being highly deteriorated, technologies – outdated, such machine-building production as machine tools, agriculture equipment, road building equipment, motor vehicles industries experience increasing influence of competitive import.

Analysis of specific features of investment goods market formation is of fundamental importance since over the recent years it has been the anticipating growth of investments in the fixed assets as compared with the dynamics of final consumption that had the prevailing influence on GDP structural shifts. As to growth rates machine-building in last three years is considerably behind the dynamics of the investments in the fixed assets, which aggravated the disproportions of domestic production of investment goods and demand, which is formed under the influence of urgent necessity to change reproduction and technological structures of investments and maintenance of high business activity in the Russian economy.

It is the simultaneous expansion of both external and internal market that has been a positive factor of steady economic development in recent years. Whereas the dynamics of external demand was formed under the influence of exceptionally favorable situation at the world markets of fuels and raw materials, the expansion of internal market was defined by cumulative effect of factors of the increase in domestic business activity and the systematic growth of solvent demand of the population against the background of steady growth of incomes in all sectors of economy.

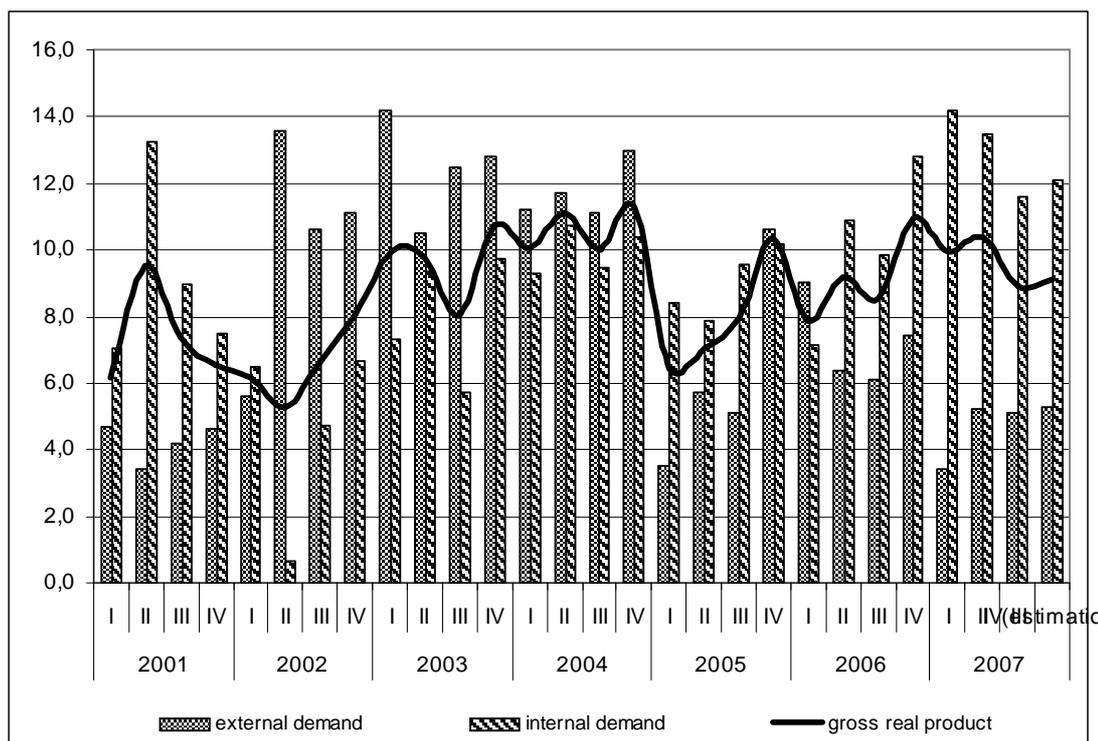


Fig. 2 Growth Rates of Internal and External Demand over 2004-2007, as percentage to the corresponding quarter of the previous year

Source: Federal State Statistics Service

Analyzing the dynamics of internal demand change in the structure of resources formation should be taken into account. Under existing domestic production growth rates anticipating growth of import supplies

volumes is the factor that secures balance of demand and supply at the consumer and investment market. In January-September 2007 the share of import in the structure of retail trade goods resources increased up to 47%, exceeding by 1 p.p. the figure of 2006 and by 4 p.p. the average level of 2003-2004.

During 2007 significant slow-down of foodstuffs production development has been observed, which was accompanied with the decrease in the share of domestically produced goods in foodstuffs retail trade turnover resources. Over January-November 2007 foodstuffs production increased by 6.4% retail trade turnover of foodstuffs growing by 12.3%. The share of import supplies of foodstuffs increased up to 37% against 34.8% in the previous year.

In January-November 2007 the drop of production by 0.5% was observed in textile and sewing production, and growth rates deceleration from 13.7% against 2.0% in leather goods and footwear industry was registered. As a result the share of import supplies of non-food goods increased up to 54.4% against 51.7% a year ago.

The situation is aggravated by the fact that along with ruble appreciation and shift of consumer preferences towards average price segments as to ratio of price and quality Russian producers cannot compete with import. The exception is the companies that with production modernization and reconstruction, construction of fundamentally new marketing and logistic system occupied niches at the market after ruble devaluation in 1998. However the created potential was not enough to sustain steady trend of production growth, labor efficiency and profitability.

In 2007 the ratio of real wages growth rates and labor efficiency has worsened. Whereas in January-September 2006 they were 12.9% and 5.3%, correspondingly, in January-September 2007 they were 16.2% and 5.3%.

In the first half of 2007 the share of employees' labor remuneration in the GDP was approximately 49.8% and was above the figures of 2004-2006. High differentiation of average wages by kinds of economic activities sustained. In industry the extent of wages differentiation was defined by the deepening of the gap in rates of labor remuneration in extractive and processing industries. Nominal accrued wages in minerals extraction exceeded the average level throughout the economy by 2.1, and in fossil fuels extraction – by 2.5 times. In processing industries wages were equal to 97% of the average throughout the economy and 42% of the figure for extractive industries. Exceeding of the average throughout the economy figure by 2.3 and 2.2 times, correspondingly, was observed in production of oil products and fossil fuels transportation. In education, health care average wages was equal to 75-77% of the average throughout the economy, in government management and national security - to 120% and in financial activity – to 260%. Specific features of labor remuneration by kinds of economic activities influenced considerably the formation of incomes and expenditures, population's consumer demand, employment character, distribution of labor resources in the economy.

Table 2

Structure of GDP Formation by Incomes in 2001-2007, as percentage to the total

	2004	2005	2006	1 half year	
				2006	2007
Gross Domestic Product	100	100	100	100	100
Of which:					
Employees' labor remuneration, including hidden wages	46.0	43.8	44.1	46.0	49.8
Net taxes for production and import	16.8	19.7	20.0	21.4	19.1
Gross profit of economy and gross mixed incomes	37.2	36.5	35.9	32.6	31.1

Source: Federal State Statistics Service

In the structure of the employed population only 8% accounts for people not working for wages, that is employers, hiring employees for work at their own enterprises on permanent basis, self-employed workers. This correspondingly defined the peculiarities of population's incomes formation and the GDP formation. More than 69% of the incomes account for labor remuneration of employees.

The level and share of labor remuneration of employees in the structure of GDP had primary influence on social indicators, including labor market. Trend for increasing demand for labor force was characteristic for 2001-2007. Shortage of labor resources increasing the number of the unemployed has decreased by 1 mln of people since the beginning of the year and was equal to 4.4 mln of people in October 2007. In 2007 average annual number of the employed in the economy increased by 2.5% as compared with the previous year and was equal to 70.5 mln of people. It should be noted that the change of demand for labor force was defined by the shift of employment towards kinds of activities rendering market services. Formation of this trend at the

initial stages of economic growth recovery had a powerful positive influence on life quality and gave stimulus for acceleration of service sector development rates.

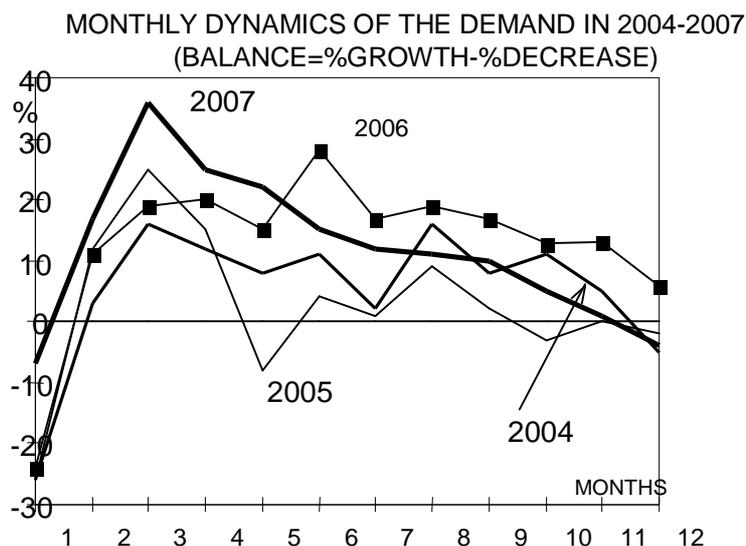
However deceleration of industrial growth rates and import acceleration provoked the trend for reduction of average annual industrial production staff. In the last four years reduction in employment was observed in nearly all kinds of economic activity, the number of vacancies reducing most intensively at processing industries. In 2006 as compared with 2004 the number of the employed in the processing industry decreased by 532 thousand of people, in minerals extraction – by 52 thousand. Formation of this trend was proceeding along with slackening of the trend for labor efficiency growth in the industry. Whereas in January-September 2006 indices of wages and labor efficiency growth were, correspondingly, 10.6% and 6.5%, in January-September 2007 they were 14.7% and 6%. Negative impact of this trend is strengthened by growing shortage of qualified labor force in nearly all kinds of activities. Existing structure and professional indices of demand for labor and its supply are becoming one of the main problems of labor force market operation, employers having to decrease gradually qualitative requirements for specialists. Such a situation leads to slow-down of the industry efficiency growth rates due to irrational use of production factors.

Business Survey in December 2007

S. Tsukhlo

2007 is coming to the end leaving us, according to the estimations of enterprises managers, not in high spirits. Continuous slow-down of demand growth decreases satisfaction with its volumes and forces the enterprises to restrict output growth. Forecasts for the beginning of 2008 are also not very rosy and less optimistic than those at the end of 2006.

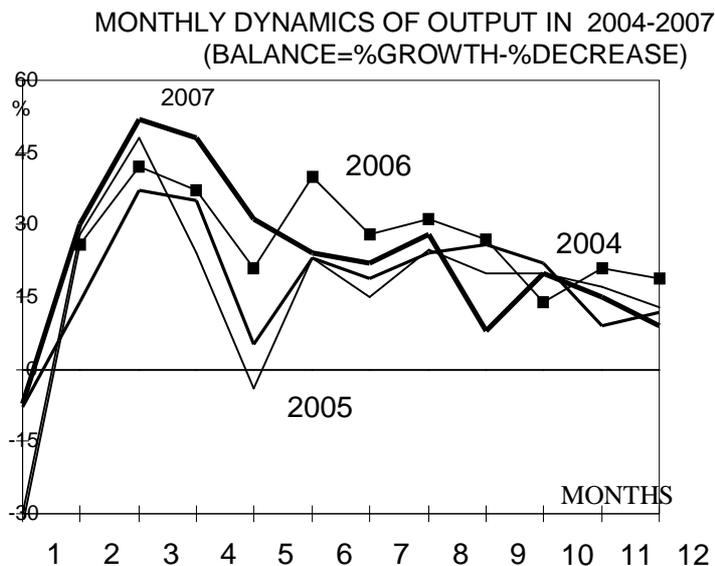
According to the data of the Federal State Statistics Service in January-November 2007 industrial production in Russia increased by 6.3% as compared with January-November 2006. In November of the current year industrial production increased by 4.7% as compared with November 2006 and decreased by 0.8% as compared with October 2007. According to the Center for Macroeconomic Analysis and Short-term Forecasting upon excluding seasonal and calendar factor average daily output in November increased by 0.9% as compared with October (in October figure being 0.5%). However managers of the enterprises give other estimations of the dynamics of the main indices of the Russian industry.



First, the comparison of December figures of the previous years indicates that the end of 2007 from is as to demand dynamics worse than the finals of three previous years. Demand for industrial production growth rates upon exclusion of seasonality from survey results remains at the level that is the lowest from March 2006. And as compared with March 2007 when the best result of the current year was observed, it decreased by 4 times. At present only 66% of enterprises consider the demand for their production as normal. In August 2007 this figure reached 72%, which is the absolute maximum for 1992-2007. In December 2007 the lowest satisfaction with the demand was registered in the construction industry (45%, December 2006 – 54%), machine-building (57%, 2006 - 55%) and foodstuffs production (66%, 2006 -78%).

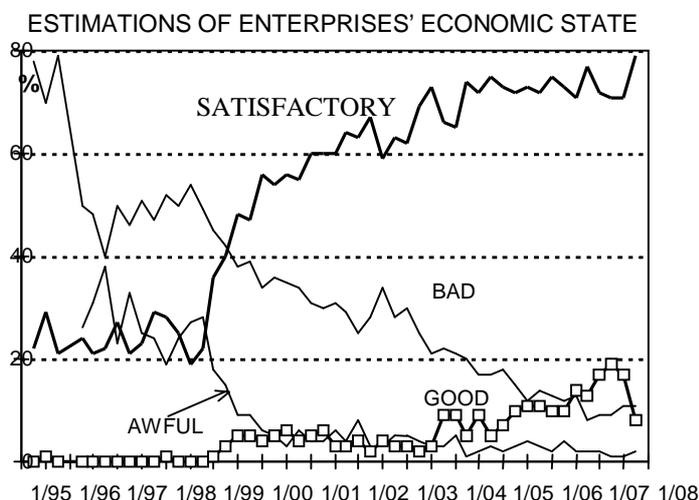
Second, the dynamics of the output at the end of 2007 does not cheer the producers as well. According to the estimations of enterprises' managers output growth in the industry continues to slow down. In December

growth rate of the index was the worst for the corresponding months of the last five years. Exclusion of seasonal factor demonstrated the lowest but not one result of the year, a worse was observed only in September. At the same time the output dynamics began to correspond better to demand dynamics. Coincidence of changes in production and sales was characteristic for 64% of the enterprises in December (in November – for 59%), anticipating changes of output as compared with changes in demand was observed at 23% (29%).



Third, changes in estimations of finished goods stocks does not add optimism taking into account the dynamics of situational indicators. In December the balance of estimations increased up to +14 points, figures being +8 in November and +4 in October. As a result the level of excessive stocks accumulation returned to the level registered by surveys up to the middle of 2006, when there were enough staff and facilities. At the moment there are shortages of the both in the industry. In other words, everything that is capable of producing more or less competitive goods has been put in operation. Nobody is willing to stop the production and put facilities out of service. Under such conditions slow-down of the demand growth forces the enterprises to work for stocks, hoping that in the forthcoming months sales will go up again and stocks accumulations will disappear. Demand forecasts however remain not very comforting and force the enterprises to consider their stocks as excessive, not normal or insufficient. Such a situation will most likely slow down the start of the Russian industry at the beginning of 2008.

Fourth, financial and economic state of the enterprises stopped getting better. In 4 quarter the share of estimations “good state” reduced down to 8%, whereas it was 19% in the second quarter of 2007, which was the maximum for 1995-2007. At present it is happening due to the increase in responses of “satisfactory state”, whose share has increased up to 79%, which is also the maximum for 1995-2007. Two quarters in a row the surveys has not registered the growth in the profit in industry. The balance of the changes in this indicator upon excluding seasonality is no more positive, not becoming significantly negative, which would enable to register profit decrease.



Balances of forecasts for changes in demand based on initial data remain negative second month in a row: there are still more enterprises in the industry that expect decrease of demand for their products. At the end of 2006 the ratio was better. Upon exclusion of seasonality the balance (growth rate) was positive (+17 b.p.), but was the worst figure for the last seven quarters. The forecasts for changes in output also dropped down to minimum values for the last eight quarters (basing both on initial and cleared from seasonality data).

Problems Connected with Entrance to New Geographical Sales Markets

Expansion of Sales Geography of Russian Industrial Enterprises

As it is demonstrated by IET surveys Russian industrial enterprises have wide geography of their goods sales. Main markets (both in 2005 and 2007) were regions that are situated far from the region of origin (see Table 1)

Table 1

Regions of Primary Sale of Goods Produced by Russian Industrial Enterprises, as percentage

	2005	2007
In the territory of oblast (krai, republic) where the enterprise is situated	42	34
In bordering oblasts of the Russian Federation	31	37
In other oblasts (krajs, republics) of the Russian Federation	60	70
In CIS countries	35	32
In European countries		15
In Asia, Africa, America	30	20
Total	198	208

Sources: December (2005) and June (2007) IET surveys

By far less goods were sold in the territory of the oblast (krai, republic) where the enterprise is situated – the fact that is especially true for 2007. At the moment the oblast of location is considered as the main sales region by two times less enterprises than remote (even not bordering) oblasts. It is also notable that over two years the share of enterprises with a main focus on remote regions increased by 10 points, while the figures for other directions of sales changed less. The change nearest in scale (but with the opposite sign) occurred in the local direction of sales – only 34% of enterprises consider the oblast of location as main direction for sales (two years ago the figure was 42%).

Certainly main processing industries have their own special features with regard to regional priorities for sale (see Table 2). Machine-building enterprises have the largest geography of sales: less than a third of these enterprises regarded the oblast of their location as priority for sale. Still less enterprises sell their goods in the bordering territories. And over two years the priority of the regions (their own and bordering) has not changed very much. For the majority of machine-building enterprises main regions of sales are the remote oblasts (krajs, republics). In 2007 three quarters of enterprises are focused on these territories. The growth of this direction significance however was not big (only 8 points). In the light industry, the same as in the machine-building, main sales regions are considered to be remote regions: it is there where the main part of the goods is sold by approximately two thirds of the enterprises of the branch. The importance of this direction however went up only by 4 points over two years (that is changed but negligibly). The biggest success the enterprises of the industry experienced while promoting their products in the bordering regions which is accounted for by the fact that mainly there are customers for this industry in all regions of the country the consequence being that it is possible to spare the transportation costs while developing neighboring regions. The most intensive territorial expansion was characteristic for foodstuffs production. Due to the specific features of the industry the foodstuffs enterprise sell their goods first of all in the nearby regions. This rule was clearly illustrated in 2005, when 86% of the producers considered the oblast (krai, republic) of their location as a primary sales region. However by 2007 the role of the region of location decreased by 12 points in the industry, the importance of neighboring regions increasing by more than two times (69% after 31%).

Thus, Russian enterprises actively develop new territorial sales markets. However the enterprises face a lot of obstacles in this way. The monitoring of the obstacles for entrance of enterprises into the new markets that IET started in 2000 allows getting the most detailed image of the real obstacles being faced by the enterprises trying to expand geography of their goods sales.

Table 2

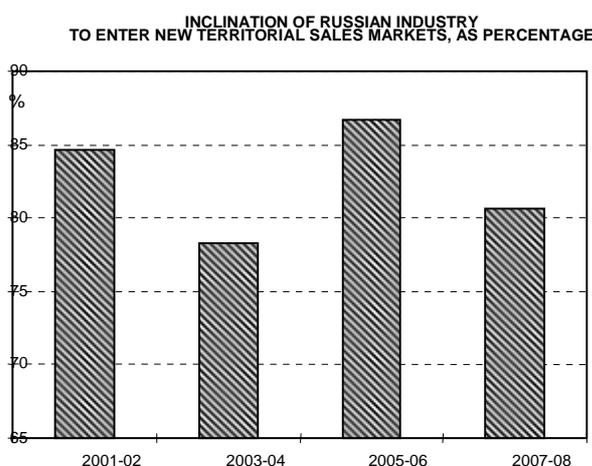
Regions of Primary Sale of Their Goods by the Enterprises of Machine-building, Light and Foodstuffs Industries, as percentage

	Machine-building		Light		Foodstuffs	
	2005	2007	2005	2007	2005	2007
Inside the oblast (krai, republic) of enterprise's location	31	28	51	45	86	74
In neighboring regions of the Russian Federation	26	27	41	50	31	69
In other oblasts (krajs, republics) of the Russian Federation	68	76	65	69	34	50
In CIS countries	42	42	18	27	9	10
In European countries		9	1	1		0
In Asia, Africa, America	26	24	3	1	13	6
Total	193	206	188	203	173	209

Source: December (2005) and June (2007) surveys by IET

Inclination of Enterprises to Enter New Geographical Sales Markets

The surveys demonstrate high inclination of enterprises to enter new territorial sales markets (see Fig. 1). Minimum willingness to develop new territories was registered by 2002 surveys (enterprises were asked to report on their plans for 2003-2004), when only 78% of enterprises informed that they have plans to enter new territorial sales markets. In other years the abundance of such plans was no lower than 80%, and in 2004 it reached the maximum of 87%.



Source: IET surveys

The willingness to search for new territories for their products sale differs by industries and sometimes (at some periods of time) quite considerably (see Table 3). On average, over the whole period of monitoring the highest inclination to develop new markets is demonstrated by machine-building enterprises. This industry has nearly always been ready to develop new markets more often than other sectors, the only exclusion being the survey of 2002 about the plans for 2003-2004, which is accounted for by growth rates deceleration followed by absolute decrease in sales. Second place of foodstuffs industry is accounted for by high willingness to expand sales geography in the first half of the current decade. At present, however, this figure for the industry is only 76%, the decrease being 19 points, main loss (12 points) occurring in recent years. The same dynamics and average level of readiness to enter new markets were registered in chemistry and petrochemistry.

Table 3

Inclination of Enterprises to Enter New Territorial Sales Markets, as percentage

	2001-02	2003-04	2005-06	2007-08
Metallurgy	81	81	77	66
Chemistry and petrochem- istry	92	95	89	78
Machine-building	93	83	94	92
Wood processing complex	78	78	91	70
Construction industry	75	81	81	71
Light	95	94	88	76
Foodstuffs	87	87	92	74

Source: IET surveys

Obstacles to Entrance New Geographical Sales Markets

The results of IET monitoring demonstrate that nearly all the set of the causes hinders Russian industrial enterprises from entrance new geographical sales markets (see Table 4). Average frequency of obstacles citing over four surveys covering 2001-2008 was in the range from 16% (that is the number of enterprises hindered because of competitors' advantage due to possession of the unique sources of raw materials, energy, technology, patents, licenses) to 43% (that is the number of enterprises that on average cited low prices at new markets, that do not cover enterprise's expenditures).

Table 4

Obstacles for Entrance New Geographical Sales Markets in Russian Industry in 2001-2008 (as percentage to the number of those that responded)

	2001-02	2003-04	2005-06	2007-08
1. lack of information on situation at new markets	31	33	21	28
2. low prices at new markets that do not cover costs	41	46	43	43
3. saturation of new sales markets and apprehension of prices fall	16	30	20	28
4. fierce counteraction of traditional producers	27	29	25	40
5. support of traditional producers by local authorities	14	19	17	16
6. attachment of suppliers and customers to traditional producers	28	35	25	29
7. high costs necessary to start new products output	29	24	21	22
8. high transportation costs	37	40	27	28
9. impossibility to reach scale of output and sale that is profitable soon	16	15	15	21
10. competitors' advantages due to possession of unique sources of raw materials, energy sources, technology, patents and licenses	18	14	15	16
11. no special obstacles	10	5	14	10

Source: IET surveys

It has always been obstacles of economic nature that were main (most widespread) obstacles to enter new territorial sales markets. Administrative barriers (support of local producers by authorities and competitors' advantages due to possession of unique raw materials, energy sources, technology, patents, licenses) were as a rule cited less often.

First place has always been held, leaving others far behind, by the obstacle "existing low prices at new markets, that do not cover enterprise's costs". It is to be noted that the frequency of this obstacle citing has been relatively stable throughout the time, and in the last two surveys it was steady at the level of 43%. Judging by the fact which obstacles hold the next places in the rating high costs of enterprises while promoting their products in other territories are formed by transportation costs (which is normal and characteristic for any economy), overcoming of traditional producers' counteraction and costs connected with search for customers at new markets. The problem of low price at new markets was normally in the first place (places) in all the branches of industry (see Table 5).

Table 3

Place Held by the Obstacle “Low Prices at New Markets, Not Covering the Costs” in Industries

	2001-02	2003-04	2005-06	2007-08
Metallurgy	1	4	5	3
Chemistry and petrochemistry	1	1	1	1
Machine-building	1	1	1	2
Wood processing complex	4	4	3	1
Construction industry	4	2	5	4
Light	1	1	1	1
Foodstuffs	1	1	2	1

Source: IET surveys

On average over the years of monitoring high transportation costs were mentioned by 33% of enterprises and hold second place in generalized (over the years) rating. However in the last survey this obstacle sank to the sixth place. But three of the obstacles exceed the figures of transportation costs by no more than 1.12 per cent, that is they share places from the third to sixth. In fact it is only the obstacle “fierce counteraction of traditional producers” that exceeds transportation costs.

But there are two branches of industry where the obstacle “high transportation costs” has always held the first place. In the construction materials industry transportation costs hinder on average 74% from expansion of sales geography, the second frequent cause (low prices at new markets) was cited nearly two times less often (38%). In wood processing complex price of transportation hindered sales expansion for an average of 53% of enterprises and exceeded figures for low prices obstacle by 11 points. And in 2007-2008 low prices in this industry ranked first. In recent years transport tariffs has started causing more and more anxiety to foodstuffs enterprises. It was in 2004 when transportation costs for the first time topped the chart, 92% of enterprises planning to expand sales geography. Facing such a problem, which is not typical for the industry, foodstuffs enterprises, on one hand, managed to expand sales geography (see Table 2), and on the other hand, had to reconsider their territorial ambitions: willingness to enter new markets in 2007-2008 dropped to the absolute minimum (see Table 3). It is the machine-building enterprises that are least worried about transportation costs. On average this problem holds 7th place in the industry. In the environment of industrial growth only 13-18% of machine-building plants are worried about costs for their products transportation and now (in 2007-2008) this obstacle holds only 8th place.

The obstacle “fierce counteraction of traditional producers” holds on average third place, frequency of citing being 30% as a result of all four surveys. It is to be noted that during 2001-2006 only 25-29% of enterprises faced the counteraction of traditional producers, while in 2007-2008 counteraction was experienced by 40%. Growth by 15 points was the highest increase for the obstacles for all the years of monitoring. It seems that not only have the enterprises started active expansion to other territories but they are also seriously concerned with the protection of their markets from “invaders”. In machine-building industry counteraction of traditional producers became the biggest obstacle for sales geography expansion: its citing has increased up to 48%, whereas earlier this obstacle was mentioned by only 25-29% (6th place in rating by the industry). In metallurgy and construction materials industry the obstacle mentioned ranked second (see Table 6).

Table 4

Place Held by the Obstacle “Fierce Counteraction of Traditional Producers” in Industries

	2001-02	2003-04	2005-06	2007-08
Metallurgy	4	3	4	2
Chemistry and petrochemistry	3	5	6	5
Machine-building	6	6	2	1
Wood processing complex	7	9	5	8
Construction industry	7	6	2	2
Light	8	8	8	6
Foodstuffs	3	2	5	3

Source: IET surveys

The attachment of suppliers and customers to traditional producers is only a bit (on average) below the previous obstacle as to its spread in the Russian industry. Earlier 25-29% of enterprises suffered from this hindrance, excluding 2003-2004 period, when it was the obstacle for 35% of enterprises. Now (in 2007-

2008) 29% of producers report the damage from this attachment. Its stable frequency of citing suggests the lack of progress in the sphere of business ethics and reputation that makes the enterprises be cautious with regard to new partners and prefer tried-and-true contractors.

Absence of information on the situation at new markets by the extent to which it is spread in industry is near the two obstacles mentioned before: on average this problem hinders 28% of enterprises from promoting their goods in other territories. It is the enterprises of machine-building, wood and wood processing complex, light industry that suffer from the lack of information most often (characterized by third place in the industry ratings).

According to the estimations of enterprises, administrative barriers for sales geography expansion hold last places in the general list of hindrances. Both the governmental support of the competitors and competitors' advantages due to possession of unique sources of raw materials, energy, technology, patents, licenses is cited by 16% of enterprises on average, and this figure does not change a lot throughout the time (see Table 4). Thus administrative barriers are the lowest among the obstacles for sales geography of Russian enterprises expansion. The fact that the change in frequency of these obstacles citing is only 2 per cent from 2000 to 2006 gives evidence that there is little progress in struggle of federal authorities with administrative barriers for free flow of goods and services in the territory of the country. However the minimum level of these obstacles detriment and its stability can also mean that the main work on eliminating of administrative barriers has been conducted earlier and measures being taken at the moment are not experienced by the enterprises. The consequence of this is that one should either seek for new measures to solve the problem once and for all or to attend to lifting other barriers with which the majority of producers face at the moment.

Investments in the Real Sector of Economy

O. Izryadnova

Characteristic feature of 2007 was the increase in the share of investments in the fixed assets up to 19.4% of the GDP, which was the maximum value of the index over the whole period of reforms. High growth of investment demand was supported by the increase in importance of domestic market in the formation of the economic dynamics. In 2007 the volume of investments in the fixed assets increased, according to preliminary estimations, by 18.8% against 13.7% in the previous year and 12.1% on average over the period of 2000-2005.

Focus of producers on modernization and reconstruction of production caused growth of demand for machinery and equipment in nearly all kinds of economic activity. The development rates of domestic machine-building and fixed assets reproduction being reserved, the influence of import supplies at the domestic market increased. Factors that had positive effect on the change of technological and assortment structure of investments in the fixed assets were, first, import machinery and equipment becoming cheaper as a result of ruble real appreciation, second, application of zero customs rates for import equipment and, third, implication of industrial assemblage regime, the duties for import components being reduced.

Taking these steps stimulated acceleration of machinery and equipment import growth rates. In January-September 2007 investments in fixed assets growing by 21.2%, production of machinery and equipment – by 20.9%, transport vehicles and equipment - by 15.7% and electric equipment - by 14.8%, machinery and equipment import increased by 1.56 times. The share of investments for import equipment purchase in the total volume of investments in machinery, equipment and transport vehicles over January-September 2007 was equal to 18.9%.

Earnings in the economy growing, the share of budget funds in the sources of financing of investments in the fixed assets went up. In January-September 2007 investments in the fixed assets of RUR 542.7 bln were financed at the expense of budget funds, which comprised 18.5% of the total volume of investments in the fixed assets throughout the economy as a whole, of which at the expense of federal budget – 6.3%.

Characteristic feature of 2005-2007 was the change in the ratio of funds of federal budget and the budgets of subjects of the Federation that is directed towards the investments. Anticipating growth of investments in the fixed assets at the expense of the federal budget funds had a considerable impact on investment process. The share of budget funds used for investments in the fixed assets was equal to 3.23% of the GDP in 2006, including from the federal budget funds – to 1.18% of the GDP. In January-September 2007 as compared with the corresponding period of the previous year the increase in the share of budget investments in the GDP is observed by 0.7 p.p.

During January-October 2007 the volume of funds envisaged for construction sights and objects of the Federal Targeted Investment Program (FTIP) was reconsidered three times and as a result government in-

vestments in FTIP fulfillment increased by 42.6% or by RUR 156.2 bln in 2007 in fixed prices as compared with 2006. The share of expenditures for FTIP financing is expected to be at the level of 1.71% of the GDP in 2007, exceeding by 0.34 p.p. the level of the previous year.

Table 1

**Структура инвестиций в основной капитал по источникам финансирования,
в январе-сентябре 2004-2007гг. % к итогу**

	2004	2005	2006	2007
Investments in the fixed assets – total	100	100	100	100
of which by sources of financing:				
<i>Own funds</i>	47.4	47.5	45.1	42.8
of which:				
Profit	17.0	20.1	19.9	19.4
<i>Borrowed funds</i>	52.6	52.5	54.9	57.2
of which:				
Bank credits	7.7	6.5	9.3	10.2
Of which of foreign banks	1.4	1.1	1.8	1.1
Funds borrowed from other organizations	7.3	7.9	5.6	6.3
Budget funds from:	16.9	18.7	17.3	18.5
Federal budget	4.9	6.0	5.8	6.3
Budgets of the subjects of the Russian Federation and local budgets	11.2	11.8	10.7	11.1
Investments from abroad in the total amount of the investments in the fixed assets	5.4	5.3	7.3	4.8

* not including small business enterprises and parameters of informal business

Source: Federal State Statistics Service

In 2007 the number of Federal Target Programs and subprograms financed from the federal budget has decreased considerably, which allowed concentrating resources on the priority directions of social and economic development of the country.

Limit of government investments for 2007 was RUR 544.0 bln. According to program part financing at the sum of RUR 312.8 RUR is envisaged, which comprises 59.7% of the total limit, and according to non-program part – at the sum of RUR 211.4 bln or 40.3% of the investment limit for the year. The volume of governmental defense order according to program and non-program part of FTIP was equal to RUR 95.9 bln or 18.3% of the total limit.

Table 2

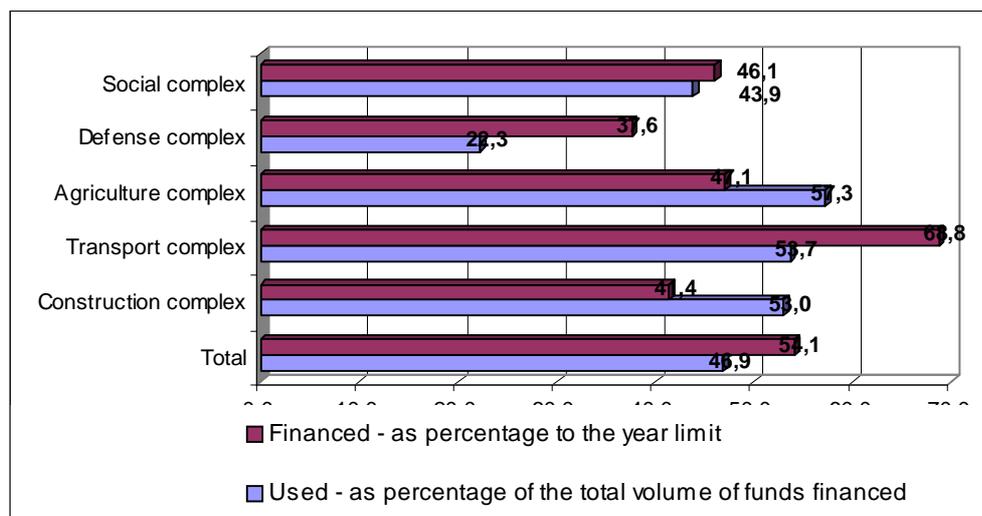
**Use of Investment at the Expense of All the Sources for Financing the Objects Envisaged by
the Federal Targeted Investment Program¹⁾,
in January-October 2007, as RUR billion**

	Limit of governmental investments in 2007		Investments used at the expense of all sources of financing	Financed from the federal budget
	total	Including from the federal budget		
Total	544.0	394.4	254.9	213.3
including:				
Construction complex	0.4	0.4	0.2	0.2
Transport complex	247.4	147.6	132.8	101.5
Agriculture complex	10.4	9.6	6.0	4.5
Special complex	44.3	29.5	9.9	11.1
Social complex	217.0	189.1	95.2	87.1
Other objects	24.5	18.3	10.8	8.9

1). Not including investments, allocated from the federal budget for equipment purchase and conducting design and engineering work for construction sights and objects included in the Federal Targeted Investment Program for 2007 and which are kept on books of government clients (builders) that supervise these investments.

Source: Federal State Statistics Service

In January-October 2007 the level of financing of the annual limit of government investments in construction sights and objects of FTIP (not taking into account construction sights and objects, envisaged by the government defense order), which the Federal State Statistics Service monitors, comprised 54.2% of the year limit. Investments in the transport and production complex are financed above the average level, the level of financing of defense and social complex is far below the average level.



Source: Federal State Statistics Service

Fig. 1 Level of Financing of Government Investments Use over January-October 2007, as percentage

According to the Federal Targeted Investment Program by the specified list of the Ministry for Economic Development and Trade of the Russian Federation government investments for construction of 5976 construction sights, objects, of which 3714 objects were intended to be put in operation, were to be allocated in 2007. In January-October 2007 1413 construction sights and objects were fully financed. At the same time the level of financing of 843 objects is still less than 50%. By 1 November 2007 1607 objects or 26.9% were technically ready by 51.0%-99.9%. In January-October, according to the data of the Federal State Statistics Service, 223 objects were put into operation, of which 170 fully and 53 – partially.

Table 3

Objects, Envisaged by Targeted Investment Program

	Number of objects for 2007 ¹⁾		Put in operation in January-October 2007 ²⁾	
	total	including with the deadline of putting in operation in 2007	fully	partially
Total	5976	3714	170	53
of which:				
Construction complex	3	3	-	-
Transport complex	982	546	32	6
Agriculture complex	1204	1030	24	12
Defense complex	265	176	-	2
Social complex	3165	1716	90	29
Other objects	357	243	24	4
1) including conduction of engineering works and purchase of equipment that is not envisaged by construction calculations				
2) number of construction sights and objects put in operation according to the procedure established				

Source: Federal State Statistics Service

Traditional delay with FTIP financing at the beginning of the year, low execution discipline and absence of strict control over the use of funds are the main factors of systematical growth of unfinished construction against the background of annual increase of the number of new construction sights and objects.

In accordance with the amendments made to Budget Code this situation should change dramatically in 2008. It is envisaged that no FTP will be financed if it is not approved a month before submission of the project to the State Duma, that is all FTP should be approved by 26 July. In the next two years the procedure of the list of construction sights and objects formation financed from the federal budget that is approved in

FTIP will be changed. It will be enough to list the object in FTP or in the decree of the Government and this will be decision for the whole period of construction. Under such a procedure there will be no need to approve expenditures for each object every year.

Fundamentally new feature of economic growth in 2004-2007 was the shift from financing the investments in the fixed assets from the enterprises and organizations' own funds to the expansion of borrowed funds participation. This was a bright example of qualitative changes in the investment process that are directed towards rationalizing of investment flows. As a result of January-September 2007 the share of borrowed funds in the structure of investment financing sources increased up to 57.2%, which exceeds by 2.3 p.p. the figure of the corresponding period of the previous year.

In January-September 2007 the share of banks in crediting of investments increased up to 10.2% against 9.2% in 2006 and 6.5% in 2005 in the structure of investment sources. The trend for the increase in insurance and investment companies, industrial and trade enterprises as well as foreign capital participation in investment process financing sustained.

Attention should be paid for special features of foreign banks participation in investment activity financing. Since 2000 the increase of the share of foreign investments has been observed and growth of foreign banks participation in financing investments in fixed assets has been registered in Russian economy. However in January-September 2007 investments in the fixed assets from abroad were equal to 4.8% of the total volume of investments, having decreased by 3.5 p.p. as compared with the corresponding period of the previous year, and the share of foreign banks credits decreased down to 1.1% against 1.8%. In January-September 2007 absolute reduction in the volume of funds used from abroad for investments in the fixed assets by USD 1.2 bln as compared with January-September 2006 was observed. In the structure of use of funds coming from abroad in the form of foreign investments it is the increase of share of expenditures for shares purchase and bank credits and loans repayment up to 28.7% against 9.5% in January-September 2006 that was of primary importance.

Formation of these proportions took place against the background of intensive growth of net capital import and foreign investments. Over January-September 2007 net import of private capital was, according to the preliminary estimation by the Central Bank of the Russian Federation, equal to USD 56.8 bln against USD 26.3 bln in 2006, and the volume of foreign investments – to USD 87.9 bln against USD 35.3 bln.

Change in the structure of investments by kinds of economic activities in January-September 2007 was defined by trends formed in the previous year.

In 2006-2007 the trend for investments in fixed assets in trade and transportation as well as in kinds of activities oriented to rendering of social service – education, health care – sustained. Characteristic feature of investment process in transportation in 2007 was the change in investment structure by kinds of economic activities. In 2006 the reduction in scale of investments in railway transport and communication – the areas for which the period of recovery growth of 1995-2005 was characterized by high investment activities – was observed, against the background of rates acceleration and growth of share of pipeline transport in investment expenditures up to 39.9% of the total volume of investment in transport. In the period of January-September 2007 the reduction in investment scale in pipeline transportation was the factor for slowdown of investment rated in the development of transport as whole.

Against the background of steady growing demand for trade services in 2006-2007, redistribution of investments by kinds of activities was observed material and technical base of retail trade and motor vehicles trade, increase in investments in which was equal to 22.3% and 31.8%, correspondingly, to the level of 2006.

Characteristic feature of structural shifts in goods production in 2006-2007 was overcoming of the trade of investments in minerals extraction reduction, which was observed since 2002. As a result of 2006 the increase in investments in fossil fuels extraction was equal to 25.1% against the drop of 2.6% last year. Over January-September 2007 the increase of investments in minerals extraction was 19.5%, including in fossil fuels extraction - 19.1% investments in processing production increasing by 10.9%. In electricity, gas and water production and distribution increase of investments in January-September 2007 reached 29.3% and was accounted for by the increase in investment activity in electricity production and transmission by 1.49 times, dynamics of investments in production and distribution of gas fuel being negative.

The share of processing industries in the structure of investments in the fixed assets on the whole throughout the economy was equal to 16.7% in January-September 2007 as compared with 17.5% in the previous year. Concentration of profits in the export-oriented industries being traditionally high and interindustry capital transfer being weakly developed, it could hardly be expected that acceleration of investment rates be steady and nature of fixed assets reproduction be changed fundamentally. Analysis of dynamics and structure of investments demonstrates that low share of investments in machine-building is characteristic for Russian economy. The share of enterprises producing investment goods was 2.3% in 2007 against 2.7% in

2002. Under existing age, technological and reproduction structure of fixed assets low rates of investments in machine-building production was the factor that restricted rates development of enterprises of production of finished and intermediate goods. Under existing structure of domestic production of investment goods import remains one of the main resources of fixed assets reproduction, production reconstruction and modernization.

Table 4

**Structure of Investments in Fixed Assets by Kinds of Economic Activity
in January-September 2004-2007, as percentage to the total**

	2004	2005	2006	2007
Total	100	100	100	100
of which by kinds of economic activities:				
Agriculture, hunting and forestry	3.1	3.1	3.9	4.7
Industry	37.1	37.2	43.6	43.6
Minerals extraction	18.4	16.5	19.1	19.0
of which fossil fuels extraction	12.4	13.9	17.4	17.3
Processing industries	16.9	14.6	17.5	16.7
Electricity, gas and water production and distribution	8.3	8.2	7.0	7.9
Construction	3.6	3.5	3.6	2.7
Wholesale and retail trade, repair of motor vehicles, motor cycles, household appliances and objects of private use	3.1	3.8	2.8	3.0
Transportation	17.9	20.3	22.0	20.4
Communication	6.9	5.1	4.0	3.9
Financial activity	1.4	1.3	1.1	1.4
Operations with real estate, renting and service rendering	16.8	16.4	10.8	11.9
Education	1.6	1.8	2.2	2.2
Government management and guaranteeing of national security, compulsory social provision	1.5	1.3	1.5	1.3
Health care and social services rendering	2.0	1.9	2.3	2.4
Rendering of other public utilities, social and personal services	2.3	2.5	2.3	2.4

* Not including small business enterprises and parameters of informal activities

Source: Federal State Statistics Service

Foreign Investments

E. Ilukhina

By the state of affairs by the end of September 2007 foreign capital accumulated in Russia exceeds the corresponding figure for 1 January 2007 by 38.4%. In 2007 the concentration of foreign investments in industry and trade sphere sustained. As a result of January-September 2007 it is Cyprus, the Netherlands, Luxemburg, the Great Britain and Germany that still hold the leading positions in the total volume of accumulated foreign investments. Against the background of dramatic increase of investments in Russian economy the volume of capital withdrawal in the form of foreign investors' profits transferred abroad as well as interest payment for use of credits and repayment of credits in January-September 2007 increased by 36.1% as compared with the corresponding period of 2006.

According to the state of affairs by the end of September 2007 foreign capital accumulated in Russia (not taking into account of monetary and credits regulation bodies, commercial and saving banks), including investments in form of rubles, recalculated in US dollars, was equal to approximately USD 197.7 bln. This exceeds the figure of 1 January 2007 by 38.4%, and the figure of 1 October 2006 – by 52.2%.

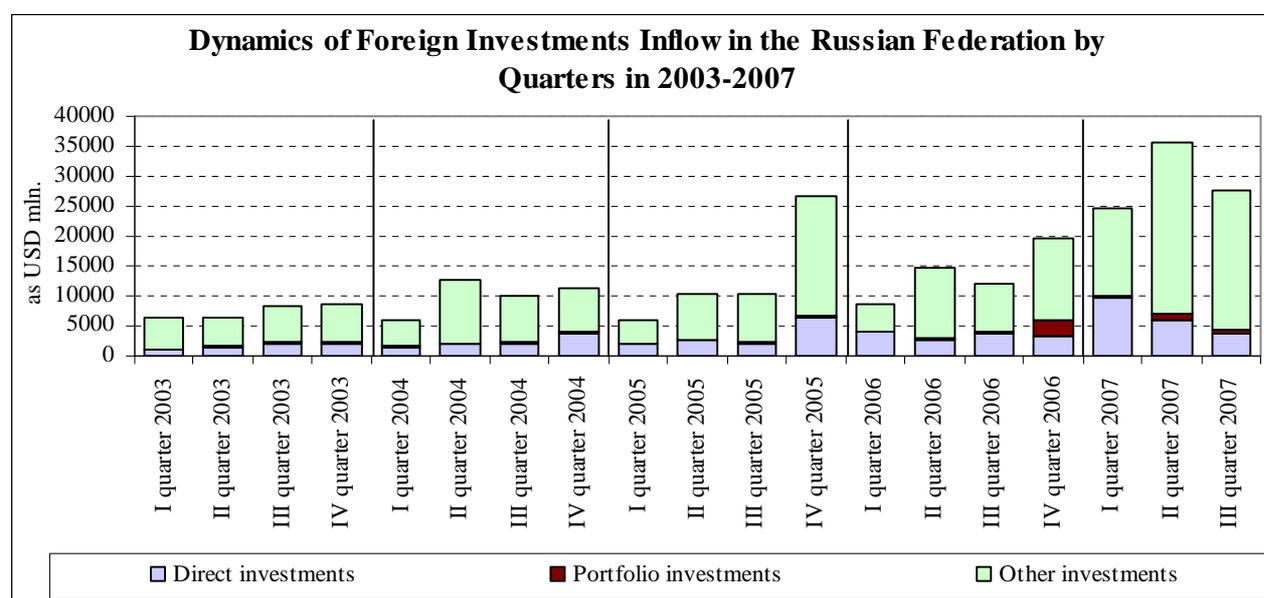
The total volume of foreign investments received by the Russian economy in 2007 increased due to the growth of all its components. Highest and steady growth was observed in the segment of other investments.

Table 5

Structure of Foreign Investments in Russian economy in January-September 2003-2007

	As USD million				As percentage to the previous year			
	Total	Direct	Portfolio	Other	Total	Direct	Portfolio	Other
2003	20 899	4 665	81	16 153	161.9	177.3	36.2	160.7
2004	29 135	5 590	227	23 318	139.4	119.8	280.2	144.4
2005	26 829	6 602	365	19862	92.1	118.1	160.5	85.2
2006	35 323	10 268	665	24 390	131.7	155.5	182.3	22.8
2007	87 936	19 644	1 547	66 745	248.9	191.3	232.6	273.7

Source: Federal State Statistics Service

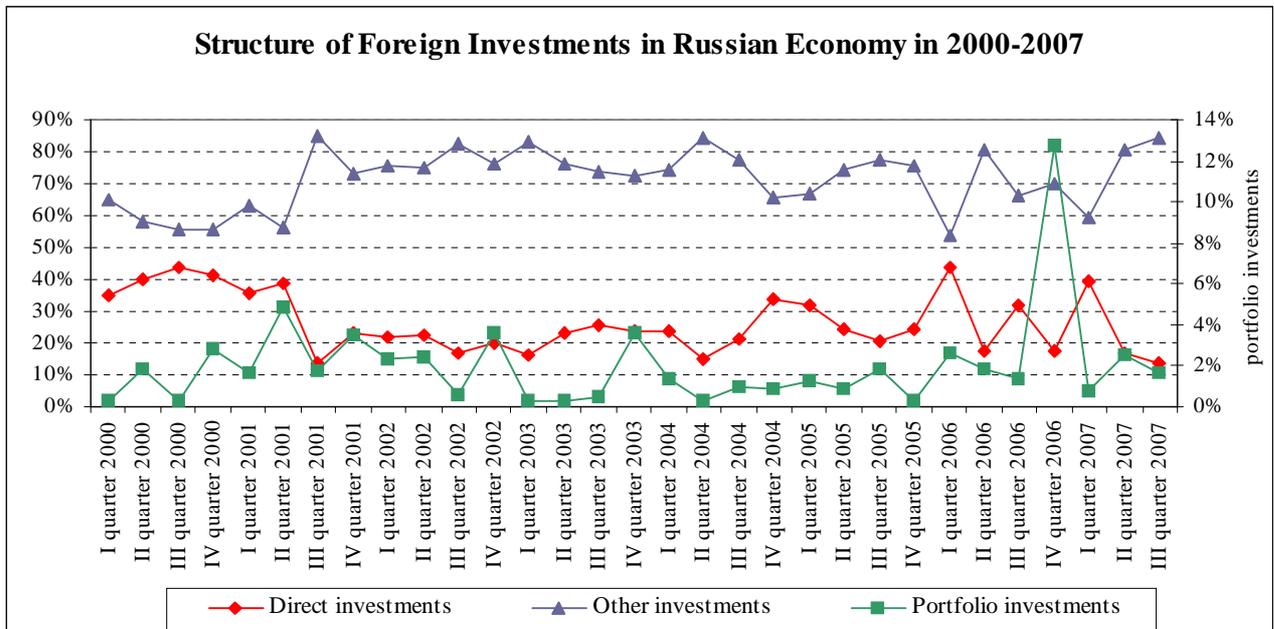


Source: Federal State Statistics Service

Other investments in the Russian economy increased by 3.1 times in 1 quarter, by 2.4 and 2.9 times, correspondingly, in 2 and 3 quarters. In the segment of direct placements by foreign investors the growth was observed only in the first half of the current year (by 2.5 times in 1 quarter and by 2.3 times in 2 quarter). In 3 quarter 2007 the level of direct investments nearly corresponded to the level of the similar period of 2006 (-0.4% against 3 quarter 2006). In 1 quarter 2006 decrease in portfolio investments by 14.3% as compared with the corresponding period of the previous year was observed. In 2 and 3 quarter 2007 they increased by 3.4 and 2.7 times, correspondingly.

Different dynamics of various directions of foreign investments demonstrate the following changes in structure of foreign investments by quarters.

In 2007 the concentration of foreign investments in industry and in the sphere of trade sustained, 84.4% of the total volume of foreign investments in the Russian Federation in January-September being directed in these areas. Considerable growth of investments in trade (by 5 times) has led to the increase of its share in the industrial structure by nearly 2 times as compared with January-September 2006.



Source: Federal State Statistics Service

Table 2

**Structure of Foreign Investments in Russian Economy by Industries
in January-September 2005-2007**

	As USD mln			Change as percentage to the previous year			As percentage to the total		
	2005	2006	2007	2005	2006	2007	2005	2006	2007
Industry	12 410	17 465	37 008	86.9	140.7	211.8	46.1	49.4	42.1
Transport and communication	2253	4 381	5 725	151.3	194.5	130.7	8.4	12.4	6.5
Wholesale and retail trade	8586	7 381	37 207	89.8	86.0	504.1	32.0	20.9	42.3
Operations with real estate, renting and services rendering	1823	3151	4 236	160.9	172.8	134.4	6.8	8.9	4.8
Finances, credit, insurance, pensions provision	1376	2060	2 152	199.1	149.7	104.5	5.1	5.8	2.4
Other industries	381	885	1 608	19.2	232.3	182.5	1.4	2.5	1.8

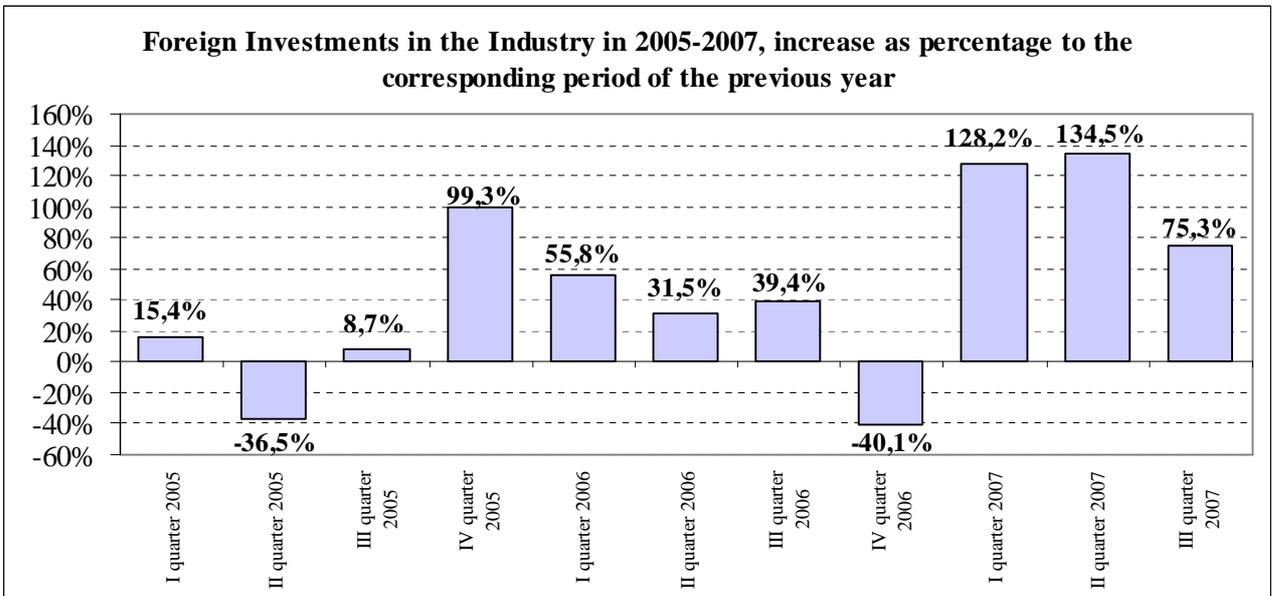
Source: Federal State Statistics Service

The highest growth of foreign investments in industry (238.0% to the level of January-September 2006) was observed in processing industries. Foreign investments in fuel industry increased by 1.9 times over 9 months of 2007. In processing industries investments in metallurgy increased by 4.3 times, in foodstuffs production – by 2 times, in chemistry production – by 12.8%, reaching the figures of USD 11.4 bln, USD 1.9 bln and USD 1.1 bln, correspondingly.

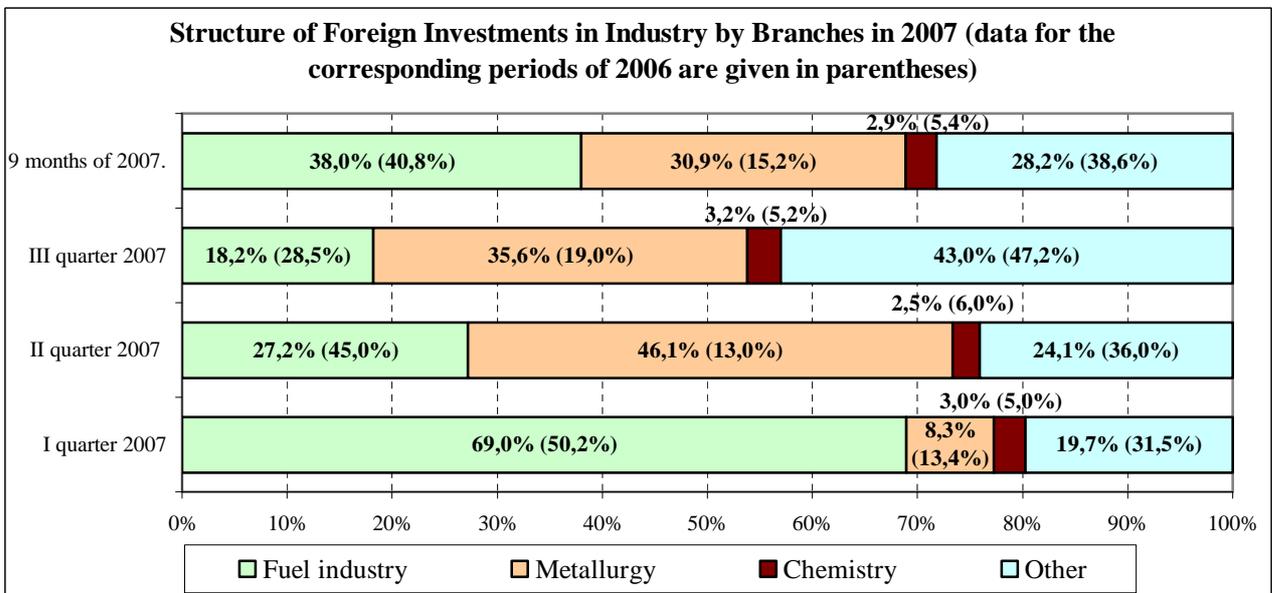
Analysis of dynamics of foreign investments in industry by quarters in the current year testifies higher growth rates as compared with the corresponding periods of 2006.

The highest growth of foreign investments in metallurgy over 9 months of 2007 was fixed in 2 quarter (by 8.3 times as compared with 2 quarter 2006), in 1 and 3 quarters the growth was equal to 41.4% and 330%, correspondingly. Interest of foreign investors in fuel industry in 1 quarter 2007 increased by 3.1 times, later, in 2 and 3 quarters, their growth was estimated as 41.9% and 11.9%. In 2 quarter 2007 the decrease of foreign investments in chemistry production was observed that was equal to 0.8% as compared with the corresponding period of 2006 (in 1 and 3 quarters their growth was equal to 38.5% and 7.5%).

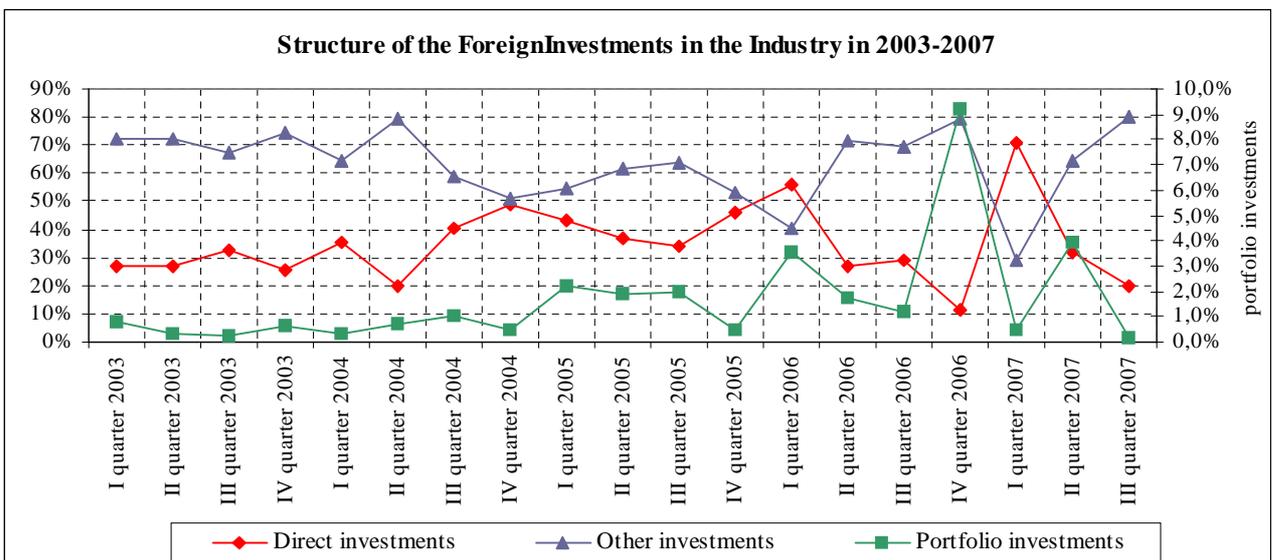
Differences in the dynamics by branches of industry were reflected in the change of branch structure of foreign investments in industry by quarters in 2007.



Source: Federal State Statistics Service



Source: Federal State Statistics Service



Source: Federal State Statistics Service

The share of direct investments in industry increased from 36.7% in January-September 2006 to 40.7% in January-September 2007, the share of other investments over that period decreased from 61.9% to 57.5%. The dynamics by quarters demonstrates considerable differences in the structure of foreign investments in industry in the current year. For instance, the share of the direct investments reduced from 70.6% in 1 quarter 2007 (56.2% in 1 quarter 2006) to 19.8% in 3 quarter (29.1% in 3 quarter 2006). The share of other investments, vice versa, increased from 28.9% to 80.1% (40.3% in 1 quarter 2006, 69.7% in 3 quarter 2006).

In the structure of foreign investments by branches of industry there were also changes noted. In the field of minerals extraction in January-September 2007 the share of direct investments having increased by 2.8 times as compared with the corresponding period of 2006 went up to 83.1%. The share other investments in extraction, whose decrease is estimated at 31.4%, has decreased to 16.8%.

In the processing industry, vice versa, the main part of investments in January-September 2007 was accounted for by other investments, which went up by 2.7 times as compared with the corresponding period of 2006 and reached in resulting figures of investments in the processing industries the level of 86.4%. Direct foreign investments in processing industries grew up not that dramatically – only by 27.1%. thus, the share of direct investments in processing industries decreased down to 11.0%.

The same as in the previous years it is the Great Britain that holds the leading position in the geographical structure of foreign investments receiver by the Russian economy during nine months of 2007, its share being 23.6% of the total amount of investments received by the Russian economy over the period (15.5% in January-September 2006), the second place is held by the Netherlands, figure being 19.6% of the total volume (14.7% in January-September 2006).

The most remarkable growth of investments was observed for Luxembourg in January-September of the current year they increased by 5.2 times as compared with the corresponding period of 2006, being USD 8.1 bln. At the same time about 50% of the investments from Luxembourg directed to the Russian Federation over 9 months of 2007 were made in 1 quarter.

Investments from the Great Britain over 9 months of 2007 increased as compared with the corresponding figure of 2006 by 3.8 times up to USD 20.7 bln (57.4% investments from the Great Britain was received in 2 quarter), from France – by 3.6 times up to USD 4.4 bln (the biggest part of French investments also being made in 2 quarter), from the Netherlands – by 3.3 times up to USD 17.3 bln, from Germany – by 73.9% up to USD 3.4 bln.

Table 3

Inflow of Foreign Investments in the Russian Federation by Main Investing Countries in 2007

	Received as USD mln			Change as percentage to the corresponding period of 2006			As percentage to the total		
	I quarter	II quarter	III quarter	I quarter	II quarter	III quarter	I quarter	II quarter	III quarter
USA	364	761	864	111.3	173.0	190.7	1.5	2.1	3.1
Germany	666	1340	1441	79.7	270.7	221.4	2.7	3.8	5.2
Great Britain	3124	11907	5698	407.8	367.5	386.8	12.7	33.3	20.7
Cyprus	2820	5205	3856	208.9	466.8	141.7	11.5	14.6	14.0
Netherlands	7760	4039	5471	701.0	148.5	399.3	31.5	11.3	19.8
Luxembourg	4048	2691	1384	808.0	320.0	607.0	16.4	7.5	5.0
Other countries	5842	9776	8879	149.7	169.2	177.2	23.7	27.4	32.2

Source: Federal State Statistics Service

Differences in the dynamics of investments have led to the change in the geographical structure of foreign investments in the Russian economy. The share of Luxembourg increased from 5.6% as a result of 9 months of 2006 to 9.2% in January-September 2007, of Germany – decreased from 5.6% to 3.9%. At the same time the share of the USA and France in the geographical structure of foreign investments in the Russian Federation did not change considerably, remaining at the level of 2.3% and 5.0%, correspondingly.

As a result of 9 months of 2007 Ireland became one of the biggest 10 countries making investments in the Russian economy, placing USD 4.4 bln in the Russian Federation or 5.0% from the total volume of the foreign investments. Main interest of the investors from Ireland is concentrated in the field of transportation and communication, where 62.9% of Irish investments was directed.

Entrepreneurs from the Great Britain continued investing in trade, placing 5.9 times more in this field in January-September 2007 than in the corresponding period of 2006. As a result of nine months of 2007

77.7% of the total investments in the Russian Federation from the Great Britain accounted for trade (in January-September 2006 the figure was 50.0%). The share of processing industries in the investments of the Great Britain decreased from 21.1% in January-September 2006 to 18.0% in January-September 2007.

In the structure of the investments to the Russian Federation from the Netherlands the increase in the share of fossil fuels extraction was observed from 50.7% in January-September 2006 to 68.0% in January-September 2007.

For the investors from Cyprus the most attractive spheres were trade, operations with real estate and constructions, where they invested 50.7%, 17.0% and 6.2% of the total investment from Cyprus to the Russian Federation in January-September 2007. As a result of nine months of 2006 the main direction of capital placement from Cyprus in the Russian economy was processing industries (23.9% of the total investments from the Cyprus).

As a result of January-September 2007 it is Cyprus, the Netherlands, Luxembourg, the Netherlands and Germany that hold the leading positions as to the total volume of accumulated investments, their share being 71.3% (over 9 months of 2006 – 70.7%). At the same time the share of the leading five countries-investors in the segment of direct investments went up to 76.7% (January-September 2006 – 71.0%), in the structure of portfolio investments it increased to 51.3% (January-September 2006 – 46.5%), but decreased in the structure of other investments to 67.3% (January-September 2006 – 71.3%).

Against the background of vast expansion of foreign investments in the Russian economy the volume of withdrawn capital in the form of foreign investors' profits transferred abroad as well as payment of interest rates for use of credits and credits repayment in January-September 2007 increased as compared with the corresponding period of 2006 by 36.1% and was equal to USD 39.8 bln. The same as in the previous year the biggest outflow of the capital was observed in 3 quarter 2007 (53.0% of the foreign investments received during this period). Over 9 months of 2006 82.8% of the foreign investments received were removed, in 3 quarter 2006 the figure being 96.1%.

Foreign Trade

N. Volovik

In October 2007 export and import indices reached record-breaking level for the last 17 years. Export growth rates exceeded import growth rates for the first time over the year. At the same time the number of countries with which Russia has negative foreign trade balance is growing. Russia and Poland have signed memorandum that lifts a more than two-year ban for Polish meat import in Russia.

In October 2007 Russia's foreign trade turnover reached record-breaking value of USD 56.8 bln. October cost indices of both import and export supplies were the highest for the last 17 years.

In October 2006 value volume of export exceeded the corresponding figure of 2006 by 39.5% and reached USD 34.8 bln. In October annual growth rates of export exceeded import growth rates for the first time in 2007, import being equal to USD 22 bln and having increased by 37.8%.

In October 2007 foreign trade surplus of the Russian Federation was positive and equal to USD 12.754 bln, exceeding the corresponding figure of 2006 by 42.4%. For the first time over the year the growth of foreign trade surplus has been observed as compared with the corresponding month of the previous year.

Such a high export index in October is accounted for by exceptionally high prices for oil. In October 2007 average monthly price for oil grade Brent was equal to USD 81.41 per barrel, which is 7.25% higher than in September 2007 and 40.6% higher than in October 2006. Such a situation at the market was caused by the shortage of crude oil and furnace fuel in the USA as compared with the corresponding period of the previous year. Thus before beginning of the winter crude oil reserves in the USA are below the last year's by nearly 4%, and the reserves of furnace fuel are below their last year's level by 26.5%. Decrease in the US dollar exchange rate also contributed to the growth of oil quotation.

Average price for oil grade Urals in October was equal to USD 79.6 per barrel, having increased by 44.5% as compared with the level of October 2006 and by 7.9% - with the level of September 2007.

Prices for petrol at the world market have increased by 5.39% as compared with the previous month and by 43.5% as compared with October 2006.

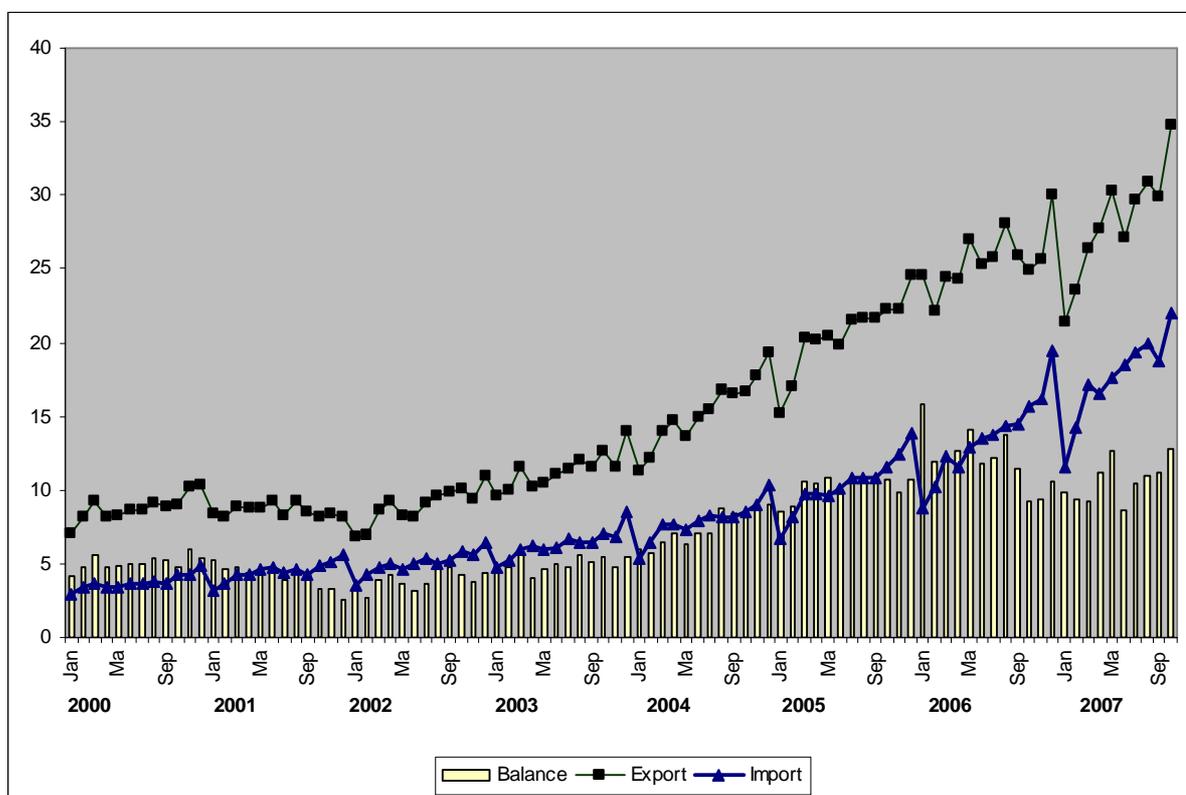


Figure 1. Main Indices of Russia's Foreign Trade (as USD billion)

Source: Central Bank of the Russian Federation

Prices for natural gas as compared with the previous month increased by 15.72%.

In October 2007 aluminum rose in price by 2.05% as compared with the previous month and became by 8.2% cheaper as compared with October of last year. Copper grew in price by 4,6% in October 2007 as compared with the previous month, nickel became more expensive by 4.7% as compared with September 2007. Growth of prices for non-ferrous metals is connected with reduction in stocks reserves.

Table 1

Average Monthly Prices in October of the Corresponding Year

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Oil grade Brent, as USD per barrel	17.9	12.8	24.1	32.14	21.45	27.2	29.6	49.8	58.2	57.9	81.4
Natural gas, as USD per 1 mln BTU	2.346	2.205	2.558	5.767	2.649	4.144	5.162	7.7	12.2	12.76	7.47
Gasoline, as USD per gallon	0.569	0.421	0.699	0.895	0.603	0.801	0.841	1.43	2.056	1.484	2.13
Copper, as USD per ton	1900.7	1659.2	1748.1	1838.6	1405.1	1519.0	1916.4	3012.0	4060	7500	8008
Aluminum, as USD per ton	1538.5	1354.2	1470.7	1473.5	1280.8	1313.2	1474.8	1822.8	1929	2659	2442
Nickel, as USD per ton	6240.5	4262.4	7984.2	7353.2	4836.8	6840.9	11030	14483	12403	32348	30999

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

Main factors that account for import growth were high growth rates of the Russian economy, growth of population income, continuous ruble appreciation. According to the Ministry for Economic Development and Trade of the Russian Federation appreciation of ruble exchange rate against dollar in real terms was equal to 11.6% over January-October 2007. Appreciation of ruble exchange rate against euro in real terms was 4.9%, against pound of sterling – 10.2%.

In the second half of the year the role of price factor become more significant, prices for foodstuffs and agriculture raw materials import for instance increased.

Over January-October Russian export increased by 12.7% up to the level of USD 280.4 bln, and import – by 36.5% up to USD 175.5 bln. Positive Russia's foreign trade balance in January-October 2007 reduced down to USD 104.9 bln as compared with USD 120.1 bln a year ago.

The question of how long under existing trades for export and import development positive balance of the foreign trade can be maintained remains exceptionally important for estimation of further development of the Russian economy.

In medium-term run there is a possibility of sustention of export excess over import. A number of conditions should however be fulfilled for this. First, the factor of importance is the situation at the world trade markets. Continuous growth of prices for oil, metals, raw materials for chemistry production and wood allows counting upon the growth of export of raw materials value volumes despite stagnation in physical volumes of importing goods. Second, exhausting of possibilities of production and technological base that was created in the territory of the CIS countries during Soviet times creates opportunities to increase export of processing industries to these countries. Third, intensification of struggle against inaccurate customs declaration of a number of goods in 2007 can case the slow-down of import value volumes growth rates by these items in 2008-2009.

In January-October 2007 in geographical structure of Russia's foreign trade countries that are members of the European Union still prevailed. The volume of foreign trade turnover with this group of countries increased as compared with the corresponding period of the previous year by 15.6% and was equal to USD 224.6 bln. At the same time export went up by 6.7%, and import - by 42.8%. The share of EU countries in foreign trade turnover decreased as compared with January-October 2006 by 3.4 percentage points and was equal to 51.6%.

Second place by the volume of foreign trade turnover is held by the countries of Asia-Pacific Economic Cooperation zone, whose share in foreign trade turnover as a result of January-October 2007 increased up to 19.2% (growth by 2.4 per cent) and was equal to USD 83.6 bln. Increase in volume was equal to 40.9% in foreign trade turnover, being 16.6% by export and 64.2% - by import.

The share of CIS countries in foreign trade turnover was equal to 15.2%, increase in volumes in January-October 2007 being, correspondingly, 25.4%, 20.3%, 35.4%.

The number of countries with which Russia has negative foreign trade balance by import and export goods is increasing. Whereas in January-October there were 19 such countries, in January-October 2007 there number increased up to 24.

It is with Germany, the USA and China that export and import ratio changed especially sharply. In the first 10 months of 2006 Russia had steady positive balance and in 2007 it became negative.

The growth of trade turnover with China occurred due to increase of machinery, equipment and transport vehicles, textile, clothing and footwear import that make up about 70% of import into Russia from this country.

Analysis of contemporary structure of Russia-American trade testifies its goods misbalance. It is oil and oil products (52.3%), aluminum and goods thereof (11.7%), ferrous metals (7.3%) and inorganic chemistry production (7%) that prevail in export from Russia. Machinery, equipment and transport vehicles constitute only 12% of the export. Among other export goods major positions are held by uranium, platinum, nickel as well as clothing goods and fish products.

In import from the USA into Russia it is traditionally different kinds of machines and equipment (oil and gas equipment, planes, electric equipment, optical and measure tools, medicinal equipment) as well as grain and meat products that prevail. Thus, in Russian export to the USA it is the raw materials that prevail, the share of finished goods being small, while it is technology and food that prevail in import.

The most unexpected was the negative trade balance with Germany. Russian oil and gas are intensively supplied to this country. Partially negative trade balance with this country is accounted for by the fact that at the beginning of 2007 there was a drop in oil prices. Moreover last warm winter but the main reason is a sharp growth (44.5%) of import supplies from Germany. It is machine tools, equipment and transport vehicles that are imported from this country.

On 19 December 2007 representatives of Russia and Poland signed a memorandum that lifts more than a two-year ban for Polish meat import in Russia.

Corresponding document was prepared together by Federal Veterinary and Phytosanitary Supervision Service and Veterinary Service of Poland. Polish party guarantees that qualitative production of Polish origin will be supplied to Russia and that there will be no import from other countries in Russia through Poland.

Limitations for import of meat from Poland were introduced by Russia in November 2005. Embargo concerned raw meat, used for food production. There were two main reasons for embargo. First, several consignments of meat from other countries that were transported as transit goods through Poland Russian veterinary doctors considered as not meeting the sanitary norms. Polish side gave official explanation: according to trade rules between EU countries Polish authorities check sanitary certificates only for import of products from another EU country and not for export. That is the reason why from the point of view of Warsaw Polish sanitary authorities did not violate international norms. Russia required the products to be checked while exporting from Poland. However Poland did not do it out of principle, conducting, however, prosecutor check-ups concerning falsification of documents for meat in its territory.

Second reason for embargo was discovery in Russian shops of pork and beef liver of the sorts initially aimed for production of food for cats and dogs. For these claims Poland responded that it is not responsible for its meat that is supplied to Russia through Moldova and the Ukraine.

These explanations did not satisfy Moscow and in November 2006 the relationships between two countries became even tenser. As a result Poland banned the negotiations on new basic agreement between the Russian Federation and the European Union, whose validation period is coming to the end in December 2007, connecting it with the lift of the ban for meat import by Russia. Besides, Poland claimed that Russia's obstinacy will cost it negotiations on admission to the Organization of Economic Cooperation and Development. It is possible to begin these negotiations only on condition of all member-countries being consent. Then Warsaw declared that it will ban Russia's accession to the World Trade Organization.

As a result of parliamentary elections in October 2007 new government presided by Donald Tusk has come to the power and the situation started changing. The new Minister of Agriculture Marek Savitski immediately after being appointed declared that he is going to solve the "meat problem" with Russia "without political prejudices".

Lift of the ban will allow beginning of negotiations on signing new Agreement on strategic partnership between Russia and the EU. Poland does not have intention of blocking negotiations on Russia's accession to the Organization of Economic Cooperation and Development.

Results of Special Economic Zones Operation in 2007

I. Sokolov

There have already passed two years since regulatory documents concerning creation of the first special economic zones (SEZ) were signed. Whereas 2006 was primarily devoted to the regulation of administrative and organizational issues of creation of two industrial and production and four technology and innovation zones, beginning of construction of engineering, transport and communication infrastructure construction in them, selection of the first residents, in 2007 the nature of production and investment activity of the zones started to outline more distinctly, which allows drawing first conclusions and estimating middle-terms prospects for SEZ operation.

The first Federal Law No 116-Φ3 "On special economic zones in the Russian Federation" was adopted in Russia in July 2005, and in December of the same year, that is two years ago, the first results of contest of the applications submitted were analyzed. According to the Decree of the Government of the Russian Federation 4 technology and innovation zones were created (Moscow (Zelenograd), Moscow region (Dubna), Saint-Petersburg, Tomsk) and 2 industrial and production zones (Lipetsk oblast, Tatarstan (Alabuga)) were created. It should however be noted that due to the absence of complex program documents that identify the main directions of innovation and industrial activity of the policy of the Russian Federation for a long run, the kinds of activities whose development stimulation should be carried out within these zones, according to the point of view of the Government, were not defined legally.

As a consequence the approach to the selection of residents for industrial and production zones was based not on the kind of economic activity as a criterion but on the consent to invest in its own development no less than Euro 10 mln over the period of zone existence (20 years). The result of such a policy of selection is that in industrial and production zone "Alabuga" it is the enterprise on production of cars model Fiat "Ducato" that is the main resident, and in Lipetsk oblast it is a number of companies for production of household appliances and agriculture equipment, electronics and biological fuel.

For the residents of the technology and innovation zones the minimum sum of investments is not defined at all, and the status of the resident of technology and innovation zone was obtained by all the scientific and production organizations that operated in the territory of the subjects of the Federation long before the decision on creation of zones of such a type was made.

Thus the first industrial and production as well as technology and innovation zones were created in Russia on the basis of the kinds of specialization existing in the territory of the Federation instead of selecting territories that are best suited for placement of priority production and research and development complexes. Should this approach be followed in future one can hardly expect the development of new directions of innovation process, creation of processing production of high technology that are capable of making considerable macroeconomic effect.

The results of the functioning of the zones in 2007 are the following: 10 companies-residents are registered in industrial and production zones, 42 – in technology and innovation zones. Existing residents, according to the data of the Federal Agency for Management of Special Economic Zones, have already invested about RUR 8.5 bln, and by 2010 the results of their investment activity should be about RUR 27 bln and about 13 thousand of additionally created job vacancies.

It is generally expected that by 2010 the number of residents of these zones will increase up to 250 and the amount of additional investments will exceed RUR 35 bln.

Not only does the government in its turn provide residents with a number of quite considerable tax, customs and administrative preferences but it also takes the responsibility to make modern infrastructure for these zones. For instance, in 2007 the government invested in construction of their infrastructure RUR 12.2 bln, and according to the federal budget for 2008-2010 the expenditures at the sum of RUR 31 bln are planned for SEZ. Thus by the end of 2010 the government intends to allocate nearly RUR 43 bln for infrastructure improvement of the zones.

However making such huge investments one should very carefully approach the estimation of the efficiency of zones operation, since the return from the investments could be less than the forecasts based on business plans submitted by the residents state. Moreover, it seems very unlikely that that in the environment of privileged taxation regime (there are no taxes for enterprises' assets and land during first five years of residence, the rate of profit tax is reduced to 20%, 30% limitation of transfer of the losses of the current taxation period on the forthcoming periods is cancelled, accelerated amortization is allowed) there is real opportunity to return the federal funds spent in the form of taxes for the budget even by 2015.

As to estimation of the economic efficiency of the zones, even their contribution to the Gross regional product of the regions where they are located, in middle-term run will remain not very significant, not mentioning the influence on competitiveness and diversification of the Russian economy as a whole.

Impact of the zones on the unemployment situation in these regions also won't be significant, and consequently the social effect being however positive could hardly be called significant.

Uncertainty of the authorities as to the question whether the approach to the conduction of the experiment on creation of such zones is correct can be seen from the cautiousness as to the issue on declaration of the second contest for industrial and production as well as technology and innovation SEZ, whose possibility of conducting is dependent on the results of currently operating experimental areas.

From our point of view, the prospects for special economic zones development as a mechanism for public-private partnership should be connected with the creation of tourism and recreational as well as port zones in the territory of the Russian Federation. Effect from their operation could be far more significant for the Russian Economy than in case of the SEZ mentioned above, and there are several prerequisites for it.

First of all, annual expansion of direction and volumes of international freight flows, considerable growth of world and domestic tourism force Russia to get more actively involved in creation of international transition transportation passages and in formation of modern tourist complexes in the country's territory.

Second, the spheres of tourism and transportation, having traditionally high potential for growth in the country, can significantly expand their contribution to the GDP on condition of creation the necessary infrastructure, meeting the requirements of rendered services quality and availability.

Third, readiness of the government to make large-scale investments in transport and tourism infrastructure, presence of additional tax privileges (for instance in concordance with subparagraphs 22-23 paragraph 2 clause 149 of the Tax Code services and works for servicing of airplanes and sea-crafts and inland ships during the mooring in the ports and exempted from VAT payment) as well as increased requirements for residents of port zones to make investments (no less than Euro 100 mln per resident building the objects of infrastructure of new seaport and no less than Euro 50 mln while construction of new river port or airport).

At the beginning of 2007 there were 7 tourism and recreational zones created in Russia according to legislation (in Krasnodar and Stavropol kraies, in Altai krai, in Republic of Altai) but in fact that will not start to operate until 2012. It is expected that already by 2016 the creation of the zones will contribute to trebling the flow of the flow of tourists in the country, and by 2026 about 86 thousand of new job vacancies will be created in their territory.

Creation of port zones in Russia was postponed for a long time and all necessary changes to legislation were made only in October 2007. Port zones can be created both in territories open to international communication and entrance of foreign sea-crafts and inland ships and airports, operating international transportations, and in the territories that are intended for ports and airports construction and expansion. There are good chances for seaports in Novorossiysk, Murmansk, St. Petersburg as well as airports Domodedovo and Krasnoyarsk to become port SEZ. It is expected that the contest to choose port zones will be conducted in the first quarter of 2008.

Organizational Changes in Governmental Sector of Science

I. Dezhina

Changes in the status of Russian Academy of Science and its dependent institutions in connection with adoption of new Charter of Russian Academy of Science are discussed in this section. Advantages and disadvantages of new system of Russian Academy of Science work regulation are considered. Specific attention is paid to the issue of integration of fundamental science and education, in connection with adoption of new legislation, regulating conditions of joined scientific and educational activity of scientific and educational activity of scientific organization and higher education institution.

One of the central events of recent months was the discussion of the new Charter of the Russian Academy of Science, which the Academy should approve in connection with the changes made to the Federal Law "On science and governmental scientific and technical policy".

The project of the Charter has been developed by the Russian Academy of Science and an alternative document, called "Project of the Model Charter of the government academy of sciences", the authors of which are still unknown. In the addenda to the document it was stated that it was developed by the federal execution bodies of the Russian Federation with the participation of an expert committee. The Ministry of Education and Science promoted and popularized the main statements of the Model Charter. In November the Government approved the Charter¹⁸, that was developed by the Russian Academy of Science and approved by the General assembly of the Academy. Main changes suggested by Model Charter and the Charter developed by the Russian Academy of Science in comparison with the Charter of the Russian Academy of Science existing before, are represented in the Table 1.

It was the statement of the Model Charter according to which Supervision board was to be introduced that attracted attention. Supervision board was empowered with executive functions concerning Academy's finances and property management as well as definition of the annual number of the Presidium, president's, first vice-president's and vice-presidents' personnel. This could not have caused positive reaction of the Russian Academy of Science's governing bodies and the Model Charter as a whole was subjected to the acute critics and it should be noted that not only by the representatives of academician society. Indeed, the Model Charter seemed to be not very well considered or worked out in detail document. For instance, charging of the supervision board with execution functions instead of control functions that it should in principle carry out contradicts the statement introduced by the Law on science that the President of the Russian Academy of Science is appointed by the President of the country and correspondingly giving the President of the Russian Academy of Science not only authority but also responsibility for all the decisions made by the Russian Academy of the Science. Model Charter did not define main directions of Russian Academy of Science work, nor did it mention the interaction of the Academy with the spheres of education and industry, badly works out the structure and mechanism of governing as well as concord of interests. Thus if the authors of the Model Charter considered its content in more detail and did not suggest such radical distribution of functions between the Presidium of the Russian Academy of Science and the Supervision board, then their idea on introduction of external control over the work of the Russian Academy of Science in the form of the Supervision board would have had the chances to be accepted.

The Charter of the Russian Academy of Science that was adopted gives the Academy considerably more freedom as to managing its finances and property and at the same time increases Academy's responsibility for the results of its work. Russian Academy of Science becomes a full member of budgetary planning and is actually made equal to the body of federal power. From now on the Academy and its regional departments will be given subsidies to fulfill the program of fundamental scientific research, Russian Academy of Science and its Organizations will be able to open accounts in credit institutions. Financing of scientific organi-

¹⁸ Decree of the Government of the Russian Federation "On Russian Academy of Science", No785 from 19.11.2007

zations, dependent on the Russian Academy of Science will be based not on the calculation but will be allocated by one line. Academic structures will have right to be founders of other organizations. Russian Academy of Science also have a right to contribute statutory capital of the commercial organizations created by it the results of research and development work in concordance with the legislation of the Russian Federation. All this makes the organizational structure of academic science more flexible and increases the possibilities of scientific organization participation in innovation process.

Table 1

Changes in Russian Academy of Science Organization and Regulation

Charter of the Russian Academy of Science existing earlier	Suggestion of the Model Charter	Charter of the Russian Academy of Science approved in 2007
President of the Russian Academy of Science is elected by the General assembly	President of the Russian Academy of Science is elected by the General assembly and his appointment is confirmed by the President of the Russian Federation	President of the Russian Academy of Science is elected by the General assembly and his appointment is confirmed by the President of the Russian Federation
Charter of the Russian Academy of Science is adopted by the General assembly	Charter of the Russian Academy of Science is adopted by the General assembly and approved by the Government of the Russian Federation	Charter of the Russian Academy of Science is adopted by the General assembly and approved by the Government of the Russian Federation
Academy has governmental status, is self-regulating and financed from the state budget	The Academy has legal and organization form of a budgetary institution and has a right to regulate its own work	The Academy is non-commercial scientific organization created in the form of governmental academy of sciences. It is a self-regulating organization.
There is no supervising committee	Supervising committee is a joint regulating body of the Academy regulation. It is composed of three representatives of the Academy, three – of the Government and one representative from the State Duma, the Federal Assembly, the Presidential Administration	There is no supervising committee
Among those who have a right to elect the governing body of the Academy there are two thirds of the academicians and one third of the representatives of the organization of the Academy	Among those who have a right to elect the governing body of the Academy there is one half of the academicians and one half of the representatives of the organization of the Academy	Changes that are made to the Charter of the Russian Academy of Science are adopted at the General Assembly of the academicians with the majority of two thirds votes of the members of the general assembly that took part in voting. It is necessary to be the majority of the votes from the full list of the members of the Russian Academy of Science and majority of votes of the full list of the full members of the Russian Academy of Science. As to other issues decisions are made by the majority of those present.
There are no age limitations for governing positions.	Age limitations (70 years) are introduced for all governing positions in the Academy	There are no age limitations for governing positions.

Sources: Charter of the Russian Academy of Science 1992; Model Charter of the government academy of science; the Charter of the Russian Academy of Science approved by the Decree of the Government of the Russian Federation from 19.11.2007 No 785.

Besides, program financing of fundamental research expands. It is planned that to manage the program of fundamental research the coordination board will be created from the representatives of the government academies of science and institutions concerned¹⁹. Creation of such a board can be the first step to expand the program of fundamental research, including other organizations of government sector of science as well as higher education institutions in it.

¹⁹ Shorthand record of the meeting of the Committee on science, technology and education from 30 November 2007 <http://kremlin.ru/text/appears/2007/11/152987.shtml>

At the same time from now on the institutions of the Russian Academy of Science will be responsible for their liabilities by monetary funds and property purchased at the expense of means, obtained from the profitable activity. Monetary funds and property purchased at the expense of means obtained from the profitable activity being insufficient at the institution, it is the Russian Academy of Science that holds subsidiary liability by the obligations of these institutions.

All these changes come into effect from 1 January 2009, and in 2008 the Ministry of Education and Science and the Ministry of Finance should come to agreement as to the mechanism of subsidies allocation, the personnel of the Presidium of the Russian Academy of Science should be reorganized and a number of other administrative and management transformations should take place.

When elaborating the Charter of the Russian Academy of Science a number of statements has been discussed that were reasonable to be introduced but that were not adopted. For instance, the Charter does not introduce the age limitation for governing positions in dependent scientific organizations. Taking into account that one of the significant factors influencing negatively the demographic situation in science is absence of opportunities and conditions for career for young scientists, this statement complicates the staff problem solution at academic institution. At the same time age structure of the Russian Academy of Science is already one of the gravest problems in the government sector of science.

One more suggestion that was declined in the final version of the Charter was the limitation for holding main administrative positions in the Academy for more than two terms. Thus the idea of replacement of Russian Academy of Science governing bodies was not adopted that is somewhat of a threat for full realization of new principles of Russian Academy of Science functioning, since flexible forms of financing and administration are introduced to the structure where outdated management practice prevails.

Nearly simultaneously with the approval of new Charter of the Russian Academy of Science the law regulating the condition of science and education integration was finally adopted²⁰. It gives to the scientific organizations the right to train according to the programs of post-graduate education as well as additional professional education. The law allows the education and scientific institutions to use staff and material resources to carry out both scientific and educational activity together. Higher educational institutions and scientific organizations also obtain the right to give to each other basing on contract, also free of charge, movable or immovable property of their ownership, as well as to create integration structures – chairs, laboratories.

Up to present moment integration of science and education was complicated due to many regulatory and legal problems that are eliminated by the adopted law. However legislative securing of necessary conditions for integration was developed and coordinated for a time too long and at the moment the integration could be complicated not by administrative obstacles but due to increased inequality of parties that could integrate. It consists in the fact that the average level of research in the higher education institutions is lower than in academic and other scientific organizations, it is especially true for natural sciences and technical subjects²¹. One of the reasons is insufficient financing of science in the higher education institutions. In 2007 only 3.8% of the federal budget funds for civil science²² was directed to higher education institutions whereas Russian Academy of Science receives about 35% of expenditures of federal budget for civil science.

Low intensity of research and development work in the higher education institutions is testified by the number of higher education institutions conducting research and by the data on the proportion of professors and tutors involved in it. There being 1071 higher education institutions, of which 662 are governmental institutions, 406 higher education institutions conduct research and development work²³. The number of research workers in higher education institutions in recent years was no more than 8% of the total number of research workers throughout the country²⁴. In this case the statistics does not take into account the faculty

²⁰ Federal Law “On making changes to some legislative acts of the Russian Federation concerning the issue of science and education integration” from 01.12.2007, No308-ФЗ.

²¹ The exception is Moscow State University that receives funds for research and development work directly from the budget.

²² A. Khlunov, head of the department for government scientific, technical and educational policy of the Ministry for Education and Science of the Russian Federation, from the speech at the round-table conference “Science in higher education institutions: present situation and prospects for development”, 14.09.2007, Center “Transparent economy”

²³ Scientific indicators – 2007. Statistics collection. Edited by the State University High School of Economics, 2007, p.20; Education indicators– 2007. Statistics collection. Edited by the State University High School of Economics, 2006, p. 74.

²⁴ Scientific indicator– 2007. Statistics collection. Edited by the State University High School of Economics, 2007, pp. 28, 189.

combing tutoring and research work. Such a calculation is not easy to make since the majority of tutors do research unsystematically and often very little. According to the data of sociological surveys²⁵, only 17.1% of the tutors of higher education institutions do research work. Among them 15.8% do fundamental research that is either textbooks preparation or PhD theses writing²⁶. Disproportions in the volume and level of research and development work conducted in academic and higher educational institution sectors of science are the obstacle for equal integration.

At the same time there is potential and readiness for integration in the education field. According to estimations, 34% of research workers in the institutes of the Russian Academy of Science are tutoring already. Academic institutes are interested in new staff inflow. Upon cooperation with higher education institutions scientific institutes get the access to students and PhD students that can be included in the number of research projects executors. In higher education institutions in their turn there is a certain shortage of scientific topics for PhD students during the work on their theses. For instance, if at the beginning of 90-ies 70% of PhD students and 30% of undergraduates were involved in research in higher education institutions, at the moment the figures are 3-4 times lower²⁷.

Meetings of the Government of the Russian Federation in December 2007

M. Goldin

In December at the meetings of the Government of the Russian Federation the following issues were discussed among others: fulfillment of federal targeted programs and federal target investment program over 9 months of 2007, project of the plan for actions of the Government of the Russian Federation to fulfill main statutes of the Program for social and economic development for middle-term prospect (2006-2008) in 2008, as well as the project of the plan for legislative activity of the Government for 2008.

On **6 December** at the meeting of the Government of the Russian Federation the issue on the course of fulfillment the federal target programs and federal targeted investment program over 9 months of 2007 was discussed. This issue is traditionally considered at the end of the year in accordance with the Plan for the meetings of the Government of the Russian Federation for June-December 2007. The report of the Ministry for Trade and Economic Development on this issue included the data on the course of federal target programs fulfillment as to every program and the data for FTIP realization including its non-program part and suggestions to improve work at FTP and FTIP. The report also contained information on the work of government customers at the preparation of the concept projects and federal target programs, suggested for financing at the expense of the federal budget funds, starting with 2008.

The following facts were voiced in the report. Some decrease in the number of target programs and subprograms financed has taken place. Thus, over 9 months of 2007, 46 federal target programs and 36 subprograms included in the open part of the federal budget were being fulfilled. In 2006 there were 51 programs and 50 subprograms financed, correspondingly.

At the same time as compared with the previous year the volume of federal target programs financing has considerably increased. The total volume of federal target programs financing for 2007 at the expense of federal budget funds taking into account changes made to the federal law on the federal budget for 2007 up to 1 October 2007 was equal to RUR 522.3 bln, including government investments of RUR 312.6 bln, for research and development of RUR 49.2 bln, for expenditures for "other uses" of RUR 160.5 bln. In 2006 these indices were equal to: the total volume of federal target programs financing – RUR 363.6 bln, government investments - RUR 204.6 bln; research and development – RUR 37.6 bln, other needs –RUR 124.1 4 bln.

Considered as a whole over 9 months of 2007 in order to fulfill program measures there were government contracts, including contracts of previous years, signed at the sum of RUR 472.41 bln or 90.5% of the budget limits. For reference, over 9 months of 2006 the corresponding figure was equal to RUR 276.1 bln or

²⁵ The survey was conducted in 2005 by the order of the Ministry of Education and Science of the Russian Federation in 501 organizations, representative for academic, higher educational institution's science and dependent institutions, located in 24 regions of Russia. Source: Sheregi F. E., Strikhanov M. N. // Science in Russia, sociological analysis (Nauka v Rossii: sociologicheskii analiz) published by Centre for Sociology Programs, 2006.

²⁶ Sheregi F. E., Strikhanov M. N. // Science in Russia, sociological analysis (Nauka v Rossii: sociologicheskii analiz) published by Centre for Sociology Programs, 2006, p282.

²⁷ Analytical report on higher education in the Russian Federation. Ed. Larionova M. V., Meshkova N. A. Published by State University- High School of Economics publishing house, 2007, p. 138.

75.9% of the budget allotments. However the level of financing of federal target programs was rather low, on average being 52.7%. For instance, the sums for which government contracts were signed and the real figures for their financing by the following programs were equal correspondingly to:

“Transfer to the completion of the positions of a number of military formations and units by servicemen, making service by contracts” – 71.4 % and 71.14 %;

“Development of judicial system” – 63.0 % and 52.5 %;

“Nations of the North” – 78.3% and 47.6%;

“Russian language” – 80.7 % and 45 %;

“Civil aviation” – 81.2% and 37.4%;

“Improvement of road safety” – 76.0% and 23.5%;

“Socially important diseases prevention and treatment” – 76.2% and 16.4%;

“Social support of the disabled” – 47.6% and 17.3%;

“Electronic Russia” - 43.1% and 13.0%.

Thus, it would be correct to say that the budget execution is delayed because of the customers of the federal target programs and its dependent organization faults.

In 2007 the attraction of funds from the budgets of subjects of the Russian Federation and municipal formation, as well as off-budget sources to fulfill 35 programs of the total sum of RUR 833.74 bln is envisaged, of which RUR 274.41 bln are at the expense of the regional budgets and RUR 559.33 bln at the expense of off-budget sources.

Actual co-financing of programs over 9 months of 2007 was equal to RUR 363.77bln or 43.6% of the amount envisaged for the year, of which: RUR 135.61 bln (49.4%) from the funds of the budgets of the subjects of the Russian Federation and local budgets and RUR 228.16 bln (40.8%) from off-budget funds.

For reference, over 9 months of 2006 there were funds from the budgets of the Russian Federation and off-budget sources at the sum of RUR 269.71 RUR attracted to the realization of federal target programs by the government customers, which comprised 32.8% of the year allotments. Thus, over 9 months of 2007 government customers attracted 10.8 per cent more funds than in the corresponding period of the previous year.

According to the estimation of the Ministry for Trade and Economic Development the work of the government customers on 9 federal target programs can be considered effective, on 30 programs – satisfactory and on 6 programs – as low effective.

The following programs were referred to as low effective: “Social support of the disabled for 2006-2010”(Ministry for Health Care and Social Development of Russia); “ “Improvement of road safety in 2006-2012” (Ministry of Internal Affairs of Russia; Electronic Russia (2002-2010)” (Ministry of Information and Communication of Russia); “Complex measures to counter fight drug addiction and their illegal traffic in 2005” (Federal Service for Drugs Control); “Development of civil aviation equipment in Russia in 2002-2010 and for the period up to 2015” (Ministry for Industry and Energy of Russia); “Industrial utilization of weapons and military equipment (2005-2010)” (Ministry for Industry and Energy of Russia).

Thus, according to the data of the Ministry for Trade and Economic Development, over 9 months of 2007 by financial indicators of federal target programs fulfillment at the expense of the federal budget funds is behind the figures of 2006. This is accounted for by the late beginning of fulfillment of the majority of federal programs in connection with the absence of financing in the first quarter of 2007. It was the lag with the elaborating of the necessary legislative act that was pointed out among the reasons for the delay in federal target programs execution. The responsibility for this was laid with the report by the vice-minister of the Ministry for Trade and Economic Development A. Belousov on “customers who coordinate the programs of the ministry and departments that submit proposals and execute federal target programs”.

At the meeting as a result of the discussion the Chairman of the Government of the Russian Federation instructed to make deep analysis of programs financing and elaborate the suggestions either to correct or stop these programs fulfillment. The Ministry for Trade and Economic Development was commissioned with preparation of the corresponding suggestions by March 2008.

On **20 September** at the meeting of the Government of the Russian Federation 2 most important issues were discussed among others: draft of the plan of actions of the Government of the Russian Federation as to realization of the main statements of the Programs for social and economic development of the Russian Federation for a middle-term run 2006-2008 and the draft for the plan of legislative activity of the Government of the Russian Federation for 2008. Not dwelling on detailed characteristics of the measures that are to be taken in concordance with these two documents, we are to note that in the first document, among other things, the preparation of Concept for long-term social and economic development of the Russian Federation up to the period of 2020 is planned.

Legislative regulation of the concept for social and economic development of the Russian Federation for the long term is based on the Federal law from 20.07.1995 No 115-Φ3 “On government prognosis and programs of social and economic development of the Russian Federation”. According to the law, every five year a Concept for social and economic development of the Russian Federation for long term should be elaborated in Russia. It is in the concept of the social and economic development of the Russian Federation where the possible aims for social and economic development of the Russian Federation, ways and means to achieve the aims mentioned should be defined. For a long time the long-term programs in Russia were not adopted but instead concepts for the country’s social and economic development for middle-term prospect were elaborated. The procedure for the development of the prognosis of social and economic development and the concept for social and economic development of the Russian Federation for a long-term run were defined by the Government of the Russian Federation. However such a procedure has not been adopted by the Government of the Russian Federation.

It is evident that legislative regulation of the government strategic planning is inadequate. For instance, the algorithm for definition of the goals of society development aims for a long-term run as well as procedures for their selection is yet unclear. The Government of the Russian Federation is yet to fill this gap.

Legal aspects of supporting exports of hi-tech products through the creation of the public corporation «Rostekhnologia»

A. Kireeva

In last quarter’s overview we discussed issues relating to the creation of a Russian nanotechnologies corporation and the possible legal consequences of the adoption of Federal Law “On the Russian Nanotechnologies Corporation” of 19 July 2007, No 139 - FZ. In this overview, we are going to further develop the theme of legislative changes in the sphere of innovations, while placing the main focus on the analysis of Federal Law “On the State Corporation «Rostekhnologia» of 23 November 2007, No 270 - FZ. Based on this Law, one more state-owned structure must be founded, to receive from the federal budget substantial funding allocated to hi-tech development.

According to Article 3 of the Law, the purpose the State Corporation (SK) «Rostekhnologia» will be “to promote the development, production and export of *hi-tech industrial products* by providing support, on the domestic and foreign markets, to Russian organizations – developers and manufacturers of hi-tech industrial products, and by attracting investments to organizations belonging to different branches of industry, including the defense-industrial complex”.

The Corporation’s main functions are determined as follows:

- assistance to organizations belonging to *different branches of industry, including the defense-industrial complex*, in the development and manufacturing of hi-tech industrial products;
- ensuring of the access to the domestic and foreign markets and of the sales on the domestic and foreign markets of hi-tech industrial products, as well as of the commodities and results of intellectual activity associated with the creation of those products;
- participation in the implementation of government policies addressing the Russian Federation’s cooperation with foreign states in the sphere of military technologies and government armaments program;
- attraction of investments to organizations belonging to different branches of industry, including the defense-industrial complex, and among other purposes, for the purpose of creating competitive samples of hi-tech industrial products, including military products;
- realization, in the interests of organizations belonging to different branches of industry, including the defense-industrial complex, of promotion, exhibitions and marketing activity, participation in the organization and conduct of exhibitions (or displays) of sample products designed for civil, military and dual use in and outside the territory of the Russian Federation;
- assistance to organizations belonging to different branches of industry, including the defense-industrial complex, in the conduct of applied studies in promising areas of the development of science and technologies and in the implementation in industrial production of advanced technologies in order to raise the development standards of Russian hi-tech industrial products and to shorten the periods and reduce the costs of their creation;
- assistance to the activity of the organization acting a state intermediary in foreign trade of military products;

- performance of other functions, in accordance with federal laws and decisions of President of the Russian Federation.

Thus, in contrast to the previously created state-owned structures, such as the Russian Venture Company and the Russian Nanotechnologies Corporation, the activity of the new corporation encompasses, among other aspects, also the commercialization of military and dual-purpose developments.

In addition to the aforesaid, the new Federal Law is intended to make more precise the list of organizations engaged in foreign trade of military products, as well as the RF President's powers relating to the creation of specialized organizations – intermediaries in foreign trade in this sphere. In fact, the aim of its adoption and of the creation of the State Corporation “Rostekhnologia” is to unite the activities of a number of defense-industrial and research organizations.

According to the estimation made by General Director of the Federal State Unitary Enterprise (FGUP) “Rosoboronekспорт” S. V. Chamazov, “the creation of the State Corporation “Rostekhnologia” on the basis of a federal law will make it possible to most adequately take into consideration the opportunities provided by the organizational – legal form of a state corporation, the specificity of its activity both in cooperation in the sphere of military technologies and in the sphere of development, production and export of hi-tech industrial products. “Rostekhnologia” will be conducive to improving the situation in Russian machine-building and in its most high-tech segment – the defense-industrial complex”²⁸.

It can be assumed that the new state corporation will incorporate “Rosoboronekспорт”, as well as all its current assets, dependent enterprises and affiliations, which include some big holding-type corporations and companies, such as the following ones:

- ‘Industrial Investments Group OJSC “Ob’edinennaya industrial’naya korporatsiya [United industrial corporation] “Oboronprom”’ (holds a managerial position in respect to the OJSC “Vertolety Rossii” [Russia’s helicopters],
- Sub-holding OJSC “Oboronitel’nye sistemy” [Defense systems] (manufactures anti-aircraft defense means and sophisticated radio-electronic complexes),
- Leasing company (Closed-end Joint-Stock Company (CJSC)) “Oboronpromlizing” - engineering and supply of hi-tech metalwork equipment of leading international manufacturers, leasing of helicopters and helicopter equipment, as well as equipment and technologies for the enterprises belonging to Russia’s defense-industrial complex (DIC),
- OJSC “AVTOVAZ”, OJSC “Corporation “VSMPO-AVICMA” (global leader in titanium production, whose products are supplied to the domestic and foreign markets, and are used by domestic aircraft- and engine-building enterprises),
- CJSC “RusSpetsStal” (the basic company responsible for the creation of a metallurgical holding, consolidation and development of assets necessary for producing specialized steels and amalgamations),
- CJSC “Kontsern “Vysokie Tekhnologii R” [“Concern Hi-Tech R”] (services in creation and use of databases and information resources, innovative products for civil use, including in the machine-building branch);
- CJSC “Industrial’naya energeticheskaya Kompaniya” [“Industrial Energy Company”] (supplies of electric power and gas to enterprises belonging to the DIC), CJSC “R.E.T.” Kronshtadt” (development and production of simulators and software, to be used in the navy, air forces and ground forces), and some others, as well as a number of defense-industrial assets”²⁹.

On the whole, all these resources will make it possible for the newly created state corporation to nearly fully monopolize foreign trade in products and technologies for military and dual use.

In this connection, it would be interesting to note that its creation was motivated not so much by the necessity to increase the profitability of trade in hi-tech products relating to military industry, but by the need to develop hi-tech exports in general.

The creation of SK “Rostekhnologia” was preceded by a comprehensive analysis of Russia’s position on the international hi-tech market, which provided the basis for a feasibility study for the new corporation. The following facts, in particular, were pointed to in the aforesaid analysis³⁰:

²⁸ See, e. g., http://rusarm.ru/roe_ru/news/pr_rel/p_r_07_11_26_a.html

²⁹ See http://rusarm.ru/roe_ru/news/pr_rel/p_r_07_11_26_a.html

³⁰ See, e. g., http://www.gosrf.ru/print_1486.htm

- the RF's share on the international hi-tech market is no more than 0.5 %;
- the share of Russian machines and equipment in the total volume of international exports of finished hi-tech products is no more than 0.3 %;
- the share of hi-tech machine-building products in the structure of Russian exports is diminishing every year, and presently constitutes 5 % of the total volume of the Russian Federation's commodity exports;
- more than 40 % of such exports is constituted by supplies of military products to foreign states.

Besides, in this analysis serving as a base for the adoption of Federal Law No 270-FZ, it is stated that the technological status of Russian machine-building is unsatisfactory: in respect to many of its developments and technologies, this country is frozen at the level of the 1970 – 1980s. Presently, only one quarter of the technologies applied in the machine-building branch correspond to the international level. The production of hi-tech and competitive products can only serve the needs of comparatively narrow market segments. The tool-making branch is in a critical state ...³¹.

It appears that the creation of SK "Rostekhnologia" can hardly be conducive to any improvement of the situation in civil machine-building, since nothing is said either in the Law or in any official plans or programs about any investments to be made in this sphere through SK "Rostekhnologia".

It may be supposed that, quite simply, no investments are planned (or at least not reflected in a precise manner in official documents). However, the segment of Russian machine-building which operates most efficiently and is in demand on the international market, namely military products, will from now on be functioning under the control of the newly created corporation.

From the point of view of organization, the State Corporation "Rostekhnologia" is a juridical person established by the Russian Federation in the organizational – legal form of a state corporation. Its administrative bodies are as follows:

- the Supervisory Board of the State Corporation "Rostekhnologia" (the Supervisory Board of the State Corporation "Rostekhnologia" consists of nine members: four representatives of the President of the Russian Federation, four representatives of the Government of the Russian Federation, and the General Director of the State Corporation "Rostekhnologia", whose post entitles him to be member of the Supervisory Board. The members of the State Corporation "Rostekhnologia" are appointed by the President Russian Federation for a period of no more than five years);

- the Managerial Board of the State Corporation "Rostekhnologia" (the Managerial Board of the State Corporation "Rostekhnologia" consists of eleven members. The General Director of the State Corporation "Rostekhnologia" and the Deputy General Director of the State Corporation "Rostekhnologia" are entitled to be members of the Managerial Board by their status. The activity of the Managerial Board of the State Corporation "Rostekhnologia" is directed by the General Director of the State Corporation "Rostekhnologia");

- the General Director of the State Corporation "Rostekhnologia" (the General Director of the State Corporation "Rostekhnologia" is appointed to his post and dismissed from his post by the President of the Russian Federation).

In actual practice, SK "Rostekhnologia" is, almost entirely, controlled personally by the RF President, who is empowered to appoint (or approve) the top managers of the new company. In accordance with Item 2 of Article 6 of Law No 270-FZ, the President of the Russian Federation:

1) appoints the Chairperson and other members of the Supervisory Board of the State Corporation "Rostekhnologia", and terminates their powers in the procedure established by this Federal Law;

2) appoints to his post and dismisses from his post the General Director of the State Corporation "Rostekhnologia";

3) exercises other powers envisaged in this Federal Law.

It is expected that SK "Rostekhnologia" will be receiving substantial budget investments. In accordance with Law No m270 - FZ, its property is formed from the following sources:

- the property contribution made by the Russian Federation,
- incomes received by the State Corporation "Rostekhnologia" from the use of its property and from its activity, regular and (or) lumpsum receipts (or contributions), the decisions concerning which are to be adopted in accordance with legislation of the Russian Federation, and from the organizations whose shares (or stakes) are federal property,
- other property transferred by the State Corporation "Rostekhnologia" in the course of its activity, other lawful receipts, and are property of the State Corporation "Rostekhnologia".

³¹ Ibid.

It should be noted that the new State Corporation, similarly to the previously created Russian Nanotechnologies Corporation, being a recipient of large budget investments that are not precisely earmarked according to their target, is thus endowed with very broad financial powers to spend such investments, which will entail very active business activity. Thus, SK “Rostekhnologia” has the right to:

- create commercial and not-for-profit organizations in and outside the territory of the Russian Federation;
- participate in charter capitals of economic societies, property of other commercial and not-for-profit organizations established in and outside the territory of the Russian Federation, whose goals are to develop, manufacture and export hi-tech industrial products, including those for military and dual use;
- make investments in Russian and foreign organizations.

In this connection, the investing of temporarily free resources of the State Corporation “Rostekhnologia” is based on the principles of recovery and profitability of the financial instruments acquired by the State Corporation “Rostekhnologia”.

The areas for, procedures and terms of investing, as well as the marginal size of the temporarily free resources of the State Corporation “Rostekhnologia” to be invested, are determined by the Supervisory Board of the State Corporation “Rostekhnologia”.

It seems that in a situation when operations involve products and technologies for military and dual use, which are subject to state secret, the activity of SK “Rostekhnologia” will be quite non-transparent, while the risks of corruption among its officials resulting from this lack of transparency – very high.

Although formally SK “Rostekhnologia” is obliged to submit annual reports of its activity³² and undergo mandatory audits, as well as to form, as a constituent part of its organizational structure, a revision commission, these control mechanisms may fail to achieve the expected results under conditions of the company’s non-transparency *for public*. Thus, in accordance with Article 9 of Law No 270-FZ, the auditing company to conduct the mandatory audits will be selected by SK “Rostekhnologia”’s Supervisory Board (on the basis of a tender). Considering this circumstance, audits cannot be judged as being fully “external” and independent. Both in the Russian and international practice there were instances when auditing companies followed the instructions of a big corporate client and composed resolutions lacking precision and objectivity (for example, this happened during the bankruptcy proceedings against Enron in the USA, as well as in the “Yukos case” in Russia).

It appears that, while granting to an organization the powers to pursue commercial activity in the military sphere, the lawmakers should have paid more attention to creating specialized mechanisms of financial control.

Considering the facts described above, the following conclusions can be drawn. It is still too early to speak of any efficient activity of the newly created state corporation. However, as said above, the very fact of defense and dual-use technologies being commercialized, as well as of the export of the products of the defense-industrial complex to foreign countries, is fraught with certain financial risks due to the lack of transparency in this sphere. No specialized mechanisms of financial control over the activity of the new corporation, designed with due regard for its specificity, are envisaged by the new law.

Besides, it is unclear in which way the creation of SK “Rostekhnologia” may improve the situation existing in the sphere of export of civil machine-building products, which was declared to be one of the main reasons for the new corporation’s creation while it was being established.

New Changes in Legislation on Local Self-Government

Slavgorodskaja M., Mironova N.

In October – November 2007, legislators adopted new alterations in legislation on local self – government which were aimed at improving the delineation of powers among the various levels of authority in the

³² The Annual Report of the State Corporation “Rostekhnologia” incorporates the following components:

- 1) report on the activity of the State Corporation “Rostekhnologia” in the completed reporting period, including in the sphere of military – industrial cooperation of the Russian Federation with foreign states, as well as indices describing the activity of the organization acting as a state intermediary in foreign trade of military products;
- 2) annual accounting balance sheet of the State Corporation “Rostekhnologia”;
- 3) account of profits and losses of the State Corporation “Rostekhnologia”;
- 4) account of the execution of the financial plan of incomes and expenditures of the State Corporation “Rostekhnologia”;
- 5) account of the formation and use of the funds of the State Corporation “Rostekhnologia”;
- 6) auditor’s estimation.

Russian Federation. Apart from the sphere of delineation of powers, alterations were introduced into the territorial foundations of local self – government, property relations, and a number of other issues pertaining to the organization of municipal administration.

In the final quarter of the year 2007, in line with the well – established tradition to introduce, at the end of each year, new changes in legislation which regulates the delineation of powers among the levels of authority, legislators also adopted two federal laws: Federal Law, of 18 October 2007, No 230 – FZ, “On the introduction of alterations in some legislative acts of the Russian Federation in connection with the improvement of delineation of powers” and Federal Law, of 8 November 2007, No 257- FZ, “On motor roads and the roads - related activity in the Russian Federation and on the introduction of alterations in some legislative acts of the Russian Federation”. The major alterations introduced by these laws in legislation on local self - government can be summarized as follows:

Firstly, these alterations clarify some issues pertaining to the territorial foundations of local self – government previously not reflected in federal laws. In particular, they envisage the procedures for changing the boundaries of urban and rural settlements, and also the procedures for the abolition of municipal formations in territories with low population density and in localities which are difficult of access.

In accordance with the new version of the Law on Local Self – government, the decision concerning changes in the boundaries of a city okrug must be taken with taking into account the opinion of the population of all the municipal formations involved in this process, namely, the city okrug, the settlement being annexed, and the municipal raion in whose territory the settlement is situated. At the same time, the procedure for taking into account the opinion of the population has become simpler: the opinion of the population should be expressed by the decisions of representative bodies; as regards most of the other types of transformations of settlements and changes of their boundaries, the opinion of the population should be revealed by voting or at citizens’ meetings. Simultaneously with the merger of a city okrug with an urban settlement, the administrative and territorial division of a corresponding RF subject should also take place, so that the city forming a part of the city okrug and the town (or settlement) functioning as the center of an urban settlement should merge to become a single city.

It should be pointed out that the introduced alterations are rather ambiguous. On the one hand, for promoting their development, cities need additional resources, and first of all, land resources. However, the possibilities for developing empty land plots within the existing boundaries of the majority of big cities have already been exhausted. On the other hand, the adoption of this amendment can lead to the beginning of mass elimination of suburban settlement resulting from their inclusion in the city limits. At the same time, extension of the city okrug’s administrative boundaries is by no means the most efficient method for administering the urban agglomerations that have emerged as a result of the cities having “spilled over” their boundaries, which manifests itself in the erection of housing blocks in suburban territories, the transfer of enterprises beyond the city limits, mass cottage building etc. Meanwhile, there exists another model, the fragmented one, which has already been introduced, on a relatively wide scale, into international practice. In this model, the administering of an urban agglomeration is effected, on the basis of inter - municipality agreements, by all the municipalities included in it. Such model can be materialized also within the framework of Russian legislation by way of organizing, within the framework of Russian legislation, inter – municipality cooperation.

The adoption of the norm concerning the possibility of abolishing a relatively small number of municipal formations existing in the territories with small population density and in localities which are difficult of access can be considered absolutely justified. It is permitted to abolish rural settlements populated by less than 100 persons on condition that the decision on the abolition has been adopted at a citizens’ meeting. In international practice, and in particular in Canada, no local administrative bodies are formed in those settlements situated in northern territories, where there exist neither the personnel nor the economic potential for adequate development, and the provision of necessary services to local population is carried out by regional authorities. Among the drawbacks of this amendment to legislation on local self – government, one could point to the absence of clarifications as to what localities should be deemed to be difficult of access, although it is apparent that settlements with the size of population less than 100 are not likely to be found in densely populated regions.

Secondly, the list of the territories entitled to special organization of local self – government has been extended. Previously, this status was accorded to the inter – city territories of the cities of federal importance, Moscow and St. Petersburg, closed administrative and territorial units, and border territories. Now this list also includes municipal formations situated in the areas of the Far North and to the localities equated thereto, which have seasonal time limitations for the delivery of cargos (or products). It is established for them that

the powers with respect to the guaranteeing of the delivery of some goods (fuel and energy resources, food-stuffs, and industrial and technological production) which require centralized supply, should be carried out by the executive authorities of RF subjects.

Thirdly, a number of alterations dealing with the delineation of powers among various levels of authority were introduced in federal legislation. The major alterations in this sphere are aimed, on the one hand, at specifying the powers vested in the bodies of local self – government with regard to resolving the issues of local importance previously consolidated to municipal formations, and, on the other hand, at expanding the competence of municipal authorities.

The first area of reforming the powers – delineation system includes, in particular, the alterations in branch legislation on protecting the health of citizens and on fire safety. The new versions of the afore – noted laws set up the concrete powers of local self – government bodies with regard to such issues of local importance as the organization of medical assistance to the population and the implementation of primary measures of fire safety in the populated localities being part of settlements and city okrugs. The adoption of these alterations has introduced clarity in the determination of powers in the corresponding spheres, and eliminated any vagueness concerning the delineation of the competence of local authorities as regards the resolution of the said issues. At the same time, the established list of powers is significantly wider than that previously implemented in actual practice by local self – government bodies, especially in the sphere of carrying out the primary measures of fire safety. The adoption of these amendments can result in the growth of local budgets' spending liabilities.

Also, Federal Law, of 8 November 2007, No 257 – FZ, “On motor roads and the roads - related activities in the Russian Federation...” has changed the formulation of the issue of local importance previously worded as “the maintenance and building of roads for general use, bridges and other transport, and engineering installations within the boundaries of populated localities of a settlement...”. In the new version of FZ – 131, this issue of local importance is worded as follows: “the roads – related activities with regard to motor roads of local importance within the boundaries of populated localities of a settlement, and also the implementation of other powers in the sphere of the use of motor roads and the conduct of roads – related activities in accordance with the Russian Federation’s legislation”. Also, the Law defines the concept of “roads – related activities” and establishes an exact list of powers with respect to its implementation. As a result, it is specified that, apart from the construction and maintenance of roads, the competence of local self – government bodies should cover their designing and reconstruction, as well as capital and current repairs. Previously, it was formally unclear, in formal terms, as to who was to implement these powers, although in actual practice they were also implemented by local self – government bodies, provided that the local budgets had corresponding resources.

The expansion of the competence of municipal formations has taken place due to the introduction of additional rights and powers for local self – government bodies. In particular, in the sphere of community health protection, the local self – government bodies of municipal raions and city okrugs are vested with the right to establish, at the expense of local budgets' revenues, an emergency medical service within the framework of health facilities. This provision of the Law expands the capacities of local authorities to provide timely medical assistance to the population.

The list of powers of local authorities was also expanded by the introduction of the power to organize the training, re – training, and advanced training of elected officials of local self – governments, members of local self - government elected bodies and deputies of the representative bodies of municipal formations, as well as to organize the professional training, re – training and advanced training of municipal officials and workers of municipal establishments. In fact, these amendments consolidate the powers which, in actual practice, have been used by local self – government bodies since the very beginning of reform.

Federal Law No 230 – FZ also increases the possibilities to delegate state powers to the municipal level. In particular, the public authorities of RF subjects may delegate to local self – government bodies the powers concerning the provision of some social protection services to veterans, disabled persons and citizens awarded the “Honorary Donor of Russia” title. The delegation of these powers to the municipal level is authorized by the new provisions of the Federal Laws “On veterans”, “On the social protection of disabled persons in the Russian Federation”, and “On the donorship of blood and its components”.

Among the other alterations in federal legislation on local self – government, special attention should be paid to the amendments expanding the types of property authorized for ownership by municipal formations. Municipalities of all types are now authorized to possess property intended for the development of small and medium businesses. This article makes it possible to retain in municipal ownership nonresidential premises, the renting – out of which, on the one hand, can become one of the measures in support of small and medium businesses and, on the other hand, represents a stable source of revenue for local budgets. However, it cannot

be said that the adoption of this amendment has been timely, because by now many municipal formations have already privatized most of the property not classified as authorized by previously existing legislation.

Federal Law No 230 – FZ defines more precisely the issue concerning the ownership of the property objects created through state investments. The amendments to Federal Law, of 6 October 1999, No 184 – FZ “On the general principles of organization of legislative (representative) and executive bodies of state authority of the Russian Federation’s subjects” establish the responsibility of regional authorities to transfer, free of charge, into municipal ownership the assets created in the process of implementing projects aimed at developing the social and engineering infrastructure of municipal formations.

Most controversial is the introduction, in Law 131 – FZ, of article 18.1 concerning the assessment of efficiency of local self – government bodies, which envisages the possibility of allocation, at the expense of a RF subject’s budget, of grants to municipal formations aimed at assisting them in obtaining and (or) encouraging them to obtain the best possible values of the indices of efficiency. The list of indices should be approved in a procedure to be determined by the President of the Russian Federation. In fact, this article envisages that the activity of municipal authorities should be subject to assessment on the part of regional authorities, despite the fact that, according to the RF Constitution, municipal authorities are detached from the system of public authorities in the Russian Federation.

Review of Economic Legislation over December 2007

Tolmacheva I. V.

Among a number of Federal Laws adopted in December there is: Law, establishing legal basis for self-regulating organizations activity; changes made to the Law “On retirement pensions in the Russian Federation”; changes and addenda concerning legal regulation of joint-stock investment funds, managing companies, special depositaries, non-governmental pension funds and other entities of investment activity.

I. FEDERAL LAWS of the Russian Federation

1. “ON SELF-REGULATING ORGANIZATIONS” from 01.12.2007 No 315-Φ3

Federal laws establishes legal basis for self-regulating organizations operation, their main functions, rights and duties.

It is the non-commercial organizations aimed at self-regulating and founded on membership principle, joining the subjects of entrepreneurial activity due to conformity of the branch of goods (works, services) production or the market of produced goods (works, services) or uniting the subjects of professional activity of some kind that are referred to as self-regulating.

Self-regulation is determined as independent and initiative activity that is carried out by the subjects of entrepreneurial or professional activity, whose aim is development and establishment of standards and rules for the activity mentioned as well as control for their fulfillment.

Self-regulation is carried out on conditions of voluntary association of the subjects of entrepreneurial or professional activity in self-regulating organization by branch characteristic or by the characteristic of professional activity of some kind. The subject carrying out different kinds of entrepreneurial or professional activity can be a member of several self-regulating organizations. A self-regulating organization should join no less than twenty five subjects of entrepreneurial activity or no less than a hundred subjects of professional activity of some kind.

Federal laws can envisage the cases for compulsory membership of subjects of entrepreneurial or professional activity in self-regulating organizations to carry out some kind of entrepreneurial or professional activity. For instance, in accordance with the Federal Laws “On insolvency (bankruptcy)” and “On appraisal activity in the Russian Federation” arbitrary managers and appraisers should be united in self-regulating organizations.

At the same time the Law does not apply to self-regulating organizations of professional participants of stock and shares market, shareholders of investment funds, management companies, special depositaries of investment funds, unit investment funds and non-governmental pension funds, housing stocking cooperatives, non-governmental pension funds, credit organizations, credit history bureau, whose activity is regulated by federal laws, controlling the corresponding kind of activity (clauses 1, 2, 3 and 5 of the Law).

The main function of self-regulating organization is development and adoption of the standards and regulations for entrepreneurial or professional activity, whose requirements are to be followed by all the members of self-regulating organization. Standards and regulations should correspond to the existing legislation, rules of business ethics and should envisage the measures of disciplinary control execution to the members of the organization for violation of these standards and regulations. Representation of the organization mem-

bers' interests in their relationship with the government bodies and local governments is also the function of the self-regulating organization. To implement such a function self-regulating organizations have a right to: call in question according to the procedure established by legislation acts, decisions, actions and absence of actions of governmental authorities and local government that violate rights and legal interests of an organization or its members; take part in the discussion of federal laws projects, connected with the subject of self-regulation, ask government bodies and local government for information necessary to execute functions, delegated to it by the federal laws.

Arbitrary settlement of disputes between the members of an organization and between them and consumers of goods, jobs and services, produced by them or other persons in accordance with the legislation on arbitrary courts also belongs to function of self-regulating organizations.

Besides, a self-regulating organization can set up professional training, certification of the employees of organization's members or goods, services, jobs, produced by them if not stated otherwise by federal law, as well as execute other functions, envisaged by its charter and not contradicting the legislation.

Self-regulating organizations should provide informational transparency of their activity by publishing in mass media of placing in information and telecommunication networks the data on its membership, standards established by the organization and rules for entrepreneurial or professional activity, the cost and list of property of the organization's compensatory fund, on cases of making its members answerable for violation of the legislative requirements as to implementation of entrepreneurial or professional activity, standards and rules of the organization as well as any claims and applications, brought to the courts by the organization (clauses 4, 6 and 7 of the Law).

In order to provide property accountability of the members of self-regulating organization to consumers of goods produced by them as well as to other persons, organization has a right to found systems of personal and collective insurance and form compensatory fund. Compensatory fund is initially formed only in monetary form by contributions of the members of the organization at the rate of no less than RUR 3000 as to every member. The compensatory fund means are to be invested in order to replenish the fund.

In case personal or collective insurance system is applied as means to provide accountability, the minimum rate of the insurance sum by the insurance contract of each member cannot be less than RUR 13000 per year (clause 13 of the Law).

The governing bodies of self-regulating organizations are the general assembly of the members of the organization, constantly operating collective management body and executive body.

The general assembly of the self-regulating organization members is the superior management body of the organization. Its terms of reference cover, for instance, approval of organization's charter, election of the members of constantly operating collective management body of the organization, appointment of the person, executing the functions of personal executive of the organization, establishing the measures of disciplinary control, procedure and grounds for their implementation, procedure for examination of cases of violation of requirements established by organization's standards and regulations, determination of priority direction of organization's activity.

Constantly operating collective management body of a self-regulating organization is formed from the members of the organization (members that are natural persons and representative of legal entities that are members of the organization) as well as independent members (not connected by labor contracts with self-regulating organization and its members), whose number should be no less than one third of the members of constantly operating collective management body. Terms of reference of constantly operating management body of an organization include, for instance, approval of organization's standards and regulations, creation of special bodies of the organization.

Executive body's competence include the issues, not covered by the terms of reference of the general assembly and constantly operating collective management body.

Special bodies of self-regulating organization that are to be formed compulsory include the body executing control over observance of standards and regulations' requirements of the organization and the body responsible for consideration of cases on application of disciplinary measures to the members of organization (clauses 15, 16, 17 and 18 of the Law).

The control over execution by the organization's members the entrepreneurial and professional activity is implemented by the employees of the corresponding body of the organization by carrying out planned and unplanned revisions.

The subject of planned revisions is observance by the members of organization of requirements of standards and regulations of the regulations. Planned revision is carried out no less often than once a year. The grounds for unplanned revision can be a complaint on violation of organization's standards and requirements by its member directed to self-regulation organization. At the same time self-regulating organization can

envisage other grounds for unplanned revision execution. In the course of unplanned revision only the facts mentioned in the complaint or fact subject to revision set for other reasons are to be investigated.

In case violation of requirements of organization's standards and regulations by a member of self-regulating organization is discovered, the results of revision are submitted to the body responsible for consideration of cases on application of disciplinary measures to the members of organization (clause 9 of the Law).

The body responsible for consideration of cases on application of disciplinary measures to the members of organization has a right to: make decision on elimination of violation discovered; give warning; impose a fine; recommend the constantly operating collective management body to expel the person from the organization; make decision on taking other measures, established by internal documents of the organization.

The decisions of the body responsible for consideration of cases on application of disciplinary measures to the members of organization, excluding the decision to recommend expulsion of the person from the organization can be appealed to the constantly operating collective management body of the organization. The decision of the constantly operating collective management body of a self-regulating organization to expel the person from the members of the organization can be appealed in the court.

Monetary funds raised by self-regulating organization as a result of fine levy are to be paid to its compensatory fund (clause 10 of the Law).

2. "ON MAKING CHANGES TO THE FEDERAL LAW "ON RETIREMENT PENSION IN THE RUSSIAN FEDERATION" from 01.12.2007 No 312-Ф3

Comes into effect on 1 January 2008, excluding some statements, coming into effect on other dates.

The law established increased sum of the basic retirement old-age pension rate and basic disability pension rate for the citizens, who have worked in the regions of the Far North no less than 15 calendar years and in the territories of the same status no less than 20 years and have necessary insurance length of service (25 and 20 years for men and women, correspondingly). Thus, for instance, the basic rate of the old-age retirement pension will be equal to RUR 2340 per month, basic rate of disability pension for people with 3rd extent of work ability limitation – to RUR 4680 per month.

Increased sum of the basic retirement old-age and disability pensions will be paid to the category of citizens mentioned above independent of place of citizen's residence.

It is also mentioned that for the purposes of establishment of the basic rates of both the pensions each year of service in the territories to which the same status as to the regions of Far North has been granted is considered as 9 months of work in the regions of Far North.

Besides, a number of changes concerns the rise of introduced increased sums of basic retirement old-age and disability pension rates from 1 August 2008 for the category of citizens mentioned.

3. "ON MAKING CHANGES TO THE FEDERAL LAW "ON INVESTMENT FUNDS" AND SOME LEGISLATIVE ACTS OF THE RUSSIAN FEDERATION" from 06.12.2007 No 334-Ф3

Comes into effect in 10 days after official promulgation, excluding statements, for which other dates for coming into effect are established.

Changes and addenda introduced by the Law concern legal regulation of the activity of the joint-stock investment funds, management companies, special depositaries, non-governmental pension funds and other subjects of investment activity.

The main part of the changes is connected with the introduction of the institute of a qualified investor. Federal law from 22.04.1996 No 39-Ф3 "On securities market" is supplemented with the clause, containing open list of the persons that can be regarded as qualified investors. For instance, the following are referred to as qualified investors:

- 1) brokers, dealers and managers;
- 2) credit organizations;
- 3) joint-stock investment funds;
- 4) management companies of investment funds, unit investment funds and non-governmental pension funds;
- 5) insurance organizations;
- 6) non-governmental pension funds;
- 7) Bank of Russia;
- 8) government corporation "Bank for development and foreign economic activity" (Vnesheconombank);
- 9) agency on deposit insurance;
- 10) international financial organizations, including World Bank, International Monetary Fund, European Central Bank, European Investment Bank, European Bank for Reconstruction and Development;
- 11) other persons defined as qualified investors by federal laws.

Conditions, procedure and consequences of referring of natural persons and legal entities to qualified investors have been established.

Federal Law from 29.11.2001 No 156-ФЗ “On investment funds” has been supplemented with the norms on introduction of the statement, according to which fund’s stocks, investment units are envisaged for qualified investors, to the charter of the joint-stock investment fund, to the rules of trust management of closed and interval unit investment fund.

Besides, the changes concern the licensing procedure of joint-stock investment funds, management companies, special depositaries, non-governmental pension funds’ activity.

For instance, the following kinds of activity are excluded from the list of activities, whose licensing is carried out in concordance with Federal law from 08.08.2001 No 128-ФЗ “On licensing of some kinds of activities”: activity of investment funds, activity on management of investment funds, unit investment funds and non-governmental pension funds, activity of special depositaries of investment funds, unit investment funds and non-governmental pension funds; activity of non-governmental pension funds for pension provision and pension insurance.

Detailed rules for licensing of the kinds of activity mentioned are established in the Federal Laws from 29.11.2001 No 156-ФЗ “On investment funds” and from 07.05.1998 No 75-ФЗ “On non-governmental pension funds”.

Clause 1012 “Contract for property trust management” of part 2 Civil Code of the Russian Federation is supplemented with the statement that the special features of trust management are established by the law.

Changes and addenda are made to other federal laws and a number of transitional statutes is envisaged that enable to bring regulated kinds of activities in concordance with new standards.

Review of Regulatory Documents Concerning Taxation over November-December 2007

1. According to the Federal Law No 315-ФЗ from 1 December 2007 “On self-regulating organizations” a new type of organizations whose taxation is not regarded separately in the Tax Code of the Russian Federation is introduced.

These organizations have the following specific features that will influence taxation. According to paragraph 3 clause 3 and clause 13 of the Federal Law it is envisaged that additional property accountability of each member of a self-regulating organization to consumers is secured by introduction of insurance requirement and compensatory fund formation as regards to the members of this organization.

Insurance is provided by creation of personal and collective insurance system for self-regulating organization. Compensatory fund is formed by membership fees and earnings from compensatory fund investment and placement.

The terms used by the Federal Law as regards to the insurance “formation of personal and collective insurance system” with a particular insurance sum mentioned are not quite clear. The fact is that it is not mentioned in the text of the Federal Law “On self-regulating organizations” if the organization is to obtain license to carry out insurance activity or not. In case it is, insurers should be mentioned in the special Law “On organization of insurance business in the Russian Federation” (earlier – “On insurance”), which regulates the rules of insurance service rendering. Besides, insurance activity is subject to licensing. If this is the case, the rules of insurers’ incomes and expenditures formation will apply to self-regulating organizations, including deductions to insurance reserves. If not, then it is not clear why the insurance sum is specified in the text of the Federal Law. Insurance sum is paid by the insurer according to the insurance contract in case of insured event taking place.

From the legal point of view the issue of compensatory fund status and resources of payments in it (whether they are membership fees for current expenditures or they are paid from their own profit after taxes deduction) is not clear. Payments from compensatory fund formed by membership fees are envisaged to be distributed for the benefit of the member that has not fulfilled his liabilities to product consumers. Such payments if not stated otherwise in the text of the Tax Code of the Russian Federation are to be included in the taxation base for profit tax of the person, whose liabilities are paid for by self-regulating organization (since it practically takes the responsibility to compensate for losses claimed by the consumer).

2. According to the Federal Law No 286-ФЗ from 29 November 2007 “On reciprocal insurance” the creation of reciprocal insurance companies is envisaged. These are non-commercial organizations acting on the basis of licenses (clause 5 paragraph 5). The sources of company’s assets formation (clause 17) are: 1) admission fee; 2) insurance premium (insurance contribution); 3) additional premium; 4) voluntary contribution and other property premiums and contributions; 5) earnings from investment and placement of tempo-

rarily spare funds of insurance reserves and other funds; 6) loans; 7) contributions to compensate for expenditures connected with company's activity envisaged by charter; 8) other incomings not prohibited by the legislation of the Russian Federation. According to clause 20 of the Federal Law reciprocal insurance company is allowed to form insurance reserves. As to taxation the sources of admission fee, insurance premium etc. financing by the members of reciprocal insurance companies – whether they belong to current expenditures or are to be paid from the profit after taxation of the members of reciprocal insurance company – are unclear. The point is that fees (contributions) to charter (statutory) capital (fund) according to the Tax Code of the Russian Federation are made from the profit after taxation, while insurance premiums are subject to be referred to current expenditures of the insurers. This, as well as other issues connected with taxation of reciprocal insurance company members as well as the company itself, has not been regarded in the Tax Code of the Russian Federation yet.

3. According to the letter of the Ministry of Finance of the Russian Federation from 26 November 2007 No 03-05-06-01/136 the issue on the position of the Tax Code of the Russian Federation as regards to taxation with enterprises assets tax of the assets that make up a unit investment fund.

Ministry of Finance of the Russian Federation clarifies that according to the Federal Law from 24.07.2007 No 216-ФЗ the changes to clause 378 of the Code are made that come into effect on 1 January 2008, according to which the property that composes unit investment fund, trusted to assets management, purchased within the framework of the contract for assets management is not subject to taxation for founders of assets management.

As to the organization which is a trust manager of a unit investment fund this organization is considered as a tax-payer only as regard to assets that are its property kept on books and recognized as a taxation object in accordance with paragraph 1 clause 374 of the Code. Thus, the consequence of explanation by the Ministry of Finance is that in case assets are transferred to assets management they are exempted from enterprises assets tax.

3. According to the Federal Law from 6 December 2006 No 333-ФЗ in connection with changes in the Federal Law “On fishing and preservation of water biological resources” amendments are made to the Tax Code of the Russian Federation. For organizations and individual entrepreneurs that sell and (or) process caught (fished up) water biological resources delivered in the territory of the Russian Federation rates of charges are established at the level of 10% of those envisaged by the Tax Code of the Russian Federation (paragraphs 4 and 5 of clause 333.3) of the general rates of charges for biological resources.

4. According to the letter by the Ministry of Finance of the Russian Federation from 27 November 2007 No 03-03-06/1/826 the issue on the procedure of fiscal accounting of expenditures for computer programs purchase is elucidated.

Expenditures for computer programs purchase are included in the list of other expenditures connected with production and (or) sale, calculation method being applied according to the following procedure:

- if according to the conditions of the contract for unexceptional rights purchase there is a period for computer programs use set, expenditures, applying to several accounting periods, are taken into account while calculating taxation base evenly throughout these periods;
- if the period of computer programs use cannot be defined from the contract for unexceptional rights purchase then such expenditures should be distributed taking into account the principle of the even recognition of expenditures.

5. According to the letter by the Ministry of Finance of the Russian Federation from 27 November 2007 No 03-03-06/1/825 the issue on procedure of accounting for taxation purposes of expenditures in the form of compensation of property tax by investment contract.

For instance the Ministry of Finance clarifies that any expenditures on condition that they were made while conducting activity aimed at profit receive are recognized as subject to deduction while formation of tax base.

According to paragraph 1 clause 8 of the Code the tax is referred to as a compulsory, non-repayable payment, levied on organizations and natural persons in the form of alienation of monetary funds, owned by them by the right of property, economic or day-to-day management in order to finance operation of government and (or) municipal formations.

Thus, the sum of the tax for property, paid by a third party and compensated to this party by the tax-payer in concordance with the conditions of investment contract is not expenditure of business entrepreneurial activity conduction and, consequently, does not decrease taxation base of property tax.

6. According to the letters of the Ministry of Finance of the Russian Federation from 13.11.2007 No 03-07-15/183 and Federal Tax Service of the Russian Federation from 28 November 2007 No ИИТ-6-03/917@ the procedure for application of the Decree of the Ministry for Foreign Affairs of Russia and Ministry of

Finance of Russia from 08.05.2007 No 6499/41H “On approval of the list of foreign states whose representatives are subject to 0 per cent value added tax rate when sale of goods (service rendering, work execution) for official use by foreign diplomatic missions and missions of the same status or for the personal use of diplomatic or administrative and technical staff of these missions, including members of their families, living with them” is clarified.

It is elucidated that the decree of the Ministry for Foreign Affairs of Russia and Ministry of Finance of Russia came into effect on 1 October 2007. That is why with regard to the goods (works, services) purchased before the decree came into effect and included in the application for VAT compensation one should follow the list of countries mentioned in the letter of the MHC of Russia from 1 April 2003 N ПД-6-23/382 that was earlier in effect.

7 According to the Decree of the Ministry of Finance of the Russian Federation from 13 November 2007 No 108H the List of countries and territories granting privileged tax regime of profit taxation and (or) not envisaging uncovering or giving information during financial operations conduction (offshore zones) was approved in concordance with subparagraph 1 paragraph 3 clause 284 of the Tax Code of the Russian Federation. With regard to dividends received by Russian organizations from the territory of these countries, it is the general tax rate of 9% not 0% rate that is applied.

8. According to the letters by the Ministry of Finance of the Russian Federation from 30.10.2007 No 03-05-05-02/64 and the Federal Tax Service from 3 December 2007 No CK-6-11/923@ the issue on land occupied by arbitrary courts taxation is clarified.

According to the Tax Code of the Russian Federation (subparagraph 3 paragraph 2 clause 389 of the Tax Code), land plots, given for security, safety and customs needs, are not recognized as subject to taxation.

According to clause 8 of the Law of the Russian Federation from 5 March 1992 N 2446-1 “On safety” judicial power is included in the security system. In this connection, according to the Ministry of Finance and Federal Tax Service of the Russian Federation land plots, occupied by arbitrary courts, should not be subject to taxation with land tax.

9. According to letters of Ministry of Finance of the Russian Federation from 26.10.2007 No 03-04-07-01/210 and Federal Tax Service of the Russian Federation from 4 December 2007 No ГИ-6-04/930@ the issue of natural person’s incomes, obtained in connection with granting of subsidies to purchase or build housing to young families is clarified.

For instance, it is clarified that up to 1 January 2008 in concordance with the version of subparagraph 2 paragraph 1 clause 220 of the Code while calculating the natural person’s incomes tax sum a tax-payer can get tax deduction at the sum spent for new construction or purchase of a house, flat, room or share (shares) in them etc. at the rate of expenses actually made but no more than RUR 1 000 000. This norm also applied when payment for the expenditures mentioned was made at the expense of subsidies from the funds of federal budget, budgets of subjects of the Russian Federation and local budgets.

From 1 January 2008 instead of the mechanism for expenses deduction the mechanism of exemption of the subsidies sum from taxation with natural person’s incomes tax.

10. According to the letter by the Ministry of Finance and Federal Tax Service of the Russian Federation from 4 December 2007 No ИИТ-6-03/932@ the issue of VAT payment on alcoholic goods, confiscated by the law enforcement bodies is clarified. Since the goods confiscated by law enforcement cannot be used in future to carry out operations recognized as subject to taxation in accordance with chapter 21 of the Tax Code of the Russian Federation, VAT sums taken to deduction during import of alcoholic production into the territory of the Russian Federation are to be restored and paid to the budget in the taxation period when the goods were confiscated by law enforcement bodies.

11. By the Federal Law from 29 November 2007 No 284-Ф3 changes are made to the Tax Code of the Russian Federation, for instance, the possibilities to apply property deductions from income tax have been limited. According to the changes property tax deduction is not applied in case expenditures for construction and purchase of a house, flat, room or share (shares) in them are made at the expense of employer or other persons, maternity (family) capital, directed to fulfill additional measures of governmental support for families, having children, at the expense of payments allocated from the federal budget fund, budgets of subjects of the Russian Federation and local budgets as well as in cases when the deal of purchase and sale of a house, flat, room or share (shares) in them is made between physical persons that are independent according to the clause 20 of the Tax Code of the Russian Federation property tax deduction is not applied.

The version of individual statements of the Tax Code of the Russian Federation that apply to formation of the tax base of budget organizations is specified.

12. In order to apply chapters 26.2 and 26.3 of the Tax Code of the Russian Federation according to the decree of the Ministry for Trade and Economic Development from 19 November 2007 No 401 deflation

coefficient K1 necessary to calculate taxation base for single imputed income tax for 2008 at the rate of 1.081 is established.

13. According to letters by the Ministry of Finance of the Russian Federation from 13.11.2007 No 03-11-02/266 and Federal Tax Service of the Russian Federation from 28 November 2007 No CK-6-02/912@ the issue on procedure of the determination of depreciated cost of fixed assets when either the taxation object or taxation regime has been changed by tax-payers, applying simplified taxation system is clarified.

From 1 January 2008 if tax-payers transfer to simplified taxation system from the taxation object in the form of profits to taxation object in the form of difference between incomes and expenditures, expenditures referring to taxation periods, when the taxation object in the form of profits taxation was applied, should not be taken into account.

Correspondingly, if a tax-payer subject to simplified taxation system has transferred from the taxation object in the form of profits from taxation object to taxation object in the form of difference between incomes and expenditures, then the depreciated cost of fixed assets, purchased within the period of application of simplified taxation system with the taxation object in the form of profits is not determined, since expenditures made should not be taken into account. Correspondingly, the depreciated cost of fixed assets for the date of transfer of taxpayer from the simplified taxation system with the taxation object in the form of profits to general taxation regime is not determined as well.

If an organization transferred from the general taxation regime to simplified taxation system with profits as taxation object, and then transferred to profits reduced by the sum of expenditures as a form of taxation object, the depreciated cost of fixed funds, purchased within the period of general taxation regime application also is not defined.

14. According to the letter of the Ministry of Finance of the Russian Federation from 09.11.2007 No 03-05-05-02/69 and Federal Tax Service from 26 November 2007 No CK-6-11/908@ the issue on the procedure of application tax privileges in the form of taxation base reduction by the sum not subject to taxation, envisaged by paragraph 5 clause 391 of the Tax Code of the Russian Federation (at the rate of RUR 10000 per one tax-payer in the territory of municipal formation (cities with federal importance Moscow and St. Petersburg) as to a land plot, which is owned, is in unlimited or life-time heritable use by some kinds of tax-payers) while calculating land tax is clarified.

The Ministry of Finance and Federal Tax Service of the Russian Federation draw attention to the fact that in case tax-payer owns several land plots, the taxation base while calculating land tax is reduced by the sum not subject to taxation only with regard to one of the land plots by choice of the tax-payer.

15. Since single social tax is partially placed to the budget and partially to non-governmental social funds, the letter of Ministry of Finance of the Russian Federation and Federal Tax Service from 10 December 2007 No 05-2-05/481@ clarifies which sums are accounted (compensated) by Social Insurance Fund and which – by the Federal Tax Service of the Russian Federation. Taxation bodies do not make such repayment.

Taxation bodies make return (offset) of sums of single social tax excessively paid only if excessive payment by single social tax in monetary terms is reflected in the databases of taxation bodies “Settlements with budget”.

16. According to the letter of the Ministry of Finance of the Russian Federation and Federal Tax Service from 10 December 2007 No 05-1-03/505@ the issue of notaries' taxation with single social tax is clarified.

Taxation base of single social tax for notaries is defined, according to paragraph 3 clause 237 of the Code, as a sum of incomes received by such tax-payers over the taxation period both in monetary form and in kind from the professional activity, deducing expenditures connected with their derivation.

At the same time according to clause 26 of the Basic legislation of the Russian Federation on notarial system from 11.02.1993 No 4462-1 it is the authorities and president of notarial chamber elected by the assembly of the notarial chamber members whose authority is regulated by the charter of the notarial chamber. That is why the payment received by the president of the notarial chamber for execution of authority at the post is not the payment of labor or civil legal contract.

Consequently, according to paragraph 1 clause 236 of the Code notarial chamber is not subject to single social tax payment as to premiums for execution of authority at the elected post of the president of the notarial chamber.

17. According to the letter of the Ministry of Finance of the Russian Federation and Federal Tax Service from 3 December 2007 No IIIIT-6-06/925@ “On submission of the results of office taxation revision” the issue on classification of individual cases of violations found is clarified. For instance, it is elucidated that when a tax-payer applies deductions at the rate of accrued insurance contributions for compulsory pension insurance from the sum of advance payment (that is single social tax sum) there is no taxation violation in the form of underreporting of the single social tax sum. Taking into account that insurance contributions are

regulated by separate legislation, there is no resulting law infringement envisaged by clause 122 of the Tax Code of the Russian Federation. So underreporting of the sum of the single social tax that is to be paid to the federal budget mentioned above is subject to violation of legislation on taxes and duties that does not have characteristics of tax law infringement.

It is to be noted that if before the decision on refusal for prosecution for committing tax law infringement was made the tax-payer had paid the sum of single social tax charged additionally in the course of office taxation revision to be paid to the federal budget or as an insurer paid the arrears for insurance contribution over the same period, only the amount of interest for late charge of single social tax to be paid in the federal budget calculated for the date of tax or insurance contribution payment is mentioned in the decision.

18. According to the letter by the Ministry of Finance of the Russian Federation and the Federal Tax Service of the Russian Federation from 26 November 2007 No 06-6-10/526@ it is clarified which kinds of check-out equipment could be used in the passenger taxi.

Review of Budgetary Legislation over December 2007

Goldin M. P.

In December 2007 the following events took place in the legislative regulation of the budget relations: one more government corporation was created, whose aim is to join assets in the sphere of nuclear energy, the Regulations for formation and regulation of work of the federal formal enterprises were adopted by the Resolution of the Government of the Russian Federation.

Federal Laws

The Federal Law from 01.12.2007 No 317-ФЗ “On Government Corporation on nuclear energy “Rosatom” came into force on 5 December 2007 The draft of the law on the creation of government corporation on nuclear energy was submitted to the State Duma of the Russian Federation by the President of the Russian Federation V. V. Putin. Earlier it had been planned to create the company that would have joined key assets at the market of the nuclear energy in the form of a joint-stock company, however, in the end, it was decided to form the structure as a non-commercial organization – Government Corporation.

Last two years were marked with the government efforts to create enough of the structures of the new type that join the characteristics of economic entities and government bodies. The process of the creation of the Government Corporations started in Russia in 2006, when the Joint aircraft building corporation started to operate, later Joint sea-craft building company was established, and in the sphere of financial market Bank for Development and Foreign Economic Activity was organized.

The basis for legislative regulation of the Government Corporations is the Federal Law “On non-commercial organizations” from 12.01.1996 No 7-ФЗ. That is why, strictly speaking, the work of the Government Corporations is not subject to regulation of the budget legislation. However since government corporation are formed on the basis of government assets with the further accumulation of large amounts of budget funds, a new forming Government Corporation should be mentioned.

The new version of the federal law “On non-commercial organizations” that envisages the possibility to create Government Corporations came into effect in July 1999, however up to recently there was no necessity to use such organization and regulatory form. Earlier it was successfully substituted by Federal government unitary enterprises and Joint-stock companies, each of these forms of organization having its own special features. Federal government unitary enterprise is characterized by a stricter control over assets and management from the government. The owner of the property of a federal government unitary enterprise is the government. The property of the unitary enterprise belongs to it by the right of economic management or day-to-day management, is not to be divided or distributed by shares (stakes or stocks) even between employees of the unitary enterprises. The administration of the unitary enterprises is appointed by the Government of the Russian Federation. And the head of the federal government unitary enterprise is accountable before it. For federal government unitary enterprises stricter rules are in effect as to distribution of the obtained profit between the government and the enterprise as well as borrowing rules. Besides the work of the Federal government unitary enterprise is far more intransparent.

Joint-stock company is by far more flexible and convenient form for fulfillment of the large-scale investment project. Joint-stock companies are a bit more transparent than federal government unitary enterprises, so both Russian and foreign business partners can better understand the logic of decisions made by the management of a joint-stock company and they are more interested in participation in projects together with the government. However stock companies have their own drawbacks. For instance, a part of shares of Russian joint-stock companies are often owned by minority share-holders. Besides, part of them is non-residents,

which additionally restricts the strategy of the decisions by the management of joint-stock companies. The prominent example is Gazprom, where the participation of minority share-holders is 49%.

Organization and legislative form of the Government Corporations is considered to be more effective with regard to strategic industries of the Russian Federation, since it combines advantages of joint-stock companies and federal government unitary enterprises.

There is one more characteristic feature to the Government Corporation on nuclear energy "Rosatom". According to the law on its formation it will execute government management of the nuclear energy use on behalf of the Russian Federation in concordance with Chapter 4 of the Federal Law No 170-Φ3 from 21 November 1995 "On nuclear energy use", government management while conducting activity connected with development, production and utilization of nuclear weapons and nuclear energy equipment of military purpose, as well as standard and legislative regulation in the field of nuclear energy use. No other Government Corporation created has so fully the functions of a federal executive body.

Decrees of the Government of the Russian Federation

The Decree of the Government of the Russian Federation from 15.12.2007 No 872 "On creation and regulation of the work of the federal government enterprises" was adopted. According to the decree specific feature of the creation (by the way of establishing, reorganization in the form of division, appropriation or merging as well as by the way of the change of the type of the enterprise) and regulation of the work of the federal government enterprises were defined. The list of the documents prepared for such enterprises creation is given. The procedures for allocating property for the enterprises, submission of the accounting on the work of the enterprise, its financing and profit distribution are determined.

Besides, the same Resolution recognizes the Resolutions of the Government of the Russian Federation from 12.08.1994 No 908 "On approval of a Typical charter of a government plant (government manufacture, government enterprise) formed on the basis of the closed federal government enterprise" and from 06.10.1994 No 1138 "On the procedure of planning and financing the work of the government plant (government manufactures, government enterprises)" as invalid.

The change was made also to the Resolution of the Government of the Russian Federation from 03.12.2004 No 739 "On authority of federal executive bodies to exercise the rights of the owner of the property of a federal governmental unitary enterprise".