

RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES
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Major developments and trends

In December, Mr. V. Putin and other Government Heads have clearly stated that the sharp devaluation of the ruble will not happen. That is, smooth devaluation, started since summer, will be continued. The Government continues to declare the intention to spend considerable sums of money to support domestic enterprises. The list of applicants for public assistance, compiled in December, includes, in fact, all more or less large enterprises. The Parliament has adopted the laws, restricting the powers of several authorities under the Ministry of Internal Affairs to control businesses, but at the same time, it is planned to restrict the jury trial authority. In the Far East, there were massive protests by automobile users, who are disappointed with the decision of the authorities to increase the import duties on second-hand cars. The Head of the Moscow Patriarch Church Alexiy II has passed away, and it is not yet clear how the election of his successor will take place, on a consensus or a competitive way.

In November 2008, for the first time in the past three years, there was recorded a negative trend in virtually all indicators of micro-economic development. This has resulted in reduction of the estimates of GDP growth for the fourth quarter to 102.3 per cent and to 106.0 per cent for 2008 in general. The decline in real incomes of population in November 2008, as compared with preceding month (97.1 per cent) and with November 2007 (93.8 per cent), has affected the annual rates of living standards growth. In November, the number of unemployed has grown 8.1 per cent as compared with November 2007. By the end of the year a significant growth of the number of unemployed, who applies to public employment service agencies is expected.

The growth of investments in November 2008 amounted to 3.9 per cent as compared with November 2007, and in comparison with the preceding month of 2008, the investments increased by 1.9 per cent, what has offset the decline of investment in October. According to the tentative estimates of the Central Bank of Russia, in the third quarter of 2008, the net outflow of private capital amounted to USD 16.7 billion. The total volume of foreign investments in the Russian economy in 2008 has decreased by 14 per cent, in all kinds of investments. According to the IET estimates, the expected growth rate of investments in fixed assets will account to 109.0 per cent in 2008.

As of the end of November, the CPI in Russia amounted to 0.8 per cent, what is lower than the indicator of the relevant period in 2007 (1.2 per cent). Consumer prices growth in January - November reached 12.5 per cent. Despite the slowdown of the decline in international reserves in November, as well as reduced outflow of capital, it is still too early to speak about the emerging new trend. To stabilize the financial system, the Bank of Russia has increased the refinancing rate by 1 percentage point up to 13 per cent and increased the rates on credits and deposits of the RF Central Bank. Moreover, since mid-November, the Central Bank of Russia is pursuing a policy of ruble «soft devaluation».

In December, the deterioration of the economic crisis in the Russian industry has somewhat slowed down. According to the survey, the rate of production output has stabilized. Regardless of seasonal factors, the balance of changes at the end of 2008 has made -41 points, while in summer that indicator was +8 points, and in the spring that indicator was +15 points. More intensive decline in the volume of production was recorded as early as in the first six months of 1994. A massive decline in producer prices is noted, as well as declining satisfaction with the demand level. The stocks of finished products is growing. The availability of credits is getting reduced. For the first time in recent years there observed a decline in oil production.

The aggravating global liquidity crisis, the continuing decline in oil prices, as well as the policy pursued by the Central Bank of Russia on ruble devaluation and upgrading the key interest rates were the main factors, resulting in reducing the Russian stock market indices. Moreover, on December 15, Moody's agency has downgraded the rating of Russia from «positive» to «stable». Besides, on December 8 Standard & Poor's agency has downgraded the forecast for the Russian credit rating due to the sharp decrease of foreign currency reserves and investment inflow. However, a number of anti-crisis measures, taken by the Government of Russia, the support of the automotive industry helped to improve the expectations of investors. The effect of divergent factors was observed, on the one hand, in the growth of the «blue chips» quotations (up to 40 per cent) and increased activity of investors in the short-term market, MICEX and RTS, and on the other hand, in the decline of government securities profitability in the market. MICEX index has grown nearly by 15 per cent within the month. There has been noted an increased level of government bonds, which is the result of higher risks to borrowers and creditors of the debt market.

The deterioration of the external market situation provides an increasing affect on export contracts. The sharp decline in credit activity, the decrease of real disposable monetary income of the population and dollar strengthening have provoked a reduction of imports.

In November, additional amendments were made to the Law on the federal budget for 2008-2010, which were made for the fourth time. Moreover, the Russian government has adopted a number of new anti-crisis measures to stabilize the Russian economy.

Apparently, the deterioration in the financial status of business entities inevitably entails a decline in budget revenues, and therefore calls into question the financial stability of the entire national budget system. Under such circumstances, it is necessary to pursue a restrained fiscal policy. One should avoid a decrease of the tax rates, that are dependent on the global oil prices to a lesser extent.

Among other important decisions in the field of economic policy are:

- the Russian government has established limits for rented premises to be privatized in the framework of a simplified procedure, available to small and medium-sized enterprises, as well as the deadline for installment payments;
- the maximum amount of unemployment benefit increased, as well as the some other social benefits.

The political and economic results of December 2008

S. Zhavoronkov

In December, Prime Minister Putin and other leaders of the RF Government unambiguously stated that there would be no any drastic devaluation of the ruble. This means the continuation of its smooth and gradual devaluation, which has been visible since last summer. The RF Government, as before, declares its intentions to spend considerable sums of money on rendering support to enterprises; the December list of candidates earmarked for government assistance includes all more or less large-scale enterprises. Parliament adopted laws designed to relatively restrict the ability of the bodies subordinated to the Ministry of Interior Affairs to inspect businesses; however, at the same time, it is planned to limit the jurisdiction of the jury. There were mass protests of car owners in the Far East, who expressed their dissatisfaction with the government decision to increase import duties on second hand cars. Moscow Patriarch Aleksey II died, and it has not become clear so far whether the election of his successor will be held on the basis of consensus or on that of contest.

In early December, the leader of *United Russia* party, RF Prime Minister V. Putin, appeared live on a TV hot-line and answered a number of questions put to him by citizens. Some of the questions dealt with the drastic deterioration of the living standards of some categories of citizens – as it was always emphasized, in connection with the “world financial crisis”. The most disturbing questions were asked in connection with the issue of unemployment. V. Putin explained that, unlike other countries which were forced to reduce their expenditures because of the crisis, Russia would increase expenditures, including social ones, whereas inflation was planned to be kept at the level of 12 – 13 %. At the same time, according to Putin, economic growth in 2008 had been planned to be at the level of 7.5 %, while in reality it dropped to 6.8 - 6.9 %. As regards the unemployed, their number amounted to 1.7 million, but would grow, as Putin admitted, to 2 million, and it would be possible for the situation to be made less acute by internal migration, by increasing unemployment benefits and by organizing public works in the sphere of construction dealing with the development of infrastructure. Putin then told the audience about the government measures designed to ensure that budget funds would reach their final recipients, including small and medium businesses.

It is noteworthy that the Prime Minister took a relatively tough stance on one of the most sensitive issues – that of “sealing the tariffs” on housing and utilities services. He motivated his position by saying that the infrastructure was worn up by 80 %, while “...the natural monopolies rely on the government-approved rates of tariff growth, because these figures are entered into their investment programs. What is on stake is the purchasing of metals and construction materials, the ensuring of functioning of the whole branches of the economy and the preservation of jobs”. Putin also found some positive aspects of the crisis, such as increased security of the state housing certificates issued to discharged officers being risen to the level “that would be sufficient even for purchasing apartments in major megalopolises” - however, with the help of local authorities. It was also mentioned that internal prices of energy carriers were going down – in connection with the drop in external prices.

V. Putin and other top-ranking officials stated that there were no plans to drastically devalue the ruble. V. Putin said: "...I am proceeding from the fact that we will not permit this – there will be no acute fluctuations of the exchange rate of the ruble. Naturally, it will be adjusted in one way or another according to the prices of our traditional goods on world markets – prices of energy carriers and metals – I have already talked about this – and of fertilizers. I should repeat again – our main inflow of foreign exchange is from [selling] these goods, but we also have to serve out imports, which are still coming into our country in large quantities, and this produces a natural outflow". Putin then assured his audience that the government was not planning to change the existing regime of buying and selling foreign exchange.

More than two weeks later, it was D. Medvedev's turn to talk live on radio and TV. Against the background of Putin's hot-line which was relatively rich of certain theses and target indications, Medvedev's message was practically devoid of anything concrete apart from general positive recollections. Perhaps the only thing that once again made analysts happy was his assurance that the causes of the current crisis were to be looked for "...in the state of affairs in America and in a number of other largest economics and in the not too adequate international financial regulation of recent years"; he also announced that he was keeping his savings in rubles. Putin had also accentuated the foreign origin of the crisis - but at least he had mentioned some Russian problems, including the economy being heavily dependent on prices of hydrocarbons and metals.

Putin's broadcast live on radio and TV had a very modest internal-policy component, while that of Medvedev had none of it at all. Putin pointed to the positive role of *United Russia*, which enjoyed majority in parliament, due to which the Government's initiatives were accepted. Asked of his opinion on the extension of the presidential term to six years, Putin said that "longer office is a matter of taste to a certain extent". Likewise, absolutely no comments were put forth as to the issue concerning the year 2012, although many analysts had been hoping that the New Year's messages of either Putin or Medvedev would shed some light on the possibility of early retirement of Medvedev, which the latter had refused to refute in his recent interview to the "Figaro".

It is not without interest that the person who presented his "personal opinion" concerning the situation in the Russian economy was RF Vice-Prime Minister and Minister of Finance A. Kudrin. He stated that the country's budget deficit could reach 1.5 - 2.5 trillion rubles next year, "which we will have to make up from the national Reserve Fund". The year 2009 "...will be the worst year for the world economy since World War Two", said the Minister. Not only did he acknowledge that inflation in Russia would remain at a high level, in excess of 13%, but he also noted that "devaluation will cause additional inflation". Unlike the Prime Minister, Kudrin promised, instead of a rise in social expenditures, that "...we will slightly refocus the expenditures, but will not reduce them. This will affect neither wages and salaries nor pensions".

The sum total of these assorted statements presents a relatively clear view of the State's strategy aimed at smooth and gradual devaluation of the ruble, which would devalue the present level of state expenditures without making hard decisions concerning their sequestration or abolishment.

The RF Government composed a list of enterprises which should be assisted by the State in the first instance. "The first instance" extended to 295 enterprises which answered the mandatory requirement of having a workforce in excess of 5 thousand and a turnover of no less than 15 billion rubles. According to the estimates prepared by I. Shuvalov's commission, these companies will require up to 3.2 trillion rubles to make up for their deficit of credit resources (state guarantees against credits, direct financial assistance, restructuring of tax arrears). These expenditures are several times higher than those envisaged in the existing 2009 budget.

The importance of the fact of this list having been composed should not be overestimated – it is nothing more than a political declaration, so to say, a zero stage of selecting the real recipients of funds. This was directly confirmed by both I. Shuvalov and V. Putin (for example, in December, B. Aleshin, head of the OJSC "Avtovaz", an enterprise included in the list and apparently a core one, was advised by the Prime Minister to place bonds in order to attract investment resources). The list simply slightly increases the chances of a fund seeker to obtain financing, while each relevant decision will be taken on an individual basis. Also, there exists a formal difference between direct credit and abstract "tariff support". The list was composed with sufficiently clear intentions (which does not mean 'logically') – all the more or less large-scale companies were hammered into it without any consideration being given to their financial situation – plus various smaller companies important for the decision-

makers. The fact that some structures, such as the OJSC “Rosspirtprom”, have found their way into the list is simply shocking.

But the main shortcoming of the decision concerning state assistance is, as in the case of the previous ones, its absolute discreteness. The government of a country may indeed sometimes come to the decision to directly finance enterprises proceeding from some logic – for example, that bankruptcy of a big bank could harm the interests of numerous, completely innocent depositors - both physical persons and companies, or that the stoppage of a monoenterprise which is the main source of income in a settlement could result in a social catastrophe, sharp rise in crime, etc. The aforesaid list enterprises, however, does not follow this logic. Moreover, while the established international practice is aimed at saving enterprises from bankruptcy, it is absolutely unclear what goals are to be achieved by this “state assistance”.

In December, D. Medvedev signed and put into effect two laws designed to curb the powers of the police (militia), including the abolishment of the notorious Item 25 of Article 11 of the Federal Law “On the Militia” (which authorized any inspections of businesses on suspicion of their having committed crimes or administrative offenses) and the introduction of additional guarantees of entrepreneurs’ rights. However, the new version of the Laws “On the Militia” and “On Operational and Investigative Activities” still allows the participation of the militia in tax inspections and licensing control. Also preserved are the major shortcomings of these articles, thus making it possible to seize, in the course of an inspection, practically anything and for any period of time (the only difference is that today it is preferable that a copy should be made of a document being seized). By the way, in December, D. Medvedev suggested that Internal Ministry officials prone to harassing businesses with their inspections should be severely punished – “as a minimum, there should emerge disciplinary responsibility, ... as a maximum – criminal [responsibility]”. The texts of the new laws contain nothing of this kind.

Also, D. Medvedev put forth a number of new principles to be incorporated into the Russian judicial system. Thus, for example, it was suggested that the practice of judges’ re-attestation should be abandoned, and instead they should be appointed for an indefinite term (the re-attestation procedure today being used as a means to dismiss “incorrect judges); or, that it was necessary “to consolidate various forms of making public the information on the work of courts of justice, including via the Internet”. It should be noted that, however useful these innovations might be, just as in the case of the Federal Laws “On the Militia” and “On the Operational and Investigative Activities”, they will not be very fruitful until the practice of removing judges from office by the qualification collegium of a higher court is abandoned.

The ideological orientation of yet another two laws adopted by Parliament in December is absolutely different. The laws on the introduction of amendments to the RF Code of Criminal Procedure and the RF Criminal Code will withdraw the cases of persons accused of committing terror acts, spying, subversive actions, high treason and staging mass riots from the jurisdiction of the jury. Formally, the authors of the draft law, who are all members of *United Russia*, speak of the increasing number of sentences of acquittal passed by the juries in the territory of the North Caucasus with regard to terrorists (that is, the authors of the draft law proceed from some *a priori* personal knowledge of who is a terrorist and who is not). Actually, any citizen can be accused of committing any crime (including terror acts), and the complete transfer of this category of cases into the competence of judges can mean a nearly 100-percent probability of the judgment of guilty to be passed. All this means nothing other but further toughening of legislation. Especially noteworthy is the fact that “staging mass riots” is also included in this category. The point is that nowadays the notion of “staging mass riots” is frequently applied in Russia not to violent crimes but to unsanctioned mass protests. Even a group of members of the Public Chamber, closely linked to the authorities, called upon D. Medvedev to veto this law, but it is not likely that he will be able to do so.

In December, a number of important personnel changes took place. Thus, a new, extended Board of Directors was elected in “Norilsk Nickel” to be chaired by A. Voloshin, former head of the Presidential Administration and veteran Chairman of the Board of Directors of the Unified Energy Systems of Russia - Russian Joint-Stock Company (a few days earlier, V. Putin’s acquaintance, V. Strzhalkovskii, was appointed General Director of the company). However, M. Prokhorov was not elected to the Board – he said that his failure to be elected onto the Board was an outrageous violation of a deal with shareholder RusAl (after a block of shares in Norilsk Nickel was sold to RusAl, Prokhorov became its major shareholder). Thus, this corporate conflict cannot be considered to have been resolved as yet.

The major shareholder of “Sviaz’invest”, the State, nominated E. Iurchenko to the post of General Director of the company. Before 2005, Iurchenko was Deputy-Director of Sviaz’invest; he had to leave this post after the arrival of A. Kiselev, reputedly a protégé of the former head of the Ministry of Communications L. Reiman. Also, there were rumors of a possible compromise solution of L. Reiman being nominated to the post of Chairman of the Board of Directors. Thus, it will soon become clear who is to control this important structure.

In December, there was a sharp rise, or better say resumption, of mass protests, which were nowhere to be seen in the first 11 months 2008. In Moscow, December saw the first “March of Discontent” of the year 2008 (in March and April, the attempts to organize it proved futile). But much more important were the protests of car owners against the RF Government’s decision to increase the import duty on second-hand foreign cars (adopted in December, it should come into force from 11 January 2009). Protest actions involving many thousands took place in Novosibirsk, Krasnoyarsk, Irkutsk and Primorskii Krai, where they were not limited to Vladivostok but spread to other cities as well. Protesters in Primorskii Krai repeatedly clashed with the special police units airlifted from Moscow, and the action began to assume political character. Nevertheless, V. Putin reiterated his government’s decision and refused to change it. It is noteworthy that the local authorities, as well as the local organization of *United Russia*, took the side of the protesters and not of Moscow – for the first time since the 2006 protests against the construction of a pipeline in the vicinity of Baikal. In that instance, the decision concerning the pipeline was cancelled, and the situation in the region returned to normal. It is possible that some compromise will be found again, because otherwise yet another seat of tension is sure to emerge.

In December, Moscow Patriarch Aleksey II (secular name Aleksey Rediger) passed away after having been head of the largest Orthodox denomination for more than fifteen years. In the stormy 1990s, he emphasized his detachment from politics; in the 2000s he began to support the authorities to the extent of speaking in favor of the official candidates to the post of RF President. At the same time, he managed to preserve some autonomy of his organization. The official candidate to the vacant throne of Moscow Patriarchs is Metropolitan Kirill, Head of the Department for External Church Relations of the Moscow Patriarchate, supported by the Kremlin. Apart from him, there are now two more candidates – Metropolitan Vladimir of Kiev, and the major competitor, Metropolitan Kliment of Kaluga, Chancellor of the Moscow Patriarchate. What is most intriguing is not whether Kirill or Kliment will become Patriarch (there are no doubts that Kliment, who is a member of the RF Public Chamber, is equally far from radicalism), but whether the Kremlin will manage to prevent competition among the candidates and to impose unanimity. Otherwise, the Moscow Patriarchate risks to become a new venue for discussions, which are fraught with schisms, as is exemplified by the election of the previous patriarch¹.

Budgetary and Tax Policy

N.Luksha

As of November results, the CPI in Russia amounted to 0.8 per cent, which is lower than in the relevant period of the preceding year 2007 (1.2 per cent). The consumer prices growth within January - November has reached 12.5 per cent.). In November the financial crisis was deteriorating in the country, what has affected the real sector of economy. Despite the decline in reduction of foreign currency reserves in November, as well as reduced rate of capital outflow, it is still too early to speak about the new trend in economy. To restrain prices growth rates and maintain stability of the financial system, the Bank of Russia has taken a number of measures. From December 1, the refinancing rate was raised by 1 p.p., to 13 per cent, as well as the interest rates on credits and deposits of the RF Central Bank. Moreover, since mid-November the RF Central Bank pursues the policy of “smooth ruble devaluation”.

The consumer price index in November made 0.8 per cent, as compared with 0.9 per cent in October (see Fig. 1.). From December 1 to 22, consumer prices have grown by another 0.5 per cent,

¹ In 1990, the then head of the Kiev Mitropoly of the Moscow Patriarchate, Metropolitan Filaret, founded a new denomination after having lost Patriarch’s election, and thus initiated a schism.

thereby the inflation rate has exceeded the estimates of the Central Bank, 13 per cent by the end of the year.

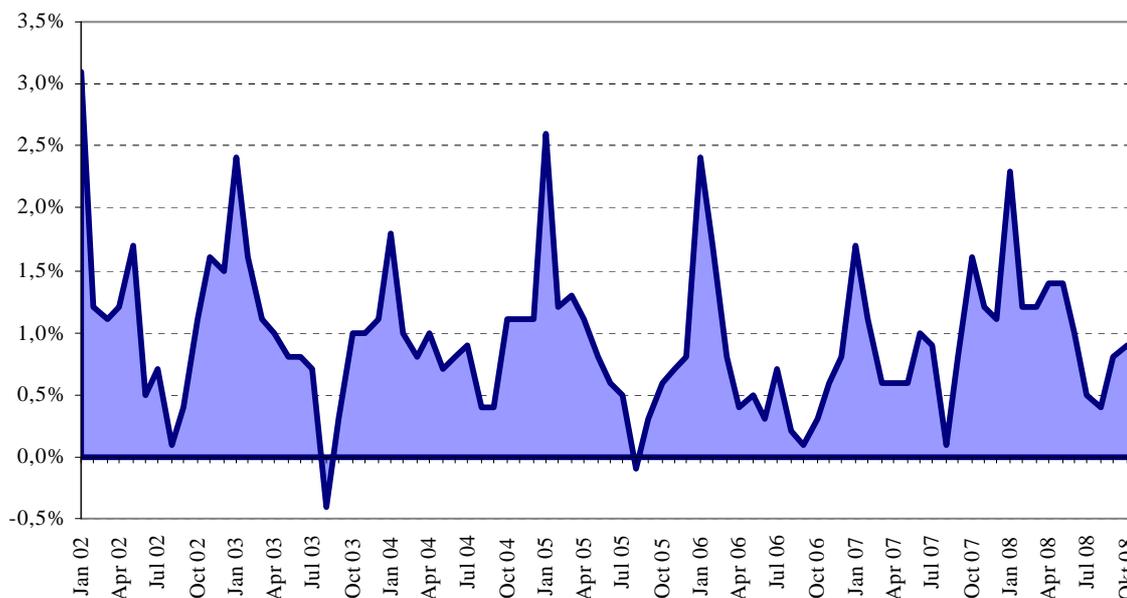
Like in October, the utmost growth rates were observed in prices for food stuffs, which have grown during the month by 1 per cent. The most significant growth was observed in regard to eggs (+2.4 per cent), meat and poultry (+ 1.7 per cent), milk and dairy products (+ 1.4 per cent). Herewith, granulated sugar and sunflower oil continued further downgrading: within the month their prices have declined by 1.4 per cent. Seasonal decline in prices for fruit and vegetables is over, prices have grown by 1 per cent.

In November prices for public services have also grown by 0.7 per cent. The utmost growth was observed in pre-school education and public services (by 1.5 per cent in each area). Due to seasonal upgrading of railway tariffs, prices for train tickets have increased (by 1.2 per cent). At the same time the costs of health and recreational services have declined (-0.4 per cent).

Prices for non-food items have increased in November by 0.5 per cent. The highest growth rates were noted in medical supplies (+2.2 per cent), detergents and cleaning agents (+1.7 per cent), knitwear (+1.5 per cent), clothes and underwear (1.4 per cent) due to the decline in prices for energy sources on the national and global level.

The reason for a further reduction in gasoline prices (-5.9 per cent) was the discrepancy between the world price for oil and petroleum products and export duties on energy sources. Thus, during the month of November due to the so-called «Kudrin's scissors»², oil companies were losing on each ton of exported oil nearly USD 70 on average. As a result, there was an excessive supply oil products in the domestic market, which has led to a sharp decline in prices in the wholesale market and their (much lower) adjustment in the retail market. However, the decline in retail prices of gasoline in our country is not likely to reach the level of the US and Europe, where gasoline prices have fallen down by tens of percent, as the Russian companies are trying to compensate for the low profits from exports by the high profitability in the domestic market. It should be noted, that this situation takes place only due to the high monopolization of retail sales in the Russian market of petroleum products.

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



Source: Rosstat

Therefore, despite the fact that as of November results, the CPI was slightly lower than the indicator of preceding month, its difference in annual terms from the growth rate of prices in the same period of

² Before the crisis, the export duty on crude oil and petroleum products were estimated basing on the monitoring of oil prices within previous two months, and were in effect during the next two months. As a result, under growing oil prices, the oil companies had a big advantage, because changes in export duties were lagging behind the dynamics of oil prices. However, when the oil prices are falling down, export duties decline slower than oil prices. This phenomenon was called «Kudrin's scissors».

2007 remains rather high (12.5 per cent versus 10.6 per cent). Growth rate of monetary supply M_2 in November has also decreased (-2.2 per cent). There are reasons to expect further reduction in the rate of inflation in early 2009.

Firstly, there are expectations for restriction in tariffs growth for natural monopolies supplies and services (gas, railway transportation and electricity for the population). Secondly, the downfall of commodity prices and the reduction of consumer demand will result in the decline of producer prices. Thirdly, the reducing monetary supply in recent months also restrains the growth of prices. However, the reduction of inflationary pressures will be restrained by ruble devaluation, which urges growth of imported goods prices.

Like in preceding year, the basic consumer price index³ in November 2008 made 1.31 per cent. According to our estimates, the CPI in December made about 0.7 per cent.

In November 2008 the monetary base (in broad definition⁴) has been decreased by RUR 80.3 bln, to RUR 5201.8 bln (- 1.5 per cent). The volume of the monetary base in broad definition made as of November 1, 2008 made RUR 5282.1 billion. Let us consider the dynamics of the monetary base in broad definition by components.

As of December 1, 2008, cash in circulation with regard to the fund balances in credit organizations made RUR 4.2 trillion (4.2 per cent reduction against November 1), correspondent accounts of credit organizations in the Bank of Russia made RUR 643.3 billion (+5.7 per cent), mandatory reserves made RUR 30.1 billion (- 12 per cent), banks' deposits in the Bank of Russia made RUR 296.8 billion (+ 32.9 per cent), the value of shares of the Bank of Russia with credit organizations made RUR 23.6 billion (+ 1.3 per cent).

As of November results, growth of excessive reserves of commercial banks has made RUR 108.3 bln⁵, whereas with the highest growth rates were noted in the deposits of banks in the RF CB, what is partly attributable to higher interest rates, established in mid-November. Moreover, due to significant infusion of public funds in the RF banking system, a number of credit organizations obtained excessive liquidity resources, which they prefer either to allocate at the RF CB deposits or foreign currency purchase, rather than to crediting the national economy due to the high credit and currency risks.

Therefore, in November the situation with liquidity has somewhat improved due to allocation of public funds into the banking system. At the same time, it is too early to speak about any long-term positive trend, as:

- 1) the rates in the interbanking credit market remain rather high (in November MIBOR rate on one-day credits were in the range of 10,6 per cent, and 9.4 per cent in December);
- 2) the demand for unsecured credits has not decreased (from October 21 to November 19, their volume has doubled, and a month later it has increased 2.2-fold);
- 3) the large volume of REPO transactions between commercial banks and the Central Bank of Russia is sustained;
- 4) capital outflow is continued.

It should be noted, that while devaluation expectations of economic agents are supported by gradual reduction of ruble nominal exchange rate, followed by the Central Bank of Russia, significant share of funds, allocated to the banking system will be further addressed in the foreign currency market and exchanged in dollars, provoking capital outflow.

The reduction of the volume of cash in circulation by 4.2 per cent and mandatory reserves by 12 per cent have led to the cut-down of the monetary base in narrow definition (cash+ mandatory reserves)⁶ by 4.3 per cent (see . Fig. 2). In the last month, for the first time since February 2008, the amount of

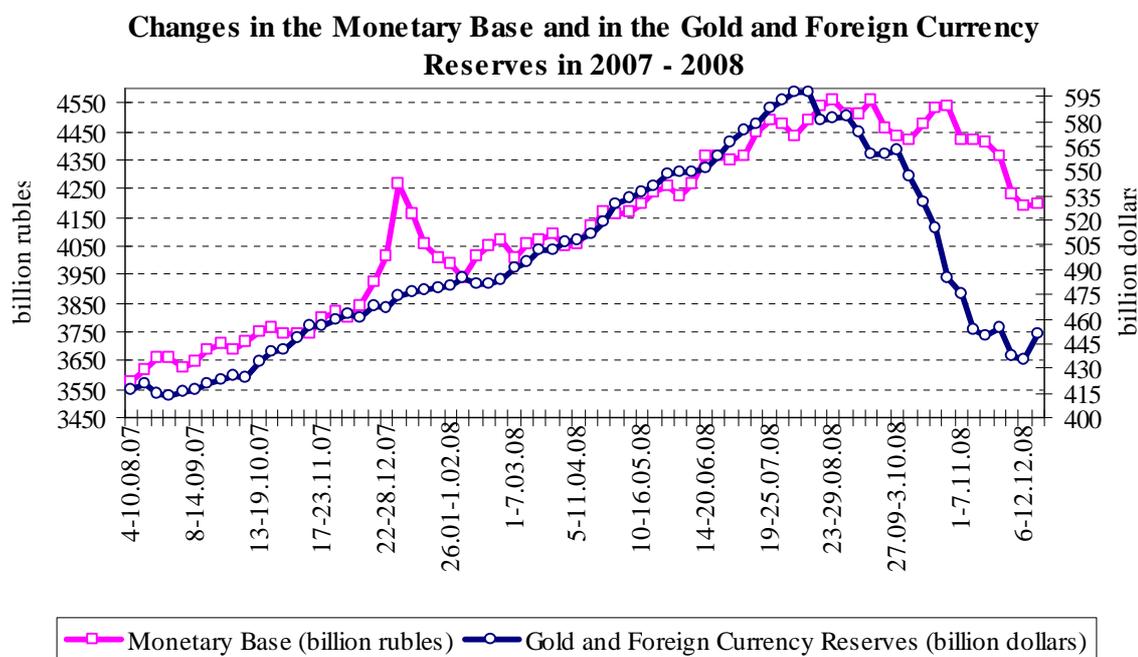
³ Basic index of consumer prices is an indicator of the inflation level without regard to seasonal price reduction (fruit and vegetable products) and to administrative measures (tariffs for government-regulated services, etc.). It is estimated by the RF Statistics Service.

⁴ 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.

⁵ The excessive reserves of commercial banks with the RF CB refers to the amount of correspondent accounts of commercial banks, their deposits with the RF CB and the CB bonds of commercial banks

⁶ We'd like to remind, that the monetary base in the broad definition is not a monetary instrument, it reflects the obligations of the Bank of Russia in national currency. The monetary base in narrow definition is a monetary instrument (one of indicators of the volume of monetary offer), which is under total control of the CBR.

cash in circulation has reduced due to the replacement of rubles by foreign currency in the assets portfolio of economic agents, urged by ruble devaluation.



Source: RF CB

Herewith, the volume of foreign currency reserves of the Central Bank of the Russian Federation has decreased in November by 6 per cent and made on December 1 USD 455.4 bln. The basic reasons of such significant reduction of gold and foreign currency reserves were currency interventions, effected y the RF Central Bank.

As of November results, the real effective exchange rate has grown (in the same period of preceding year, it remained unchanged): index of real effective rate made 141.4⁷ (see Fig. 3). As a result of ruble strengthening in real terms in the two-currency basket has reached in January-November of the current year 8 per cent as compared with 4,4 per cent in January-November of 2007.

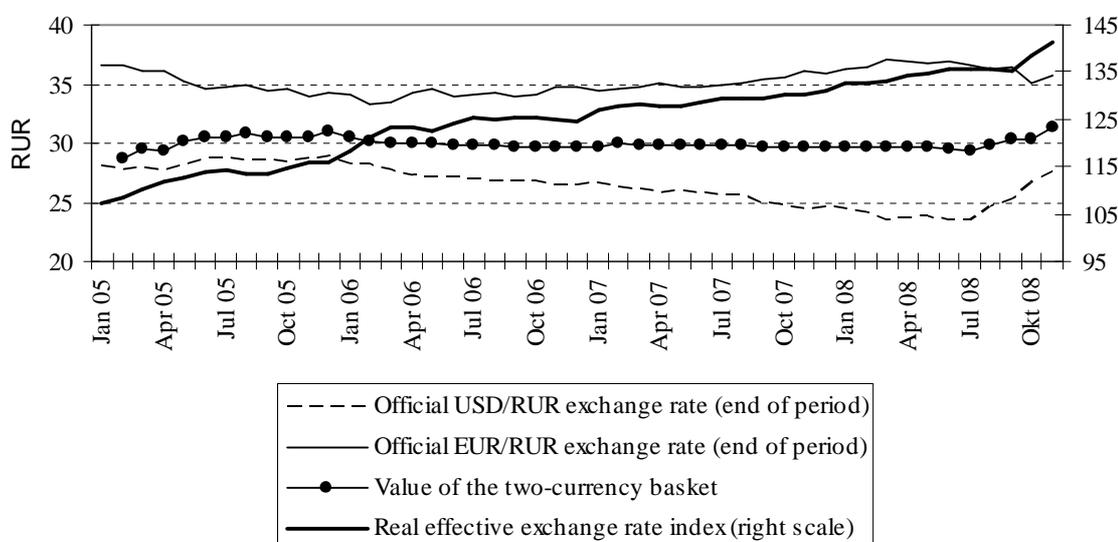
As of November results, the USD has practically not changed against EURO in the global currency market. Herewith, the official USD rate against RUR has grown by RUR 0.5 and by late November the dollar rate was RUR 27.6, as compared with RUR 21.7 as of November 1. The EURO rate in late November has grown to RUR R 35.7. As a result, in the last month ruble has been downgraded against the two-currency basket⁸, which value has grown by 88 kopeks, from RUR 30.37 to RUR 31.25.

Therefore, over the past months at the background of weakening ruble in nominal terms to the two-currency basket, a significant strengthening of ruble effective exchange rate in real terms was noted. In other words, the reduction of ruble nominal exchange rate against major international currencies has been insufficient to compensate for the difference in the rate of domestic and international inflation. We'd like to remind, that as a result of the ruble strengthening in real terms, domestic products become less competitive as compared with foreign products, provoking additional difficulties for domestic companies in crisis situations.

⁷ The level of January 2002 is accepted as 100 per cent.

⁸ Two-currency basket is the RF Central Bank operational indicator in its foreign currency policy. Currently the share of EURO in the currency basket makes 45 per cent, USD – 55 per cent.

Indicators of Ruble`s Exchange Rate Dynamics



Source: RF Central Bank, authors' estimates

On December 1, the Bank of Russia, in the framework of its measures aimed at reducing the outflow of capital from the country and curb inflation, decided to raise the refinancing rate again to 13 per cent per annum. The bank has increased the refinancing rate for the sixth time in this year. Last time the refinancing rate was increased on November 12 by 1 per cent. Due to the fact that the refinancing rate is the basic interest rate for all credit operations of the Central Bank, its growth has caused a corresponding upgrading of all other interest rates of the RF CB (see Table 1). Moreover, since December 1, the Central Bank has increased the interest rates on credit and deposits of this bank.

Due to the fact that the refinancing rate is the basic interest rate for all credit operations of the Central Bank, its growth has caused a corresponding upgrading of all other interest rates of the RF CB (see Table 1).

Table 1

| Credit type | Interest rate (% per annum) | |
|---|---|--|
| | Before amendment | Upon amendment |
| Overnight | 12 | 13 |
| Credit, secured with assets, provided for 90 calendar days | 10 | 11 |
| Borrowing against bill pledging, right of claim on credit agreement organization or guarantee lending | 8,5 – to 90 calendar days; 9,25 – from 91 to 180 calendar days | 11 – to 90 calendar days; 12 – from 91 to 180 calendar days |

Moreover, the interest rate for “cross-currency swap” transactions for 1 day term (ruble share) has also been raised by 1 p.p, to 13 per cent, while interest rates on direct REPO transactions for 1 day and 7 days term were increased to 10 per cent per annum. The RF. Central Bank has also increased interest rates on deposit operations under standard conditions: "tom-next", "spot-next" and "on demand" from to 6.75 per cent per annum, "1 week" "and" spot-week" from to 7.25 per cent per annum.

Moreover, the Bank of Russia has increased the rates under operations with liquidity, arranged on auction basis:

- under direct REPO operations for the term of 1 day – from 8 per cent to 9 per cent per annum;
- under direct REPO operations for the term of 7 days – from 8.5 per cent to 9.5 per cent per annum;
- under 14-days lombard credits for the term of 14 days - from 8.5 to 9.5 per cent per annum;

- under direct REPO operations for the term of 90 days – from 9.5 per cent to 10.5 per cent per annum.

Therefore, the RF CB has taken further measures to tighten monetary policy. It is noteworthy, that only recently the interest rates on credits, issued by the Central Bank of Russia were being expressly decreased for the purpose of stabilizing the situation in the Russian financial market. However, credits, provided by the Bank of Russia were used by banks to buy foreign currency, what results in an increased pressure on the ruble and the lack of liquidity in the RF banking system. As a result, the RF CB has decided to resist the outflow of capital by increasing the yield of ruble assets and increase the value of «currency swap» transactions. At the same time, in the situation of continuing decline in energy sources prices, such measures can hardly result in significant reduction of capital outflow and pressure on the ruble.

From November 11 to December 24, the Bank of Russia 10 times has extended the value of the two-currency basket: three times in November (on November 11, 24 and 28) and seven times in December (on December 5, 11, 15, 17, 18, 22 and 24). Initially, the extension was made approximately once in ten days for 30 kopeks each way. However, within December 11 and 24, the weakening of the ruble has accelerated, and the value of the two-currency basket has been upgraded six times within that period, whereas after December 17 the Bank of Russia upgraded the rate to a greater extent than before, by 40-50 cents, according to different estimates. It should be noted, that the RUR weakening takes place basically due to EURO strengthening, while the exchange rate of the ruble against dollar is varying within the range of RUR 27.5-28.

It is worth noting, that if in the near future the dollar starts strengthening against EURO, whereas prices for the energy sources remains at the lowest levels, the Bank of Russia will be forced to continue the policy of ruble devaluation against two-currency basket. However, in this case it will be important that this situation would not stay for a long time, because otherwise it will be difficult for the Central Bank to maintain exchange rate expectations.

To maintain the domestic enterprises in the aggravating financial crisis, on December 19 the RF CB has confirmed the decision to provide unsecured credits for the term of one year, rather than for six months (before the maximum term for the unsecured credits was six months). At the same time, there is no confidence that the major share of allocated funds will be addressed at the real sector of economy. In other words, the measures taken so far are supporting only the banking, rather than the real economic sector.

Financial Markets⁹

N. Burkova, E. Khudko

In September the Russian financial market dynamics was determined by the negative situation in the global financial and commodity market. The growing global liquidity crisis, the continued decline in oil prices, as well as the policy pursued by the Bank of Russia of the ruble devaluation and raising key interest rates contributed to the deterioration of the Russian stock market. Moreover, on December 15, Standard & Poor's Agency has downgraded the forecast for the Russian sovereign rating from "positive" to "stable". Moreover, on December 8, Standard & Poor's Agency has downgraded the forecast for Moscow long-term rating from "stable" to "negative", as well as Russian credit ratings due to sharp downgrading of the international reserves and investment inflows. However, a number of anti-crisis measures taken by the Government of Russia, including support to the automotive industry, have contributed to some improvement in investors' expectations. These volatile trends were clearly evident particularly in the Russian stock market (where the quotations of "blue chips" have been upgraded to 40 per cent), as well as in the investors' grown activities in MICEX and RTS futures markets and at the same time, lower **Government securities market**

In December, Russian Eurobonds demonstrated a volatile dynamics in the yields at the background of negative external news and aggravated global financial crisis on the one hand, and measures, taken by the RF government to support banking sector and stock market on the other hand. However, the

⁹ In the course of preparation of the survey, there were used analytical materials and surveys published by the Zenith Bank, investment company ATON, MICEX, and the materials presented at web sites of Russian issuing companies.

policy of the Bank of Russia in terms of ruble weakening and upgrading the key refinancing rates has not decreased attractiveness of government bonds to investors and resulted in low liquidity of the market.

As of December 24, 2008, the Russian Eurobonds' RUS-30 yield to maturity has decreased as compared with the level of November 23, 2008 from 11.94 to 9.89 per cent per annum (by 17.71 per cent), RUS-28 – from 11.24 per cent to 10.99 per cent per annum (by 2.22 per cent), RUS-18 – from 8.08 to 7.71 per cent per annum (by 5.63 per cent) and RUS-10 – from 5.99 per cent to – 1.63 per cent per annum. In December, there were no sales in the Ministry of Finance bonds (7-th tranche), except for December 9, when the yield to maturity was 4.65 per cent per annum, which is by 8.74 per cent higher than the earlier indicator (4.28 per cent per annum) a month before (on November 14) (See Fig. 1–2).

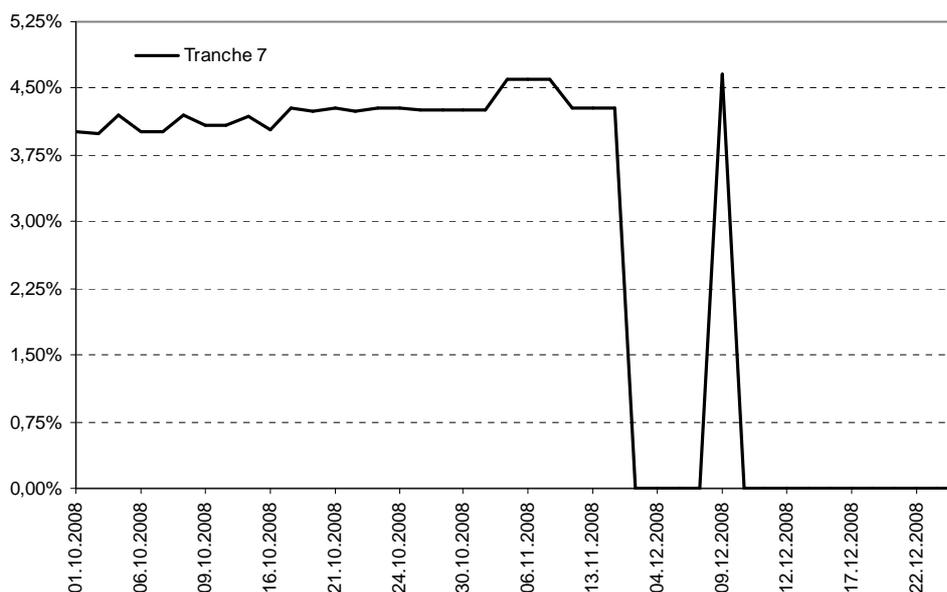


Fig. 1. Minfin bonds' yields to maturity in October - December 2008

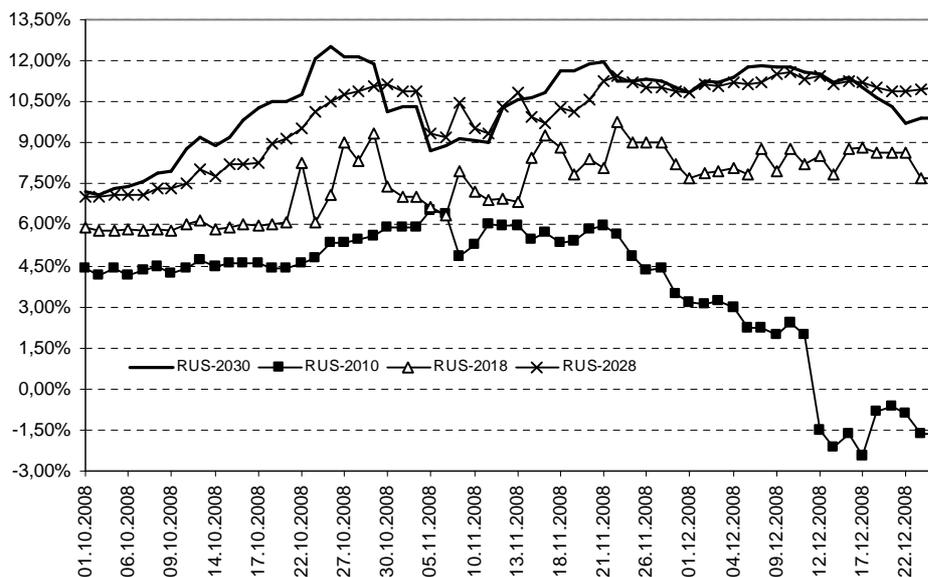


Fig. 2. Yields to maturity of the Russian Eurobonds with maturity in 2010, 2018, 2028 and 2030 in October - December 2008

Within the period from November 24 to December 24 the total turnover of GKO- OFZ secondary market amounted to approximately RUR 21.13 billion with an average daily turnover of RUR 0.92 billion. (about RUR 48.98 billion with an average daily turnover of RUR 2.58 billion in November),

what demonstrated a decline of average daily turnover in December as compared with preceding month by 2.8-fold.

Like in preceding month, there were no auctions on additional OFZ placements in the period from November 24 to December 24.

As of December 24, the GKO-OFZ market amounted to RUR 1144.02 bln at face value and to RUR 1024.32 bln at market value. The duration of the GKO-OFZ market portfolio was 1959.25 days, having decreased (by 62.97 days) as compared with preceding month (as of November 23).

Stock market

Stock market situation

In November, Russian Eurobonds demonstrated a volatile dynamics in the yields at the background of negative external news, on the one hand, and measures, taken by the government authorities, the RF government among them, to support national economies on the other hand. Further revocations of bank licenses due to the failure to perform their obligations, RUR downgrading against USD and Euro as a result of Central Bank devaluation policy, as well as upgrading the refinancing rate to 13 per cent per annum have provoked a downfall in quotations. Moreover, the situation in the Russian stock market has noticeably changed after December 8, when Standard & Poor's Agency has downgraded Russian credit ratings forecast and Moscow long-term rating from BBB+ to BBB with "negative" forecast due to the sharp reduction of the international reserves and investment inflow. On December 15, Moody's has downgraded the forecast for the Russian sovereign rating from "positive" to "stable". However, measures, taken by the Government of the Russian Federation to support the national financial market, as well as some optimistic corporate news had a positive impact on the investors' expectations. In particular, it is worth mentioning:

- Credit allocation by the RF CB to Credit Deposit Insurance Agency in the amount of RUR 65.9 billion for the banks' recovery;
- Vnesheconombank approval to provide subordinated credits to the banks;
- MDM Bank merger with "UPSA Bank";
- The decision to grant state guarantees by the Russian Government on credits in the amount of RUR 300 billion to the major Russian enterprises, as well as RUR 150 billion to support the labor market and the real sector of economy;
- Credits, provided by the RF public banks to commercial banks and enterprises of the real sector of economy;
- Measures to support the Russian automotive industry, in particular the allocation of about RUR 200 billion and subsidies of interest on credits for low-cost cars purchase.

All those volatile factors have urged the upgrading of a part of the most liquid securities in the Russian stock markets in December (up to 40 per cent), whereas a decrease in another part of securities quotations (up to 10 per cent), as well as a general trend in MICEX and RTS market stock indices growth over 15 per cent as compared with preceding month.

Throughout December a volatile dynamics was observed in the Russian stock market. Thus, throughout the month, a general trend to growth in MICEX index was replaced by short corrective periods. The minimum value of the MICEX index has reached 562.34 points on December 5 (which is by 8.78 per cent more than the relevant indicator of preceding period). The maximum value of the MICEX index for the month reached on December 23: 661.33 points (which is nearly by 15 per cent lower than the relevant indicator of previous period). Such MICEX index dynamics in December has reflected a general volatile trend in the quotations of the Russian companies' equities (*Fig. 3*).

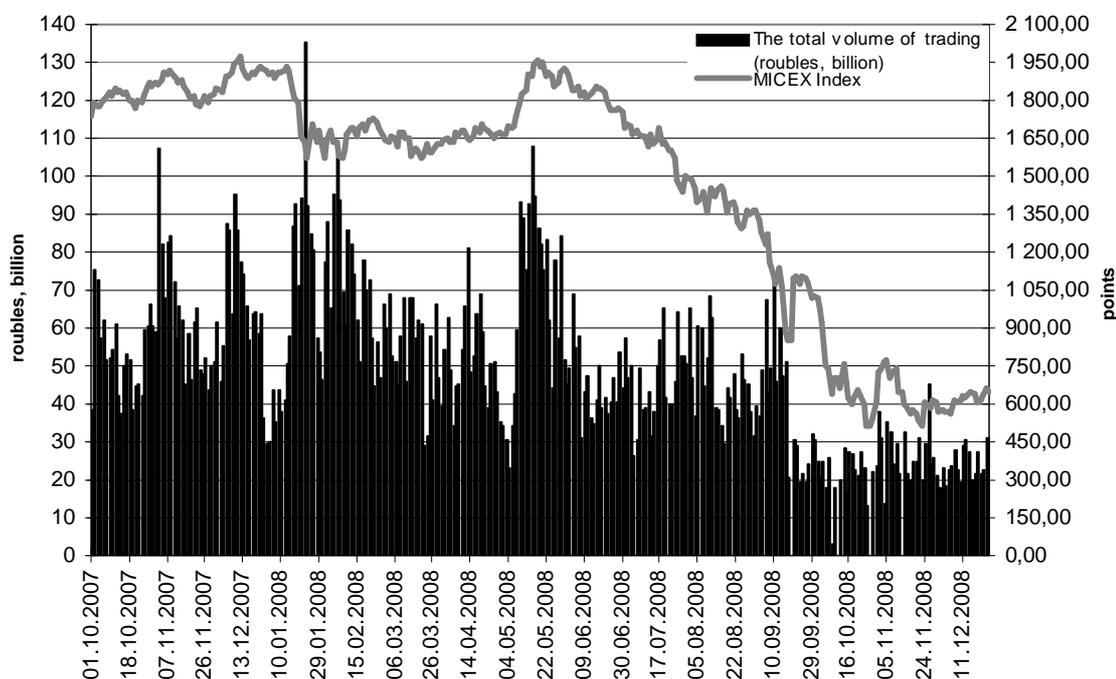


Fig. 3. Dynamics of MICEX Index and trading volume

In general, within the period from November 24 to December 24, 2008, the MICEX index has increased nearly by 7 per cent, what makes about 40.34 points in absolute terms (within the year, from December 24, 2007 to December 24, 2008 the MICEX index has downgraded 3 times). Over the same period the turnover of trades in shares, included in the MICEX index, made about RUR 590.73 bln at an average daily turnover of RUR 25.68 bln. (against RUR 455.39 billion with an average daily turnover of RUR 23.97 billion in the preceding period). Therefore, the investors' average daily activity in the stock market in December has increased as compared with the preceding month by 7 per cent. The indicators of maximum and minimum daily turnover in the market trading system in December made, accordingly, RUR 31.18 bln. (as of December 23), and RUR 17.90 bln. (on December 1).

As of monthly results (from November 24 through December 24), the "blue chips" have shown a volatile trend. The leaders of growing rates were "Rostelecom", "Tatneft" and "Gasprom Neft", shares, the value of which has increased by 42.03 per cent, 32.16 per cent and 17.58 per cent, accordingly. Some lower growth rates were observed about the shares of "LUKOIL" (by 12.88 per cent), "Rosneft" (by 11.89 per cent) "Mosenergo" (by 3.57 per cent), VTB Bank (by 1.50 per cent). At the same time, "Sberbank of Russia" and GMK "Nornickel" have demonstrated a decline by 9.92 per cent and 3.37 per cent accordingly, followed by "Gazprom" (1.23 per cent) and "Surgutneftegas" (0.71 per cent) (See Fig. 4).

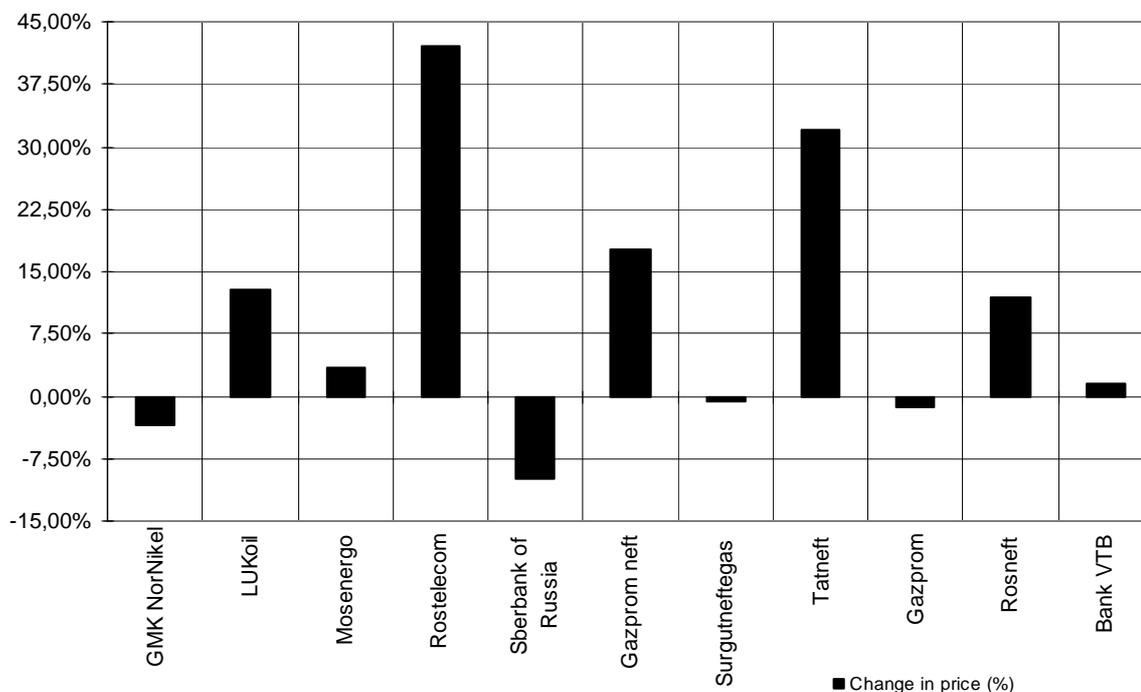


Fig. 4. Dynamics of the Russian Blue Chips from November 24 to December 24, 2008

In December the MICEX turnover leaders were: “Gazprom”(44.92 per cent of the total turnover), “Sberbank of Russia” (16.23 per cent), “LUKOIL” (9.85 per cent), “Rosneft” (6.79 per cent) and GMK “Nornickel” (4.58 per cent). Total share of transactions with the above five companies’ shares (“blue chips”) made about 82.37 per cent (all “blue chips” – 88.26 per cent) of the gross turnover in the MICEX stock market in the period of November 24 to December 24.

According to MICEX information, as of December 24, the top five leaders of the domestic stock market in terms of capitalization, estimated on monthly average results, were: Gazprom – RUR 2,359.07 bln, (RUR 2,737.61 bln in November), “Rosneft” – 955.40 bln , (RUR 922.61 bln in preceding month), “LUKOIL” - RUR 706.42 bln, (RUR 755.34 bln in November), “Surgutneftegas” – -562.54 bln , (RUR 485.87 bln in preceding month), and “Sberbank of Russia” - RUR 539.24 bln (against RUR 633.58 bln). Therefore, volatility was also noted in business capitalization in December.

Futures and Options Market

The investors’ activity in the futures market in December has grown (nearly by 2.5 per cent) as compared with the preceding month. Herewith, the number of transactions has increased by 45 per cent. Thus, in the period of November 24 through December 26 the total turnover in the MICEX futures market made approximately RUR 78.65 bln. (3,187 transactions, 2.40 mln of contracts), against RUR 76.75 bln (2,192 transactions, 2.5 mln of contracts) in November. Herewith, the largest volume of trading in December as a month earlier, was observed in futures RUR/USD, amounting to RUR 73.11 billion (679 transactions, 2.35 million contracts); the turnover in trades with those futures has remained at the same level as in preceding month. The greatest number of transactions (2 498) within the month was made with commodity futures, the volume of trades reached RUR 4.5 billion rubles. The balance of trading volume, taken by RUR/Euro and MICEX index, made RUR 1.04 billion. There were no bids for interest rates in December.

A similar situation was noted at RTS FORTS futures market, where the investors’ activity in December has grown by 55 per cent as compared with the preceding month. Thus, in the period of November 24 through December 26 the total turnover in the RTS futures market made approximately RUR 471.90 bln. (4,322 transactions, 20.83 mln contracts), against about RUR 305.41 bln (3,158 transactions, 12.46 mln of contracts) in November. Like before, futures enjoyed the greatest demand: the volume of trades in the period under review made RUR 438.98 billion (4,273.41 transactions, 19.05 mln of contracts). Options enjoyed far lower demand; the turnover amounted to about RUR 32.92 bln (48.22 thousand transactions, 1.78 mln of contracts), though the investors’ activity in the futures market in has increased nearly twice as compared with the preceding month.

The maximum daily turnover in the RTS futures market made RUR 23.93 billion in December (as of December 4), and minimum was RUR 6.96 bln. (on December 26). Herewith, volume of trades in futures of "Shares of electric power companies" aimed at maintaining the liquidity of shares of electricity companies after the suspension RAO UES trading at the stock markets on June 6, has significantly increased in December (over 87 times) in view of the forthcoming execution deadline (on December 15) and made RUR 45.23 mln. (166 transactions and 5 214 contracts) against approximately RUR 516/85 thousand (43 transactions and 80 contracts) in November.

The last trading day of those futures was on December 12. On December 15, the futures contracts execution took place in the RTS FORTS futures market, among which the number of non-executed contracts with the "Shares of electric power companies" made 9,072 contracts, and the volume of execution was RUR 75.85 million.

External factors behind the Russian stock market dynamics

In December the Russian financial market dynamics, as a month earlier, was dependant on the situation in the world financial markets, characterized by periods of sharp decline due to the negative news, sometimes replaced by more optimistic investors' behavior, urged by measures, taken by governments of a number of countries to support their financial systems. Among the adverse global market conditions, affecting the Russian market, one should mention:

- rumors in the market about the possible bankruptcy of General Motors Corp. and Chrysler LLC due to great losses from operations and the inability to make settlements with creditors;
- disclosure of negative macroeconomic information from the USA, in particular, the sustained low level for energy carriers demand in the US, growing unemployment and a significant reduction in the number of jobs and sales of new houses;
- information on the new losses of the Credit Suisse bank in November and planned further staff reduction (by 5.3 thousand employees);
- acquisition of 57.9 per cent shares in the largest bank Royal Bank of Scotland by the British government;
- bankruptcy of the major American media company Tribune Co;
- aggravating global liquidity market crisis;
- declining oil prices (in the second half of the month the price of oil has fallen down below USD 35 per bbl.);
- information on damages, incurred by the largest French bank BNP Paribas in the amount of EURO 701 million within 11 months of 2008;
- Chinese government authorities decision to pursue a policy of devaluation of the Chinese national currency;
- reduction of the net profit of the US American banks Goldman Sachs at 80 per cent, Morgan Stanley at 49 per cent within eleven months of 2008.

However, the following developments contributed to the growth of global financial markets:

- reduction of refinancing rate by the US FRS to 1 per cent per annum in late October, by European Central bank to 3.25 per cent in early November, by the Bank of England to 3 per cent (by 1,5 per cent) and by the Central Bank of Switzerland to 2 per cent contributed to the growth of global financial markets. Development of a new package of additional measures to support the US economy and the presentation of the stabilization plan for national economy by Italian Government also supported the global stock market.
- reduction of refinancing rate on December 4 by the EU Central Bank (to 2.5 per cent), by the Bank of England (to 2 per cent) and by the Central Bank of Switzerland (to 2 per cent), by the Central Bank of Switzerland on December 11 (to 2 per cent) and by the Central Bank of South Korea (from 5.25 до 3 per cent);
- decision of the US government to allocate credit to American automotive companies (General Motors Corp. And Chrysler LLC) in the amount of USD 17.4 billion;
- decisions of the US FRS to reduce refinancing rate to 0-0.25 per cent since December 16;
- information on the development of new anti-crisis plan for the support of the American infrastructure and national economic recovery;
- Japan government decision to allocate USD 54 bln for the measure to suppress economic crisis.

All those factors provoked volatility in the major stock market indices. Thus, in December (as a month earlier), a significant downfall was noted in global indices, as compared with the indicators of the beginning of 2008 (by 20-70 per cent on average). An adverse trend was observed at the end of November 2008. For example, the indices of developing markets were growing by 1-12 per cent, while in the US and European markets some indices have decreased by 1-4 per cent (See Table 1 and Fig. 5).

Table 1

**Dynamics of international stock market indices
(as of December 26, 2008)**

| Index | Ticker | Value | Dynamics within the month(%) ¹⁰ | Dynamics since the year beginning(%) ¹¹ |
|---|--------------|-----------|--|--|
| MICEX (Russia) | MICEXINDEXCF | 608,55 | -1,32 | -67,78 |
| RTS (Russia) | RTSI | 644,47 | -4,40 | -71,86 |
| Dow Jones Industrial (USA) Average (USA (USA) (USA) | DJI | 8 515,55 | -2,42 | -35,80 |
| NASDAQ Composite (USA) | NASD | 1 530,24 | -0,12 | -42,30 |
| S&P 500 (USA) | SPX | 872,80 | -1,68 | -40,56 |
| FTSE 100 (UK) | FTSE | 4 216,59 | -0,23 | -34,70 |
| DAX-30 (Germany) | DAX | 4 629,38 | -0,77 | -42,62 |
| CAC-40 (France) | CAC | 3 116,21 | -4,13 | -44,49 |
| Swiss Market (Switzerland) | SSMI | 5 399,58 | -4,28 | -38,54 |
| Nikkei-225 (Japan) | NIKKEI | 8 739,52 | 4,37 | -42,91 |
| Bovespa (Brasil) | BUSP | 36 864,13 | 1,80 | -42,30 |
| IPC (Mexico) | IPC | 22 515,34 | 11,45 | -23,77 |
| IPSA (Chile) | IPSA | 2 350,46 | -3,38 | -22,98 |
| Straits Times (Singapore) | STI | 1 725,61 | 0,88 | -50,45 |
| Seoul Composite (South Korea) | KS11 | 1 117,86 | 5,11 | -41,08 |
| ISE National-100 (Turky) | XU100 | 26 498,96 | 4,39 | -52,29 |
| Morgan Stanley Emerging Markets Free Index | EFM | 446,25 | 4,10 | -55,57 |

* Versus indices of October 26, 2008

¹⁰ Versus index indicator valid on September 27, 2006.

¹¹ Versus index indicator valid on September 27, 2006.

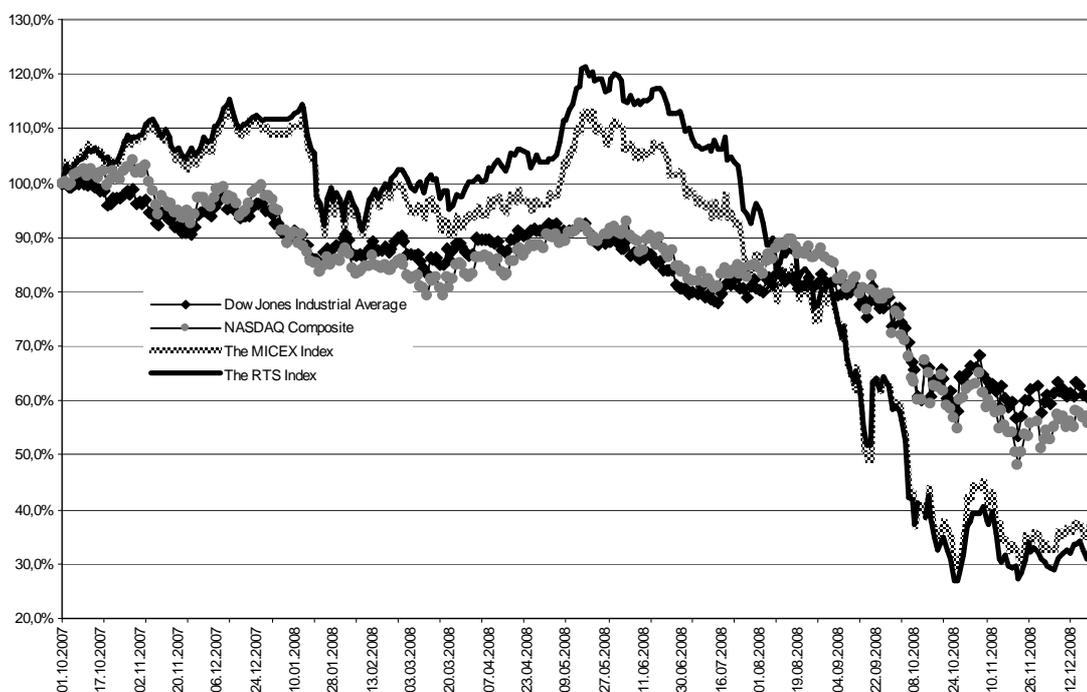


Fig. 5 Dynamics of the main USA and Russian stock indexes (in % to the date 01.10.2007)

Corporate news

OAO «VTB Bank»

In the framework of extended cooperation with the real economy sector enterprises, on December 4, the VTB-4 Bank has provided to OAO «KAMAZ» group a documentary credit limit in the amount of RUR 7 billion, credit to the automobile plant of «SOLLERS» group in the amount of RUR 4 billion for the term of one year, and credit lines to three businesses of «Mechel» group totaling to RUR 15 billion for the term of one year to replenish the working capital of enterprises. On December 10, VNB Bank has provided credit to OAO «Magnitogorsk Iron and Steel Works», amounting to RUR 4 billion for the term of one year to replenish the working capital. On December 19 VTB Bank has provided funding to AK «ALROSA» in the amount of RUR 44.2 billion for the term of 600 days, aimed at refinancing the current short-term debt on credits and loans, provided by the Russian and foreign investors. On December 24, VTB Bank has provided to OAO «Siberian Coal Energy Company», coal-extractive regional unit, funding in the volume of RUR 2.5 billion for a one-year term to finance the ongoing development activities and production facilities. Moreover, on December 25, OAO VTB has provided to «NGO «SATURN» funding in the amount of RUR 7.5 billion, aimed at financial and economic activities, as well as payments on bonds and bills.

On December 3, VTB Bank has disclosed unconsolidated results in accordance with RAS for 11 months in 2008: assets under RAS have increased by 64 per cent to RUR 2 473 billion. (decrease in November is 12 per cent); net profit of the Bank for December 1, 2008 amounted to RUR 12.2 billion. (RUR 2.6 billion as of November 1, 2008), which is explained by the growth in interest and commission, as well as the positive effect of foreign currency exchange rate.

On December 9, VTB Bank has completed the transaction on acquisition 51 per cent share in OAO «AF-Bank» in Azerbaijan. In the near future a rebranding of the subsidiary bank and its renaming to OAO VNB (Azerbaijan). Also, on December 9, VTB Group has placed posted the bonds issue of OAO «Rosselhosbank», 05 series in the total amount (total issue volume is RUR 10 billion).

OAO «Gasprom»

On December 13, OAO «Gazprom» was declared the winner of the tender for the development of hydrocarbons in Algeria (according to tentative estimates, recoverable oil reserves are estimated at nearly 30 million tons). OAO «Gazprom» is planning to invest about USD 120 million in exploration works on the project (seismic data investigation on 2500 sq. km and drilling of four prospect wells).

On December 23, the Board of Directors of OAO «Gazprom» has approved an investment program, the budget and plan optimization (reduction) of costs for 2009, providing activities, the total savings from which should amount to RUR 11.3 billion.

On December 24, OAO «Gazprom» and the Government of Serbia have signed the basic documents on cooperation in the energy sector: Framework agreement on cooperation in construction of «Southern stream» gas pipeline and transfer of natural gas through the territory of Serbia, as well as the Memorandum of Understanding on cooperation in the field of gas storage in the framework of the project «Banatsky Dvor».

OAO «Gasprom Neft»

On December 15, OAO «Gasprom Neft» has disclosed financial results under U.S. GAAP standards for the third quarter and nine months of 2008: net profit in the third quarter of 2008 amounted to USD 1 594 million (versus USD 957 million in 2007), profit before tax, interest and depreciation (EBITDA) made USD 2 642 million (USD 1,553 million in 2007); revenues amounted to USD 9,638 million (5,435 million dollars in the third quarter of 2007). Net profit for the nine months of 2008 amounted to USD 5,201 (by 84.5 per cent higher than the 2007 indicator); EBITDA accounted to USD 7,761 million (73 per cent higher than the indicator of 2007); revenues reached USD 27,315 million (86 per cent higher than in 2007).

On December 15, OAO «Gazprom Neft» and Vnesheconombank (VTB) have signed an agreement to provide a credit line limit for USD 750 million (five tranches of USD 150 million) for the purpose of refinancing a partial repayment of principal of the syndicated credit in the amount of USD 2.2 billion, provided to the company by a group of foreign banks.

On December 24, OAO «Gazprom Neft» and the Government of Serbia have signed a contract for the sale of 51 per cent shares in NIS («Oil Industry of Serbia»).

OAO «LUKOIL»

On December 11, OAO «LUKOIL» has disclosed consolidated financial statements for the first nine months of 2008 under US GAAP standards: net profit amounted to USD 10,765 million (exceeding by 70.9 per cent the results of the nine months of 2007); EBITDA indicator has grown by 60.6 per cent and amounted to USD 16,652 million; sales increased to USD 89,265 million, the growth made 56.3 per cent).

OAO «Mosenergo»

On December 25, OAO «Mosenergo» has disclosed non-audited consolidated interim financial statements for the third quarter and nine months of 2008, developed in accordance with IFRS: sales for the first nine months of 2008 amounted to RUR 66,079 million (which is higher than the indicator of the same period of 2007 by RUR 12,915 million (by 24.29 per cent)); revenues for the third quarter of 2008 increased by RUR 5,678 million (46.03 per cent).

OAO «ГМК «Norilsk Nickel»

In view of the abolition of security measures, since December 12 OAO «ГМК «Norilsk Nickel» has resumed its activities to acquire its own placed shares.

OAO «НК «Роснефть»

1 декабря 2008 ОАО «НК «Роснефть» опубликовало консолидированную финансовую отчетность по ОПБУ США за 3-й квартал и 9 месяцев 2008 г.: чистая прибыль за 9 месяцев 2008 г. составила 10,3 млрд долл. (на 139,0 per cent больше 4,3 млрд долл. за 9 месяцев 2007 г.); показатель EBITDA – 17,08 млрд долл. (на 81,7 per cent больше показателя за 9 месяцев 2007 г.). В 3-м квартале 2008 г. EBITDA составила 5,3 млрд долл. (на 31,4 per cent выше по сравнению с 4,1 млрд долл. за 3-й квартал 2007 г.), а чистая прибыль – 3,47 млрд долл. (на 79,9 per cent выше по сравнению с 1,93 млрд долл. в 2007 г.).

OAO «Rostelecom»

On December 8, OAO «Rostelecom» has disclosed the unaudited consolidated results for the first six months of 2008, developed under IFRS: the net profit has increased to RUR 9.8 billion (four-times growth as compared with the same period of 2007); OIBDA indicator (operating income before amortization, depreciation of fixed assets and losses (gains) on disposal of fixed assets) amounted to RUR 7.8 billion (14 per cent more than in 2007), profitability on OIBDA made 25 per cent.

On December 17, the international rating agency Standard & Poor's has upgraded the credit rating of OAO «Rostelecom» from «BB-» to «BB» with a stable forecast.

«Sberbank of Russia»

On December 18 «Sberbank of Russia» has attracted a subordinated credit in the amount of RUR of \$ 200 billion from the Bank of Russia in the framework of public strategy of the major banks' recapitalization in the situation of financial instability.

On December 22, «Sberbank of Russia» has disclosed financial reporting for 11 months of 2008, developed under RAS: profit before taxes amounted to RUR 146.0 billion (against RUR 148.9 billion for 11 months of 2007), net profit made RUR 113.2 billion (versus RUR 118.4 billion in 2007).

OAO «Tatneft»

On December 22 OAO «Tatneft» has disclosed unaudited consolidated interim condensed financial reporting under to U.S. GAAP standards for the nine months of 2008: sales revenue amounted to USD 14 973 million (against 10,235 million for the relevant period of 2007); net profit made USD 1,204 million (USD 1,169 million dollars for the relevant period of 2007).

Corporate bonds market

In December, the volume of the Russian domestic corporate bond market (at face value of the securities) was the highest since the beginning of 2008 and amounted to RUR 1,666.5 billion, what is by 0.6 per cent exceeds the indicator of November 2008. Within November 25 to December 24, 33.0 thousand transactions in corporate bonds were made at the MICEX Stock Exchange for the total amount of RUR 51.2 billion (as compared with 23.7 thousand transactions for RUR 38.1 bln within October 27 – November 21).

After a continuous decline in the Russian market index of corporate bonds RUX-Cbonds since mid-2008 there was a slight increase in December, from November 24 to December 24, nearly by 5 points (or 2.5 per cent). Herewith, the effective yield increased from 18.88 per cent to 20.20 within the period under review and the duration of the portfolio of corporate bonds has considerably decreased and made 587 days, what is 97 days less than as of the end of November(See Fig. 6).

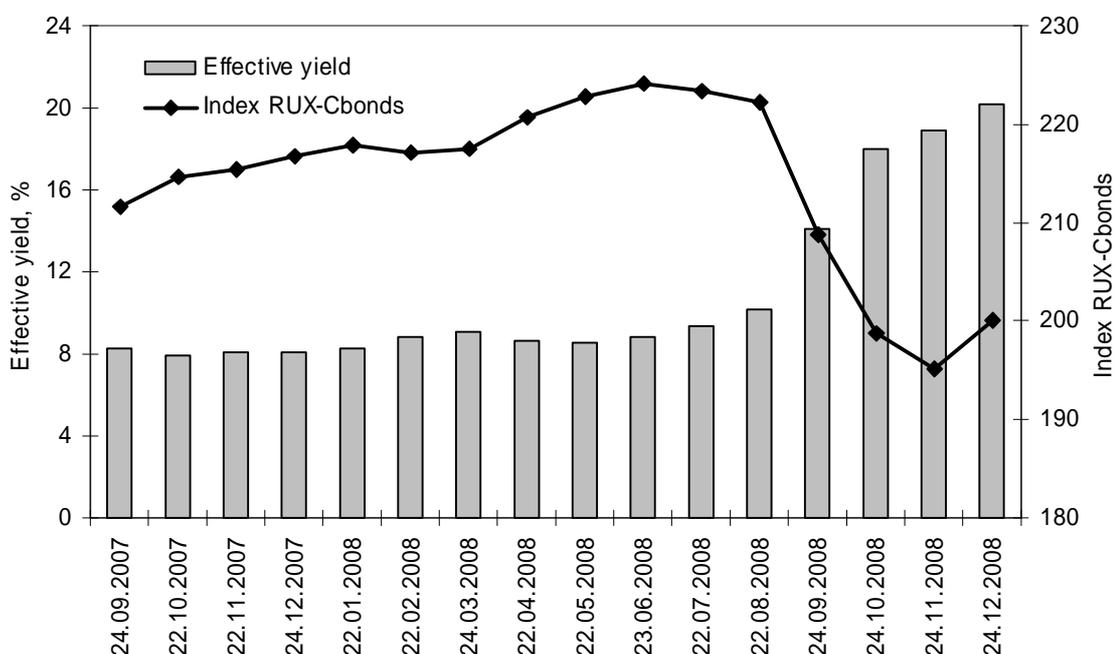


Fig. 6. The dynamics of the Russian corporate bonds market index and the weighted average yield¹²

In December the number, as well as the amount of corporate bond issues has decreased. From November 25 to December 24, there were only 5 issues of corporate bonds totaling to RUR 18.7 bln, whereas in the period from October 25 to November 24 there were 15 issues of corporate bonds for the amount of RUR 21.5 billion, and, for example, from August 25 to September 23 there were 42 issues for the volume of RUR 168.0 billion, including those bonds, issued by only one emitter. The bulk of

¹² Cbonds data.

the registered corporate bond issues was made by the two series of bonds, issued by OAO «Bank Zenit» for the total amount of RUR 8 billion and two series of bonds, issued by OAO «Mosenergo», totaling to RUR 10 billion.

In December, the number of corporate bond issues remained unchanged, but the their total volume has increased in the past few months. Thus, in the period of November 25 through December 24 the total face value of all placed bond issues has increased over 30 per cent as compared with the preceding period and reached RUR 41.1 bln. Such growth was based on participation of the largest bond emitters: OAO «Russian Railways», ZAO «Raiffeisenbank» and OAO «Russian Agricultural Bank», which have issued the bonds for the total amount of RUR 35 billion. One should note, that OAO «Russian Railways» has also issued also a large package of bonds for the amount od RUR 15 bln in November.

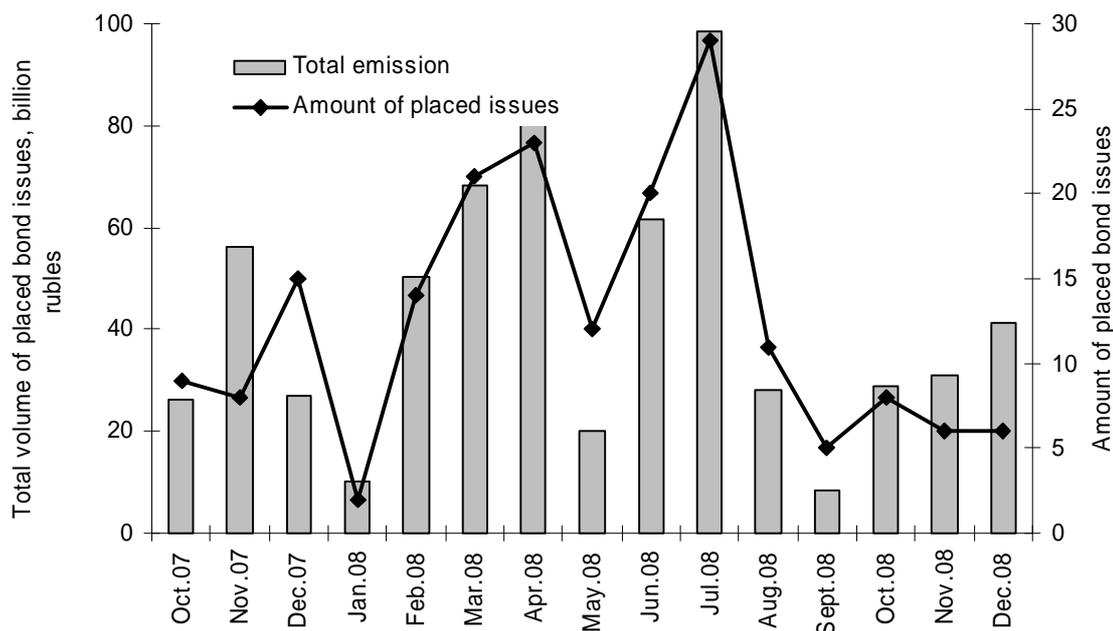


Fig. 7. Dynamics of corporate bonds primary placements ¹³

In December the number of issues, recognized invalid due to non-placement of any securities in the period from 25 November to 24 December has decreased. Federal Statistical Service for Financial Markets of Russia has recognized as invalid seven issues of corporate bonds, offered for public placement (versus twelve placements for the relevant preceding period).

From November 25 to December 24, twenty four emitters have redeemed the bonded loans totaling to RUR 30.1 billion, including the bonds of OAO «Federal Network Company of Consolidated Energy Systems» in the amount of RUR 7 billion. In January- 2009 four issues of corporate bonds for the amount of RUR 14.5 bln is expected.

In recent months, due to reduced solvency of many bonds issuers, the number of defaults and delayed performance of obligations (the so-called technical default) is increased. Since the beginning of December the default on offer (bonds redemption) was announced by four emitters and six issuers have failed to repay the coupon yield. At this negative background the Federal Statistical Service for Financial Markets of Russia plans to introduce amendments to the RF Civil code in regard to debt instruments (bonds) replacement with participation in business capital (shares). It is envisaged, that the law will consolidate the bonds holders in the event of technical default; issues of extending the terms of stock bonds maturity and the number of potential borrowers expansion are under consideration.

¹³ CbondsC data.

Real economy Sector: Trends and Factors

O. Izryadnova

In November 2008 the negative dynamics was observed for nearly all microindices for the first time over the last three years. This resulted in the decrease in the GDP growth expectations over the 4th quarter down to 102.3%, and over 2008 as a whole – down to 106.0%. The reduction of the real incomes of the population in November 2008 as compared with the previous month (97.1%) and with November 2007 (93.8%) may have a negative effect on the annual growth of the population's living standards. Over November the number of the unemployed increased by 8.1% as compared with October 2007. By the end of the year the number of the citizens registered at the state employment agencies is expected to grow.

It was the deceleration of the economic growth rates that turned out to be the specific feature of the second half of 2008, which was accounted for by the negative influence of the factors of the external economic situation and the crisis of the financial and crediting relations.

The decrease of the business was defined by the slow-down of the investment activity as compared with the dynamics of the final consumption and had a considerable effect on the nature of structural shifts of the GDP used and produced. The GDP increasing over January-September 2008 by 7.3%, real final consumption of the households and investments in the fixed assets went up by approximately 13.1%.

Over the period of January-November 2008 the deceleration of the development rates was observed in nearly all kinds of the economic activities: the increase in the minerals extraction made 0.4% against 2.0% in the corresponding period of the previous year, in processing industries – 5.4% against 9.4%, and gas, electricity and water production and distribution increased by 2.4% after the decrease of 1.3%. In November 2008 the negative dynamics of nearly all the microindices was observed for the first time over the last three years. This resulted in the decrease of the estimated GDP growth over the 4th quarter down to 102.3% and on the whole over 2008 – down to 106.0%.

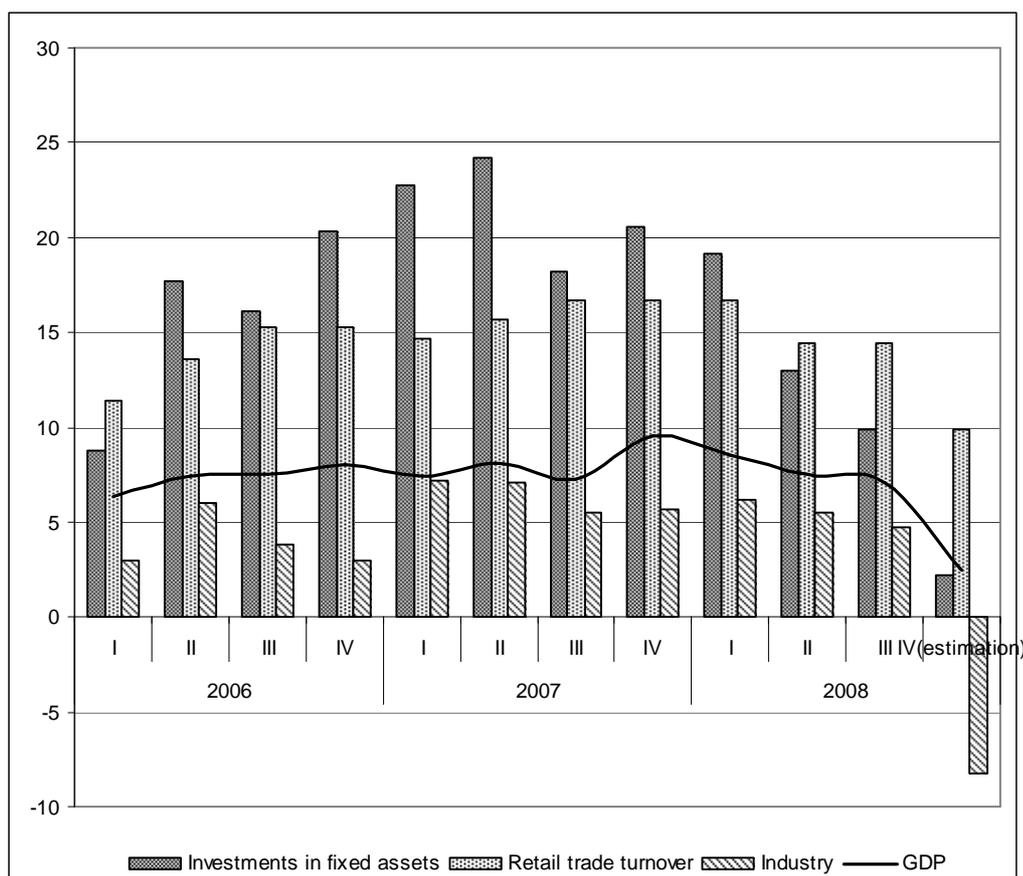


Fig. 1 Growth Rates of GDP, Investments in Fixed Assets, Retail Trade Turnover and Output in Industry in 2006-2008, as percentage to the corresponding quarter of the previous year

The facts that the dynamics of the main macroindices has been unsteady since the second half of 2008, the prices and the demand at the world markets of raw materials have been fluctuating sharply resulted in the decrease of Russia's rating by the international agency Standard & Poor's from "positive" to "stable" in September, and from "stable" to "negative" in October, leaving the ratings themselves unchanged. In December the agency lowered the long-term and short-term credit ratings of the Russian Federation concerning the liabilities in foreign exchange: from "BBB+/A-2" to "BBB/A-3". Besides, the long-term sovereign credit rating concerning the liabilities in national exchange was also lowered from "A" to "BBB+", the short-term rating concerning the liabilities in the national currency sustaining at the level of "A-2".

The "negative" forecast for the sovereign credit ratings of the Russian Federation reflects the possibility for further decrease in the ratings if the costs for the support of the financial system increase and the negative influence of some measures adopted for the long-term development aggravates, which is connected, for instance, with the capital outflow and the change in the confidence level for the monetary policy. Besides "negative" forecast reflects the increasing possibility of the budget deficit in 2009, which is opposite to the previous situation of the steady reduction of the debt of the Russian government.

For the first time since July 1998 in November 2008 there was a decrease in the volumes of the industrial production observed as compared with the corresponding period of the previous year (by 8.7%) and with the previous month of the current year (10.8%). The decrease in the production proceeded in the most acute forms in the processing industries, which is accounted for by the sharp reduction of production in the metallurgy, chemistry, machinery and equipment production. However on the whole over the period of January-November 2008 the industrial production growth rates remained in the area of positive values and made 103.7%. In the 4th quarter the decrease in the production can reach 10%, and the growth of the industrial production as a result of the year will drop to the figure of 2.0%, which is the minimum since 2002.

Starting with the second half of 2008 it has been the trade that has again become the leader of the national economy. The share of wholesale and retail trade in the GDP produced in January-September 2008 made 20.2%. However in the 4th quarter 2008 moderate growth of the foreign trade, whose drop in October was equal to 7.7% as compared with the previous month, was the main factor of the decrease in the share of trade in the GDP. The reduction of the trade volumes both inside the country and at the international level has substantially defined the change in the workload in transport: commercial freight turnover in November 2008 dropped by 7.0%.

The decrease in the economic growth was accompanied by the simultaneous slackening of the dynamics of both the internal and the external demand. The ratio of external to internal demand changed significantly throughout 2008. The decrease in the world prices for raw materials and the world demand rated started in the 3rd quarter 2008 resulted in the slow-down of the goods export supplies both in physical and in value volumes. However the high dynamics of the export growth in the first quarter of the current year allows estimating export growth as high as a result of the current year. Over 9 months of 2008 goods and services export increased, according to the preliminary estimation of the Ministry for Economic Development and Trade, by 8.5% as compared with 4.5% over the corresponding period of the previous year.

It should be noted the anticipating import growth as compared with export both in terms of physical and value volume was the characteristics feature of 2006-2008, which finally resulted in the absolute reduction of the volumes of net export in the GDP. As to the structure of the retail trade resources, the share of import in 2008 expanded to 47%, being 34.0% in the foodstuffs and 54.4% in the non-food goods sector. High share of the import goods secures the balance of demand and supply at the investment market.

The growth of the retail trade was supported by the sustention of high growth rates of the real disposable incomes of the population. The increase in real disposable incomes of the population in January-November 2008 made 5.0%, in real wages – 11.8%, in real volume of the accrued pensions – 18.8% as compared with, correspondingly, 11.9%, 16.1% and 3.8% over the analogous period of the previous year. It should be noted that the growth of pensions and social benefits in the first half of 2008 assisted in the limitation of the growth of the population with the incomes below the subsistence level.

However, the negative dynamics of the growth of the real disposable incomes of the population in November 2008 as compared with the previous month (97.1%) and with November 2007 (93.8%)

together with a considerable deceleration of the increase in real wages (101.2% and 107%, correspondingly, as compared with 103.5% and 116.8% in the analogous period of 2007) may have a negative effect on the annual figures of the population's living standard.

The share of the labor remuneration in the structure of the incomes of the population decreased by 2.9 per cent as compared with the figures of January-September 2007 and was equal to 68.5%, the share of the social benefits increasing from 11.3% to 13.0%. In January-October 2008 the share of the monetary incomes of the population was equal to RUR 20568.6 bln. The population spent RUR 15089.8 bln for the purchase of goods and services and savings were equal to RUR 2559.6 bln. In 2008 the intensification of the trend for the decrease in the population's inclination for saving was observed. Over January-October 2008 the share of savings in the incomes of the population decreased by 1.5 per cent and made 6.3%, the expenses for foreign currency purchase increasing up to 6.1% against 5.3% in January-October 2007. the dynamics of the savings of the population is substantially influenced by such factors as inflation acceleration, change of the situation in the real estate market, period problems with the liquidity concerning the banks and ruble depreciation. In January-October 2008 savings in the form of deposits and securities made 1.9% of the total aggregated incomes of the population as compared with 5.8% in the corresponding period of 2007, and it should be noted that in October an absolute decrease in the volumes of savings by 0.3 per cent was observed together with the acceleration of the processes for their conversion into foreign currency. The share of expenditures for currency purchase in October 2008 reached 10.2% of the incomes of the population and was the maximum figure for the past four years.

The dynamics and structure of the consumer expenditures was substantially influence by the increase in volumes of natural persons' crediting despite al the problems in the financial system. The credits granted to the natural persons by the banks to purchase housing (in terms of rubles and foreign currency) made RUR 614.5 bln in January-September 2008 as compared with RUR 424.1 bln in the corresponding period of the previous year, of which the hypothecary housing credits comprised RUR 537.3 bln against RUR 363.8 bln a year ago. It should be noted that the debts for credits to natural persons went up to RUR 4004.1 bln as compared with RUR 2658.3 bln in the corresponding period of the previous year.

As compared with October 2007 there is a decrease in the proportion of the debts for the consumer credits, the debts for the credits for housing purchase increasing up to 28.7% as compared with 23.4% a year ago, and for the hypothecary credits, correspondingly, to 24.3% against 18.7%.

The growth rates of the monetary incomes of the population decelerating, the expenditures of the households decreased down to 47.6% of the GDP as a result of the first half of 2008 compared with 49.2% in 2007. The share of the expenses for goods purchase in the monetary incomes of the population is observed to increase from 54.7% in January-October 2007 to 57.0% in the corresponding period of 2008. On the whole over January-November 2008 the turnover of the non-food goods increased by 18.7% against 18.6% in the corresponding period of the previous year, in contrast to the deceleration of the foodstuffs goods turnover down to 8.7% compared with 12.4%. The trend for the gradual growth of the retail trade turnover and the volume of the paid services to the population was abolished in November 2008. The decrease in the solvent demand of the population resulted in the reduction of the retail trade turnover volume by 3.4% and the paid services to the population by 2.0% in November 2008 as compared with the previous month. As a result the retail trade turnover in January-November 2008 increased by 14.1% against 15.9% in the corresponding period of the previous year.

Retail volume of the non-food goods sales proceeded to develop more dynamically than that of foodstuffs and was supported by the prices growth. Since the beginning of the year the prices for non-food goods have increased by 7.8% as compared with 5.8% in the corresponding period of the previous year, while prices for foodstuffs went up by 15.3%, which is by 1.6 per cent more than the figure of January-November 2007. It should be noted that in November the total scale of the retail trade turnover reducing the volume of foodstuffs sales decreased by 2.3%, whereas the drop in the retail turnover of non-food goods reached 4.3%. The ratio of the growth rates of these indices illustrate, on the one hand, the contraction of the solvent demand of the population, and, on the other hand, reflects the formation of the pent-up demand for foodstuffs as a result of the supply decrease.

The level and share of the employees' labor remuneration had a prevailing impact on the social parameters as well as the labor market. The deceleration of the industrial growth rates determined the trend for the reduction in the number of the industrial and production staff. According to the estima-

tion by the Federal State Statistics Service the number of the economically active population by the end of October of the current year was 76.2 mln of people or 53% of the total number of the population. Starting with July 2008 the trend for the monthly increase in the unemployment has been observed. The total number of the unemployed in November 2008 was 5.0 mln of people and increased by 17.8% or by 754 thousand of people as compared with the corresponding period of 2007. By the end of the year the number of the citizens registered at the state employment agencies is expected to grow, which is a negative effect of the financial crisis.

Business Survey in December 2008

S. Tsukhlo

In December the escalation of the crisis in the Russian industry slowed down a bit. The sustention of the previous intensity of demand reduction enabled enterprises stabilizing output reduction rates. It seems that it is the producers' prices that are becoming the main tool in competition for the customer – their decrease rates exceeding even the result of the beginning of 1998. However the satisfaction with the volumes of demand is decreasing and the stocks of finished goods are growing. Credits availability continues to reduce.

Federal State Statistics Service recognized the crisis

In the middle of December Federal State Statistics Service reported the catastrophic drop of the output in the Russian industry in November. The crisis, having shaken the industry for several months, has finally been recognized officially. According to the data of the statistics service, the volume of the industrial production in November decreased by 8.7% as compared with the corresponding period of the previous year (against 0.6% in October). According to the preliminary estimation of the Centre for Macroeconomic Analysis and Short-Term Forecasting, November's drop is equal to 10.7%. The Centre for Macroeconomic Analysis and Short-Term Forecasting emphasizes that the recession in November was of frontal nature, that is the sharp decrease in the production volumes is observed in nearly all kinds of processing industries. It is the sectors, orientated for investment demand, and the sectors, suffering most acutely from the foreign economic situation, where the most dramatic drop in production has been observed.

Crisis decelerates in December

In December intensity of demand reduction did not change as compared with November. After November fall down to -59 balance points, which was preceded by -30 points in October, December decrease down to the level of -60 points appears to be slight. This is testified by the exclusion of seasonality: in December the balance of changes in solvent demand cleared from seasonal and calendar factors remained at the previous level of -51 points. Still the absolute levels of December look grave. The initial figure of -60 points reproduce the absolute record figures of all the sixteen-year period of demand dynamics monitoring: only once in remote 1994 the demand was decreasing so sharply. Considering the result cleared from the seasonality the result yields only to some months of 1996 and 1994. Even in 1998 the demand decreased at lower rates than now, at the end of 2008. And it would be good news if it was the bottom of the nowadays crisis, but, taking into account the macroeconomic situation, the end of the crisis in the near future seems unlikely.

Stabilization of the demand reduction rates enabled enterprises stabilizing the output reduction rates as well. In December this index remained practically unchanged. Cleared from seasonality balance by the end of the year makes -41 points, whereas in the summer its value was +8 and in spring - +15 points. Worse figures (i.e. the most intensive reduction of the production) were registered only in the first half of 1994. As a result (in the second month of the officially recognized crisis) the output is decreasing throughout all the industries. And it is in the light industry, machine-building and wood and timber industry where it is decreasing most sharply.

It seems that the enterprises' price policy has already had an effect on the stabilization of the demand reduction rates. At the end of 2008 the surveys registered unexampled drop in the producers' selling prices. The balance of this index has lowered down to -26 points after -15 in November and -6 in October. Such high rates of real prices decrease were not observed even in the first half of 1998. In December despite the unquenchable inflation and traditional New Year's growth of tariffs the decrease

in prices occurred in all branches of industry, which is due to the general demand contraction. It was less characteristic for light, foodstuffs and machine-building industries, which started correction their price policy only in December and just slightly.

Real demand dynamics has also influenced the sales forecast, their pessimistic nature stopped increasing. Exclusion of seasonality has demonstrated even a slight decrease in the expected rates of sales decrease, i.e. December forecasts suppose less intensive decrease in demand than the expectations characteristic for the industry in November. However absolute levels of demand forecasts (as well as its real dynamics) were absolute minima or near them. Initial (seasonality not excluded) balance of forecasts exceeded the previous record (September 1998) by 10 points at once. Exclusion of seasonality has placed the current figures for sales forecasts to the second place (that is September 1998 was still more pessimistic). But exclusion of occasional fluctuations as well made the December 2008 forecasts absolute leaders with the gap before September 1998 by 10 points. Decrease in sales is expected in all the branches and especially in chemistry, petrochemistry and machine-building.

Enterprises' production plans in December have also stabilized, i.e. there was no further worsening of output plans as compared with November. Decrease in production is planned in all branches of industry, excluding the foodstuffs. The most pessimistic plans are registered in chemistry, petrochemistry, wood and timber industry and construction industry.

The price will remain the main argument in Russian enterprises struggle for the customers. December plans of prices reduction keep the absolute record of all 199 surveys: never before has there been such a massive supposed decrease in prices in the industry. The record of the unforgettable 1998 has been exceeded by 2-3 times throughout the branch on the whole. The light and foodstuffs industries however are not ready to decrease the prices yet, though they have made their plans in this field much more moderate.

Crisis expansion

Stabilization of the intensity of the demand reduction did not put a stop to the decrease in the satisfaction with its volumes. In December only 21% of the enterprises could regard their sales volumes as normal. Only four months ago there were three times more of such estimations (63%). Now this figure is back at the level of spring 1999 when the industry was coming out of the crisis. On December the lowest satisfaction with the demand was registered in the construction materials production (4%, the minimum for the past 10 years), chemistry and petrochemistry (7%, the minimum of the past ten years as well), and wood processing complex (10%, twelve-year minimum). The maximum satisfaction with the demand was observed in the foodstuffs production and the non-ferrous metallurgy (42% each). But even in these branches the figure has decreased by 16 and 12 points, correspondingly.

The estimations of the finished goods stocks were above the traditional figure of the past few years in December – a filling of the warehouses with the extra stocks has started in the industry. In December the balance of the estimations has increased up to +29 points and turned out to be the maximum for the past thirteen years. The average value of the balance in 2007 was +5 points, in 2006 - + 8 points. Now the biggest amount of extra stocks is registered in the metallurgy (+74%), construction industry (+61%) and wood processing industry (+36%). It should be noted that in the pre-crisis years the industry managed quite quickly with the extra stock, accumulating the experience and making fewer and fewer mistakes in this field.

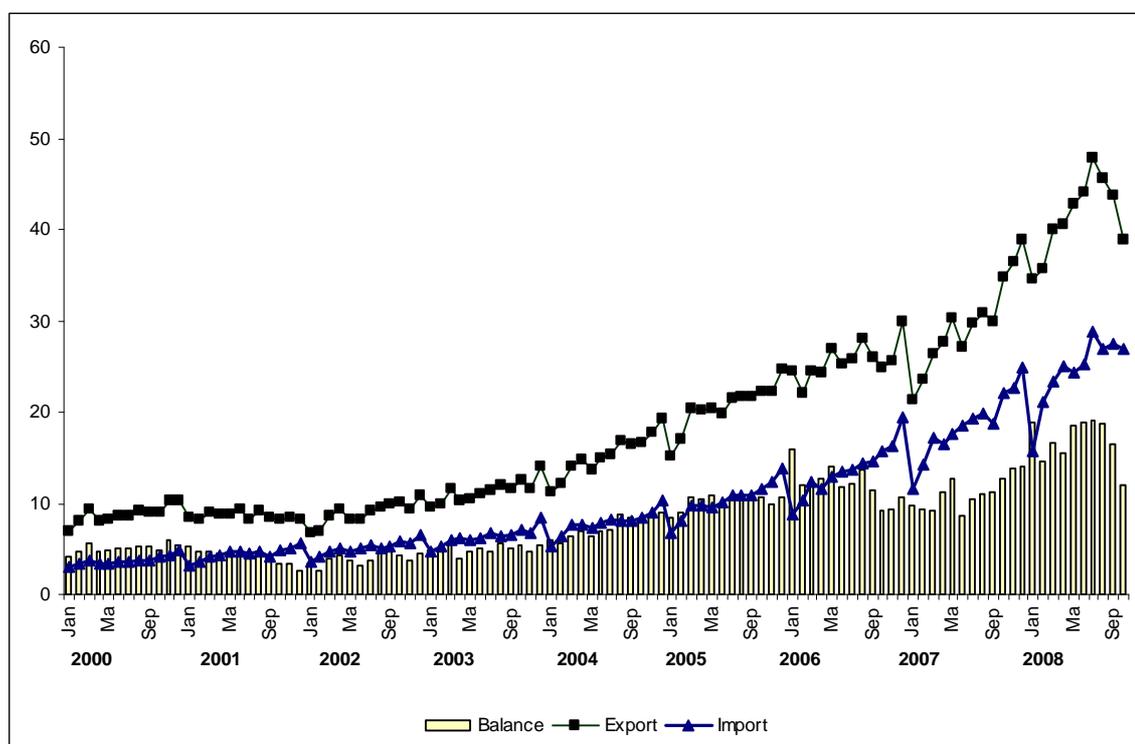
The current situation in the real sector is aggravated by the continuing decrease in credits availability. In December the normal access for the borrowed funds decreased by 5 points more and makes only 18% in the Russian industry. This is the proportion of the enterprises that regard the crediting rate and other conditions as normal in the domestic banking system, which received enormous inflow of the state liquidity and which is reporting on the thorough support of the real sector in the President's and Prime-Minister's cabinets. It is certainly possible that without the government support for the banks and the pressure of the powers the credit availability would be even lower. Though even in 2000 (the beginning of this figure monitoring, when both the banks and the enterprises had just come through the aftermaths of 1998 crisis) the availability was two times higher (41%). The best situation with the credits is characteristic for the foodstuffs production, 31% of the enterprises being satisfied with their availability (the maximum figure for the branch being 90%).

Foreign Trade

N. Volovik

In October 2008 indices of the Russian foreign trade reacted to the worsening of the situation at the world goods markets. The change for the worse in the external conditions affects ever stronger export contracts. Sharp drop of the crediting activity, slow-down of real disposable incomes growth rates and the increase in the dollar exchange rates accounted for the reduction of the import supplies.

In October 2008 Russia's foreign trade turnover calculated on the basis of the balance-of-payments methodology Внешнеторговый оборот made USD 65.9 bln, which exceeds the corresponding figure of the previous year by only 15.9%. It should be noted that the reduction in the foreign trade turnover on the previous month has been registered since August 2008. In October such a reduction was equal to 7.7%. This is mainly due to the decrease in the export value volume, which was by 11.2% smaller than in September 2008. Annual increase in export supplies made only 11.9%.



Source: Central Bank of the Russian Federation

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

The drop of prices at the world fuel and raw materials market ever stronger affects the dynamics of the Russian export. In October 2008 there was a decrease in price observed practically for all kinds of fuel and raw material goods. The prices for oil, coal, non-ferrous metals, reinforcing steel and mineral fertilizers dropped again. Saw timber, natural caoutchouc, wool and cotton became much cheaper.

In October oil prices demonstrated the most dramatic drop since 1986, falling by 23.9% as compared to the previous month – from USD 104.7 per barrel to USD 79.6 per barrel (grade Brent). It was the growth of apprehension concerning the forthcoming slow-down of the world economy growth, problems with liquidity at the world financial markets and considerable appreciation of the dollar that contributed in the drop of prices. Dollar index reflecting the dynamics of the American currency against six main currencies of the worlds went up by 8% in October.

Collapse of prices forced the OPEC to make a decision on the quotas reduction by 1.5 mln of barrels (decrease of the world supply by 1.7%) at the special meeting on 24 October 2008. This decision of the cartel supported the prices but little, they did not go up but stopped falling for some time.

On 17 December 2008 at the special summit of the OPEC in Algiers it was decided to decrease the oil production by 2.2 mln of barrels per day from 1 January 2009. The cartel also enlisted the support

of Russia and Azerbaijan that agreed to reduce oil production to increase prices at the market. However the decision on the record-breaking reduction of production by the OPEC countries did not affect the price of hydrocarbons at the world market to any extent. Moreover, on 19 December 2008 the prices for oil dropped even below the level of USD 35 per barrel that is psychologically important.

The decrease in world prices for the basic non-ferrous metals, excluding aluminum, was 20% in October 2008 as compared to the previous month. Nickel became cheaper by 31.8%, copper – by 29.5%, zinc – by 25%, tin – by 21.6%, lead – by 20.8%. Last month the price for aluminum dropped by 16% as compared with September.

Table 1

Average Monthly World Prices in October of Corresponding Year

| | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
|----------------------------|--------|--------|--------|--------|--------|--------|--------|-------|-------|-------|---------|
| Oil (Brent), USD/barrel | 12.8 | 24.1 | 32.14 | 21.45 | 27.2 | 29.6 | 49.8 | 58.2 | 57.9 | 81.4 | 79.63 |
| Natural gas, USD/1 mln BTU | 2.205 | 2.558 | 5.767 | 2.649 | 4.144 | 5.162 | 7.7 | 12.2 | 12.76 | 7.47 | 6.824 |
| Petroleum, USD/gallon | 0.421 | 0.699 | 0.895 | 0.603 | 0.801 | 0.841 | 1.43 | 2.056 | 1.484 | 2.13 | 4.195 |
| Copper, USD/ton | 1659.2 | 1748.1 | 1838.6 | 1405.1 | 1519.0 | 1916.4 | 3012.0 | 4060 | 7500 | 8008 | 4925.7 |
| Aluminum, USD/ton | 1354.2 | 1470.7 | 1473.5 | 1280.8 | 1313.2 | 1474.8 | 1822.8 | 1929 | 2659 | 2442 | 2121.4 |
| Nickel, USD/ton | 4262.4 | 7984.2 | 7353.2 | 4836.8 | 6840.9 | 11030 | 14483 | 12403 | 32348 | 30999 | 12139.8 |

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

In October of the current year the falling of the world prices for agriculture goods and foodstuffs continued, which was accounted for by the decrease in the world prices for the industrial raw materials and fuel, further appreciation of the US dollar and expectations of the decrease in the world demand for the foodstuffs.

The International Grain Board increased the estimation for the world wheat production in 2008 once again. According to the latest forecast the world wheat crop this year makes 683 mln of tons, which exceeds the previous forecast by 7 mln of tons and is 73 mln of tons above the 2007 crop. The volume of the world wheat consumption in 2008 is estimated to be 651 mln of tons that is by 37 mln of tons more than in the previous year. In October the price for wheat (American No 2) was below USD 200 per ton for the first time since June 2007 and made USD 185.9 per ton, which is 19.75 below the figure of September. As compared with December 2007 the drop in prices for wheat (American No 2) was equal to 35.6%.

Starting with August, the deceleration of Russian import value volume growth rates has been observed. In October 2008 the data of the Central Bank of the Russian Federation demonstrate the decrease in import by 2% as compared with September 2008. The yearly import growth rates in October has reduced down to 21.2% as compared with September rates of 46.5%. The drop occurred mainly due to the decrease in growth rates of the import from CIS countries. The growth rates of the import from CIS countries made 5.8% in October 2008 on October 2007 as compared with 45.2% in September 2008 on September 2007, whereas the growth of import from non-CIS countries still sustains at a higher level: yearly growth rates in October made 26.7% as compared with the corresponding figure in September of 46.7%.

In October 2008 foreign trade balance was positive and equal to USD 11.9 bln, which has been the lowest figure since September 2007. Thanks to the sharp rise in prices for oil and other raw materials in the first seven months of 2008 there was an anticipating growth of export as compared with import observed. As a result, in January-October 2008 foreign trade balance made USD 167.2 bln, exceeding the figure of the corresponding period of the previous year by 1.6 times. However the decrease in prices for many raw materials and primarily for oil in September and the following more dramatic drop in October leads to the correction of the foreign trade indices. The problem of the reduction of the positive foreign trade balance that appeared distinctly in 2007 is becoming acute again with the looming prospect of deficit balance in the nearest future.

As a part of the measures aimed at the diminishing the aftermaths of the economic crisis for the domestic car production the Government of the country has adopted a decision on the increase of the import duties for the cars. On 5 December 2008 the decree of the Government “On making changes to the Customs tariff concerning some motor transport vehicles” was signed.

According to the changes made the duty rates for passenger cars and trucks are to increase, and the period when the passenger cars are regarded as belonging to the category of the used is changed from 7 to 5 years. Import duties for passenger cars with the period of exploitation from 1 to 5 years are on average raised from 25% to 30% of the customs value with the corresponding increase in the specific rate calculated in Euros (for 1 cu. cm of the engine volume):

- up to 1000 cu cm – Euro 2.5 for 1 cu cm (earlier – 1.4 Euro);
- 1000 -1500 cu cm - Euro 2.7 for 1 cu cm (earlier – 1.5 Euro);
- 1500-3000 cu cm - Euro 2.9 for 1 cu cm (earlier – 1.6 Euro);
- 1800-3000 cu cm - Euro 4 (earlier – 2.2 Euro);
- more than 3 cu cm – Euro 5.8 (earlier – 3.2 Euro).

Duties for the import cars older than 5 years and having engine volume of less than 1000 cu cm are established at the rate of Euro 2.5 per 1 cu cm of the engine volume (earlier – 1.4 Euro). Duties for the import cars older than 5 years and having engine volume of more than 1000 cu cm but less than 1500 cu cm from now on are at the rate of Euro 2.7 per 1 cu cm of the engine volume (earlier – 1.5 Euro). Duties for the import cars older than 5 years and having engine volume of more than 1500 cu cm but less than 3000 cu cm are established at the rate of Euro 2.9 per 1 cu cm of the engine volume (earlier – 1.6 Euro).

As to the cars older than 5 years and having engine volume of more than 1800 cu cm but less than 3000 cu cm one have to pay Euro 4 per 1 cu cm of the engine volume (earlier – 2.2 Euro), and in case of the import cars older than 5 years with the engine volume of more than 3000 cu cm - Euro 5.8 (earlier Euro – 3.2).

New duties will come into force after 1 January 2009 and will be in effect for 9 months, after which period the Government has to decide how to proceed with the customs policy concerning import cars.

Thus, new cars assembled by the import cars producer in Russia will become more competitive than their import analogues and the production of the AvtoVAZ will be protected for the competition of the used import cars. Mainly it is the producers that do not have the factories in the territory of Russia that will suffer from the toughening of the car import rules. Thus, the prices for Mitsubishi, Mazda, Nissan, as well as premium-class cars of Mercedes-Benz, BMW, Audi, Volvo will increase.

Nevertheless the expansion of the Russian cars market slowed down sharply at the end of 2008. Over 11 months of the current year nearly 2 mln import cars were sold in Russia, which is by 31% more than the corresponding figure of 2007. The first half of 2008 was especially successful, the volumes of sales increasing monthly by 43-54% (in annual terms). In November 2008, however, the volume of sales reduced for the first time over last four years, which testifies the general change for the worse in the situation at the car market. The decrease in sales in November 2008 made 15% as compared with the corresponding period of 2007. As compared with the previous month sales dropped by 19.5%. In October the sales of import cars reduced by 5.7% as compared with September.

Toughening of the import regime will occur at the meat market in 2009 as well. From 1 January 2009 the Government of the Russian Federation in order to protect the domestic producers of agriculture goods increases import duty rates for pork and poultry for one year. According to the decree of the Government of the Russian Federation No 918 from 8.12.2008 the import duty rate for pork is increased up to 75% and must be no less than Euro 1.5 per kilo. Duty for poultry import above the quota is increased up to 95% and must be no less than Euro 0.8 per kilo. At the same time duty rate for beef import is decreased down to 30% and must be no less than Euro 0.3 per kilo. At present pork import duty rate in the Russian Federation makes 60% of the customs value and must be no less than Euro 1 per kilo, poultry import duty rate – 60% as well, but no less than Euro 0.48 per kilo.

As a part of a support program for the Russian producers the Government has also considered the reduction in quotas for pork and chicken import. For the next year the quota is reduced only for poultry – from 1.25 mln of tons this year down to 952 thousand of tons. The share of the USA is reduced by 180 thousand of tons and the share of the EU countries – by 60 thousand of tons.

Quota for pork import has been increased a bit by including trimming in it (it was a separate position earlier) up to 532 thousand of tons from the current of 502 thousand of tons, and the USA quota increased up to 100 thousand from 50.7 thousand.

However even before duties were introduced meat export had decreased. According to the data of the Federal Customs Service, in November 2008 meat and by-products import reduced as compared with the previous month by 13.3%. Importers do not have enough money to secure the supplies at the previous levels even despite the fact that the prices for meat are not growing at the external markets at

the moment. Meat processing productions that are the main consumers of the import meat cannot pay to the suppliers on time since they experience the crisis themselves, solvent demand for their production gradually reducing.

Investments in Real Sector of Economy

O. Izryadnova

In the environment of the financial crisis the increase in investments in November 2008 made 3.9% on November 2007, and when compared with the previous month of 2008 the growth of investments was equal to 1.9%, which compensated the decrease in investments observed in October. As opposed to the preceding years in 2008 the net outflow of the capital and foreign investments is registered. According to the preliminary estimation of the Central Bank of the Russian federation, in the 3rd quarter 2008 net outflow of the private capital made USD 16.7 bln. The expected growth rates of the investments in fixed assets, according to the IET estimation, will be equal to 109.0% as a result of 2008.

The deceleration of the economic growth rates changed the situation in the investment sector. Throughout 2008 a gradual deceleration of the investments growth rates from 119.1% in the 1st quarter to 113.0% in the 2nd quarter and 109.8 in the 3rd quarter has been observed. Over January-November 2008 the investments in the fixed assets went up by 11.3% as compared with the growth of 20.4% in the corresponding period of 2007. Against the background of the financial crisis the increase in the investments in November 2008 was 3.9% as compared with November 2007 and 1.9% as compared with the previous month of 2008, which compensated the reduction in the investment scale in October.

The growth rates of the economy deceleration the decrease in the share of the budget fund in the resources for financing of the investments in fixed assets is observed. In January-September 2008 RUR 658.2 bln was financed at the expense of the budget funds, which makes 16.8% of the total amount of the investments in fixed assets throughout the economy, including 5.5% at the expense of the federal budget.

Table 1

Structure of Investments in Fixed assets by Sources of Financing, As Percentage to Total

| | 2006 | 2007 | January-September 2008 | | |
|--|------|------|------------------------|------|------|
| | | | 2006 | 2007 | 2008 |
| Investments in fixed assets, total | | | 100 | 100 | |
| including by the sources of financing: | | | | | |
| <i>own funds</i> | 42.1 | 41.5 | 45.1 | 42.8 | 42.8 |
| of which: | | | | | |
| profit | 19.9 | 19.9 | 19.9 | 19.4 | 20.1 |
| <i>borrowed funds</i> | 57.9 | 58.5 | 54.9 | 57.2 | 57.2 |
| of which: | | | | | |
| banks credits | 9.5 | 9.4 | 9.3 | 10.2 | 11.0 |
| including by foreign banks | 1.6 | 1.1 | 1.8 | 1.1 | 1.7 |
| borrowed funds from other organizations | 6.0 | 6.1 | 5.6 | 6.3 | 6.8 |
| budget funds: | 20.2 | 21.2 | 17.3 | 18.5 | 16.8 |
| federal budget | 7.0 | 8.4 | 5.8 | 6.3 | 5.5 |
| budgets of the subjects of the Russian Federation and local budgets | 11.7 | 11.5 | 10.7 | 11.1 | 10.0 |
| Foreign investments in the total amount of the investments in fixed assets | 4.8 | 5.2 | 7.3 | 4.8 | 5.2 |

* Not including the subjects of small business and parameters of the informal activity.

Source: Federal State Statistics Service.

It should be noted that in 2008 investments at the expense of the federal budget are directed only into the objects of the capital construction of the state ownership of the Russian Federation

In 2008 the Federal Targeted Investment Program (FTIP) envisages financing of 2954 construction sights, objects and measures, of which 1247 objects are supposed to be implemented this year. By 1 November 2008 1075 objects were financed to the full extent, 628 objects were characterized by technical readiness of 51.0% to 99.9%.

As a result of 10 months of 2008 122 objects were put into commission, of which 107 were in operation to the full extent and for 15 objects a partial implementation of the facilities was made.

During January-October 2008 changes were made to the List of construction sights and objects, as a result of which the total volume of the budget allocations envisaged for FTIP financing in 2008 made RUR 520.3 bln. The volume of the budget allotments for the construction of the objects of the state ownership of the Russian Federation in 2008 increased by RUR 72.5 bln or 16.2% as compared with 2007.

Within the framework of the FTIP target programs the funds at the volume of RUR 267.1 bln are envisaged, funds for the objects of the non-program part being RUR 140.8 bln. The volume of funds envisaged to finance special works as a part of the state defense order makes RUR 112.4 bln.

In January-October 2008 financing of FTIP not taking into account the construction sights and objects that are part of the state defense order made RUR 239.5 bln or 63.2% of the annual limit. This is above the figures for the corresponding period of the previous year (54.1%) and mainly due to the approval of the List of construction sights and objects a month earlier than in the previous year.

Financing from the budgets of the subjects of the Russian Federation and other sources of annual limit for investments financing made RUR 34.3 bln in January-September 2008.

The annual limit for the state investments within the production complex (85.2%) is financed to the extent much above the average, whereas the constructions of the objects for special (47.6%) and social (46.7%) complexes are financed below the average level.

Table 2

Objects, Envisaged by Target Investment Program in 2008

| | Units | | | | As RUR bln | | | |
|------------------------|-------------------|-------------------------------------|--|-----------|---------------------------------|-----------------------------------|----------------------------------|---|
| | Number of objects | | Put into Commission in January-July 2008 | | Limit for the state investments | | Financed from the Federal Budget | Investments used at the expense of all sources of financing ¹⁾ |
| | total | including with the deadline in 2008 | to full capacity | partially | total | including from the federal budget | | |
| Total | 2594 | 1247 | 107 | 15 | 428,8 | 379,2 | 239,5 | 169,2 |
| including: | | | | | | | | |
| transportation complex | 395 | 124 | 5 | 2 | 144,1 | 141,1 | 124,2 | 81,2 |
| agriculture complex | 435 | 284 | 11 | 5 | 12,8 | 10,2 | 7,3 | 5,3 |
| special complex | 169 | 41 | - | - | 89,6 | 64,5 | 30,7 | 21,3 |
| social complex | 1509 | 763 | 91 | 7 | 169,1 | 154,0 | 71,9 | 57,6 |
| other objects | 86 | 35 | - | 1 | 13,9 | 9,4 | 5,4 | 3,9 |

¹⁾ Not including investments allocated from the federal budget to purchase the equipment and conduct design and survey works for construction sights and objects included in the Federal target investment program for 2008 and being on the books of the state customers (builders), managers of these investments

In January-October 2008 on average in Russia there was RUR 169.2 bln of the state investments used by the government customers or 39.55 of the limit of funds envisaged for the construction, and 61.8% of the total volume of financed funds at the expense of all the sources of financing.

The shift from the financing of the investments in fixed assets at the expense of the enterprises and organizations' own funds to the expansion of the participation of the borrowed funds was a fundamentally new feature in the economic growth of the last five years. As a result of January-September 2008 the share of the borrowed funds in the structure of sources of investments financing made 57.2%, which corresponds to the figure of the analogous period of the previous year.

Up to the recent time the development of this process was accounted for by the increase in the activity of the banking sector, growth of the investments in housing building by the population and the low real value of credit resources. Among the factors influencing the dynamics of the credits and other borrowed funds one can highlight the growth of the organized forms of population's savings. The share of funds directed to the share participation in the construction made 3.5% of the total amount of the investments in fixed assets, of which the means of the population were 1.7%.

In January-September 2008 the share of banks in the structure of investment resources made 11.0% against 10.2% in 2007 and 9.3% in 2006. The trend for the increase of the insurance and investments companies', as well as foreign capital, participation in the financing of the investment activity sustained. In January-September 2008 investments in fixed assets from abroad made 5.2% and the share of foreign banks' credits went up to 1.7% as compared with 1.1% in the previous year.

In contrast to the preceding years in 2008 the net outflow of the capital and foreign investments is observed. According to the preliminary estimation of the Central Bank of the Russian Federation, in the 3rd quarter 2008 net outflow of the of the private capital made USD 16.7 bln. In January-September 2008 foreign investments of USD 75.8 bln were received by the Russian economy, which is by 13.8% less than in the corresponding period of 2007, of which the direct investments made USD 19.2 bln or 97.8% on the corresponding figure of the previous year. The biggest share (73.0%) in the foreign investments received is comprised by the credits of the international financial organizations and trade credits.

As compared with January-September 2007 a considerable deceleration of the growth rates of the investments in construction, trade and communication is observed. Investments in transportation retain quite high dynamics thanks to the investments in railway transport.

The specific feature of the structural shifts in the goods production in 2008 was the recovery of the trend for the decrease in the share of the investments in the minerals extraction, which was observed since 2002, but was interrupted in 2007. As a result of January-September 2008 the increase in the investments in fossil fuels extraction made 2.4% as compared with the growth of 23.7% in 2007 on 2006, whereas the increase in the investments in the processing industries made 15.2% against 10.9% in January-September 2007. As to the electricity, gas and water production and distribution the increase in investments there was 8.3% in January-September 2008 as compared with 29.3% in the corresponding period of the previous year.

Table 3

Structure of Investments in Fixed Assets As Broken By Kinds of Economic Activities

| | 2006 | 2007 | January-September 2008 | | |
|--|------|------|------------------------|------|------|
| | | | 2006 | 2007 | 2008 |
| Total | | | 100 | 100 | 100 |
| including by kinds of economic activities: | | | | | |
| agriculture, hunting and forestry | 4.8 | 5.1 | 3.9 | 4.7 | 4.2 |
| industry | 36.5 | 38.0 | 43.6 | 43.6 | 45.1 |
| minerals extraction | 14.6 | 15.2 | 19.1 | 19.0 | 18.3 |
| of which fossil fuels extraction | 13.3 | 13.8 | 17.4 | 17.3 | 16.7 |
| processing industries | 15.6 | 15.4 | 17.5 | 16.7 | 17.5 |
| electricity, gas and water production and distribution | 6.3 | 7.4 | 7.0 | 7.9 | 8.3 |
| Construction | 3.7 | 3.5 | 3.6 | 2.7 | 2.7 |
| Wholesale and retail trade; motor vehicles and motorcycles services; repair of household appliances and items of private use | 3.5 | 3.4 | 2.8 | 3.0 | 2.7 |
| Transportation | 19.1 | 17.5 | 22.0 | 19.7 | 20.4 |
| Communication | 4.5 | 4.4 | 4.0 | 4.6 | 4.1 |
| Financial activity | 1.1 | 1.2 | 1.1 | 1.4 | 1.2 |
| Operations with real estate, rent and services rendering | 17.0 | 17.3 | 10.8 | 11.9 | 11.8 |
| Education | 2.1 | 2.3 | 2.2 | 2.2 | 1.8 |
| Public administration and military defense security; compulsory social security | 1.7 | 2.6 | 1.5 | 1.3 | 1.6 |
| Health care and social services rendering | 2.7 | 2.2 | 2.3 | 2.4 | 2.0 |
| Rendering of other utilities, social and personal services | 2.8 | 2.6 | 2.3 | 2.4 | 2.8 |

* Not including the subjects of small business and parameters of the informal activity

Source: federal State Statistics Service

The analysis of the investments dynamics and structure reveals that the low proportion of the investments in the machine building complex is characteristic for the Russian economy. The share of the productions putting out investment goods was equal to 2.5% in 2008 as compared with 2.7% in 2002.

In the environment of the existing structure of the reproduction of fixed assets and the rates of the investments in the machine-building import remains one of the main sources for the renewal of the fixed assets. The share of the investments for the purchase of the import equipment in the total amount of the investments in the machinery, equipment and transport vehicles was equal to 19.9% over January-September 2008 as compared with 18.9% in the corresponding period of the previous year.

The anticipating growth of production and infrastructure objects construction against the background of the sharp deceleration in the implementation of the total housing area was characteristic for 2008. Over January-September the total increase in workload in construction being 14.5%, the increase in housing area implementation made 4.6% as compared with 17.0% and 29.2%, correspondingly, in the analogous period of the previous year.

According to the IET estimation, the expected growth rates of the investments in the fixed assets will make 109.0% as a result of 2008. The crisis of the bank liquidity, increase in the credits interest rates will have a strong negative effect on December figures, and the indices of traditionally successful 4th quarter will become negative for the first time over the last ten years. Besides, sharp increase in the volumes of the uncompleted construction and the increase in expenditures for conservation of the started construction objects together with the negative trends in the financial and crediting sphere will account for the drop in the investment in the 1st quarter 2009 that has been unprecedented in recent years and will intensify the trend for the decrease in investments in fixed assets throughout all 2009.

Foreign Investments

E. Ilukhina

The total amount of the investments received by the Russian economy in 2008 has reduced by 14%, and it should be noted that all kinds of investments have decreased in volume. This is mainly the result of the worldwide financial crisis, which has led to the general loss of interest to the markets of the developing countries.

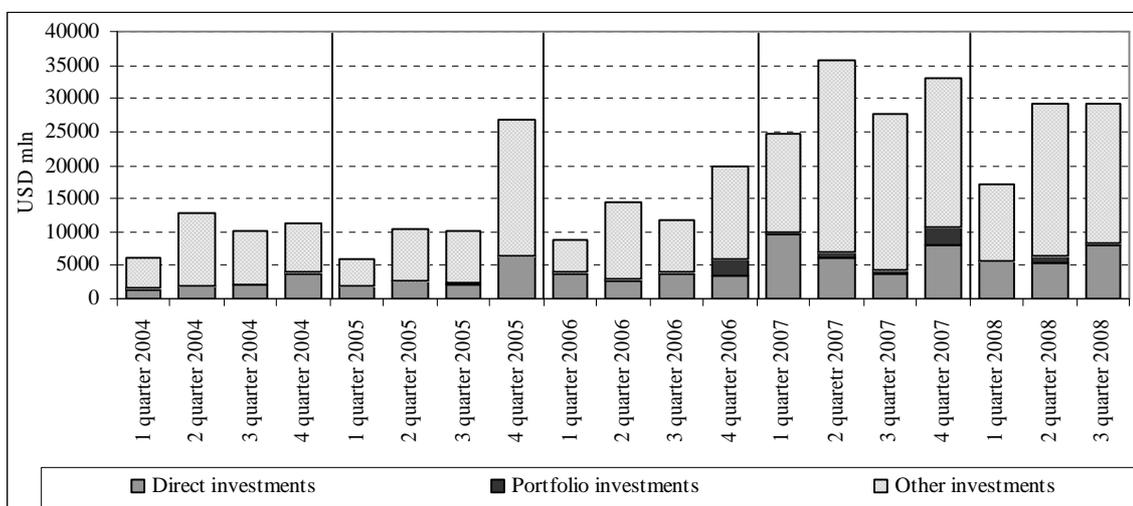
According to the state of affairs by the end of September 2008 the accumulated foreign capital, not taking into account monetary and credit regulating institutions, commercial and saving banks, including ruble investments recalculated as US dollars, made USD 251.3 bln, which exceeds the figure of 1 January 2008 by 13.9% and the figure of 1 October 2007 – by 27.0%. However the total amount of the foreign investments received by the Russian economy in 2008 has reduced by 14%, and it should be noted that all kinds of investments have decreased in volume. This is mainly due to the worldwide financial crisis, which has led to the general loss of foreign investors' interest to the markets of the developing countries.

Table 1

Structure of Foreign Investments in Russian Economy in January-September 2004-2008

| | As USD mln | | | | As percentage to the previous year | | | |
|-------------|---------------|---------------|--------------|--------|------------------------------------|--------|-----------|--------|
| | Total | Direct | Portfolio | Others | Total | Direct | Portfolio | Others |
| 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 |
| 2008 | 75 792 | 19 201 | 1 296 | 55 259 | 86.2 | 97.7 | 83.8 | 82.8 |

Source: Federal State Statistics Service

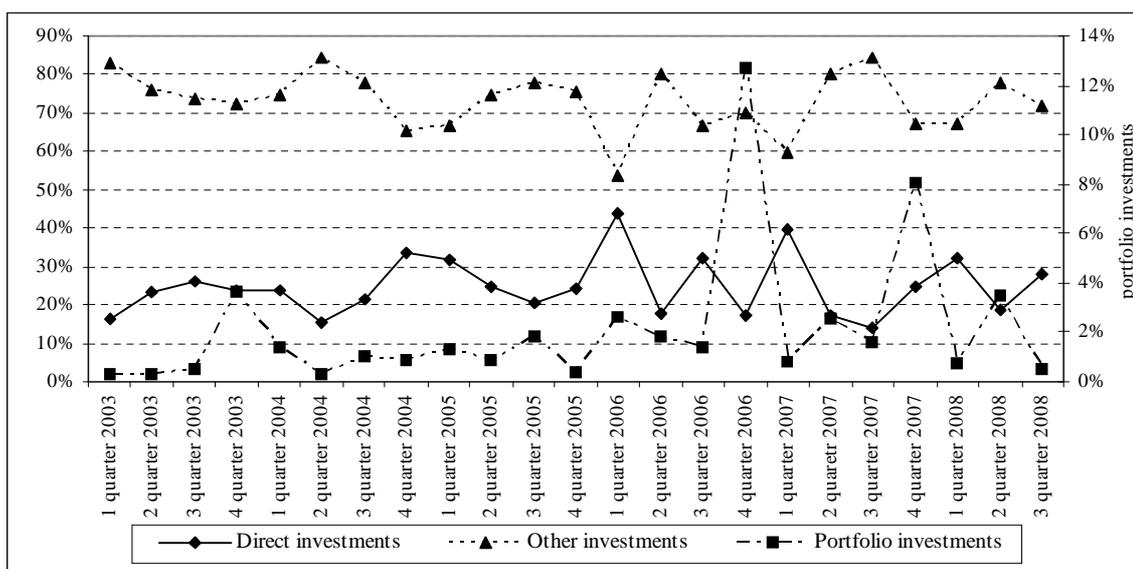


Source: Federal State Statistics Service

Fig. 1 Quarter by Quarter Dynamics of Foreign Investments Inflow in the Russian Federation in 2004-2008

Other investments in the Russian economy reduced by 21.3% in the 1st quarter, by 20.8% and 10.0% - in the 2nd and 3rd quarter. As to the segment of direct investments of the foreign investors the decrease was observed during the first half of the current year (by 42.8% in the 1st quarter, and by 9.6% - in the second quarter). In the 3rd quarter of the current year the level of the direct investments went up by 2.1 times as compared with the corresponding period of 2007. In the 1st and 3rd quarters 2008 the portfolio investments were observed to reduce by 37.6% and 67.6% as compared with the corresponding periods of the previous year. In the 2nd quarter 2008 they rose by 13.6%.

The diverse dynamics for different directions of the foreign investments in the Russian economy demonstrate the following changes in quarter by quarter structure of the foreign investments – see fig. 2.



Source: Federal State Statistics Service

Fig. 2 Structure of Foreign Investments in Russian Economy in 2003-2008

In 2008 the concentration of foreign investments in the industry and the trade remained the same, 73.8% of the total volume of the foreign investments in the Russian Federation in January-September being directed in these spheres (84.45 in January-September 2007). As a result of 9 months of 2008 foreign investments in the industry have increased by 2.9%, in the trade – dropped by 2.1 times. A

considerable reduction in investments in trade has led to the contraction of its share in the structure of foreign investments by the branches of industry as compared with the previous year.

Table 2

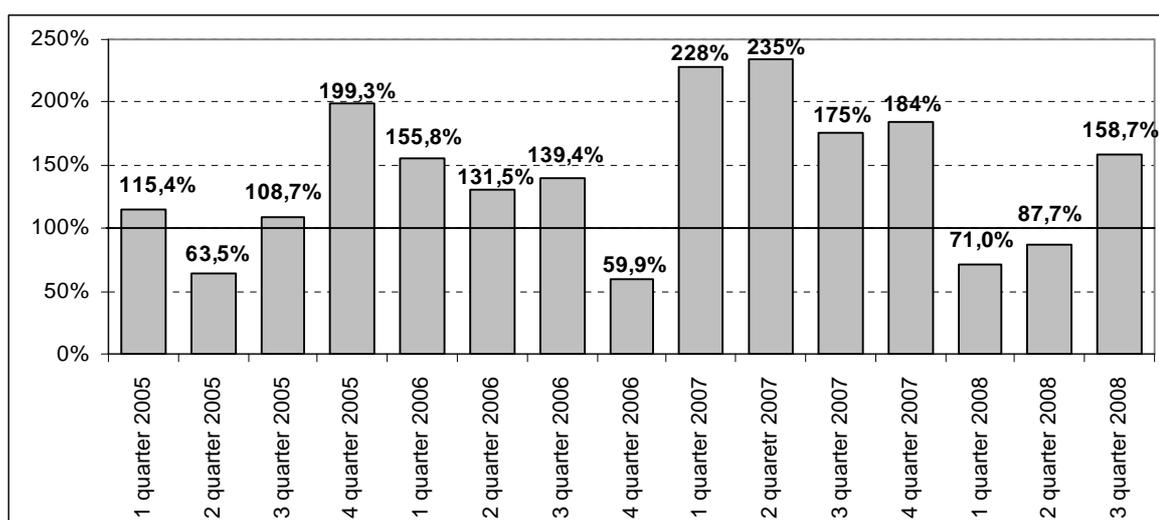
**Structure of Foreign Investments in Russian Economy
by Branches of Industry in January-September 2006-2008**

| | As US mln | | | Change as percentage to the previous year | | | As percentage to the total | | |
|--|-----------|--------|--------|---|-------|-------|----------------------------|------|------|
| | 2006 | 2007 | 2008 | 2006 | 2007 | 2008 | 2006 | 2007 | 2008 |
| Industry | 17 465 | 37 008 | 38 074 | 140.7 | 211.8 | 102.9 | 49.4 | 42.1 | 50.2 |
| Transportation and communication | 4 381 | 5 725 | 2 237 | 194.5 | 130.7 | 39.1 | 12.4 | 6.5 | 3.0 |
| Wholesale and retail trade | 7 381 | 37 207 | 17 917 | 86.0 | 504.1 | 48.2 | 20.9 | 42.3 | 23.6 |
| Operation with real estate, rent and service rendering | 3151 | 4 236 | 10 767 | 172.8 | 134.4 | 254.2 | 8.9 | 4.8 | 14.2 |
| Finances, crediting, insurance, pension provision | 2060 | 2 152 | 3 249 | 149.7 | 104.5 | 151.0 | 5.8 | 2.4 | 4.3 |
| Other branches of industry | 885 | 1 608 | 3 548 | 232.3 | 182.5 | 220.6 | 2.5 | 1.8 | 4.7 |

Source: Federal State Statistics Service

Over 9 months of the current year there were 22.6% more foreign investments invested in the processing industries than in the corresponding period of 2007 (over 9 months of 2007 there was a growth in 2.4 times observed as compared with January-September 2006). Foreign investments in the extractive industry over 9 months of the current year have reduced by 1.8 times as compared with the corresponding period of 2008 (in January-September 2007 there was a growth by 1.9 times observed). As to the processing industry there were investments in foodstuffs production that increased by 54.2%, and those in chemistry industry that doubled, reaching the figures of USD 2.9 bln and USD 2.1 bln, correspondingly. Foreign investments in metallurgy remained practically unchanged in January-September 2008 as compared with the corresponding period of the previous year, being equal to USD 11.9 bln.

The analysis of quarter by quarter dynamics of foreign investments in the industry in the current year testifies a considerable slow-down in foreign investments growth rates as compared with the corresponding periods of 2007.



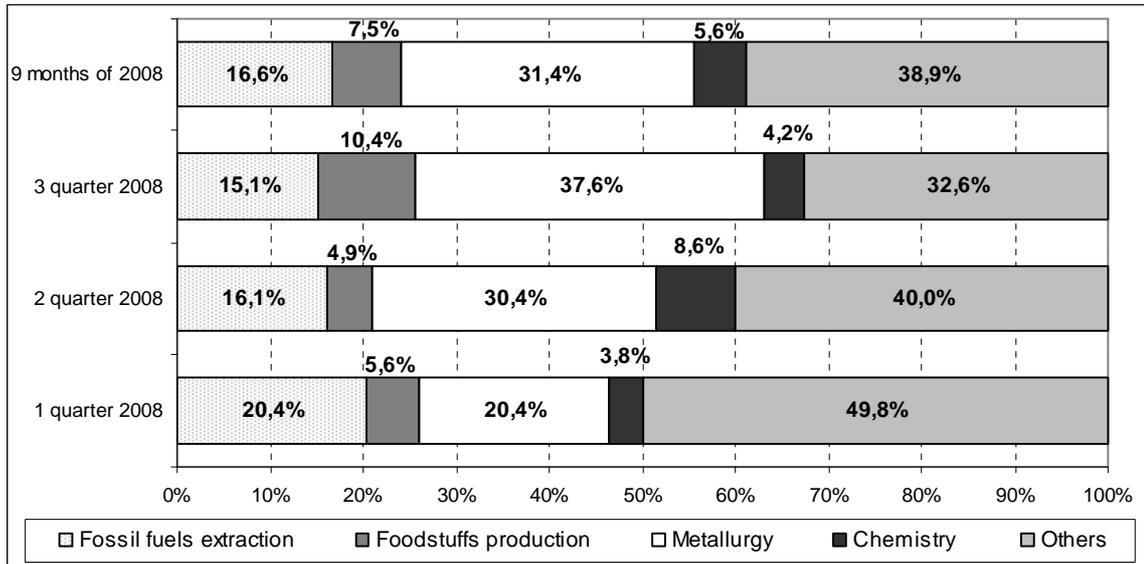
Source: Federal State Statistics Service

Fig. 3 Foreign Investments in Industry in 2005-2008, Growth as Percentage to Corresponding Period of Previous Year

In the 1st and 3rd quarters 2008 foreign investments in metallurgy went up by 74.6% and 67.5% as compared with the corresponding periods of 2007, while in the 2nd quarter the drop of 42.3% was ob-

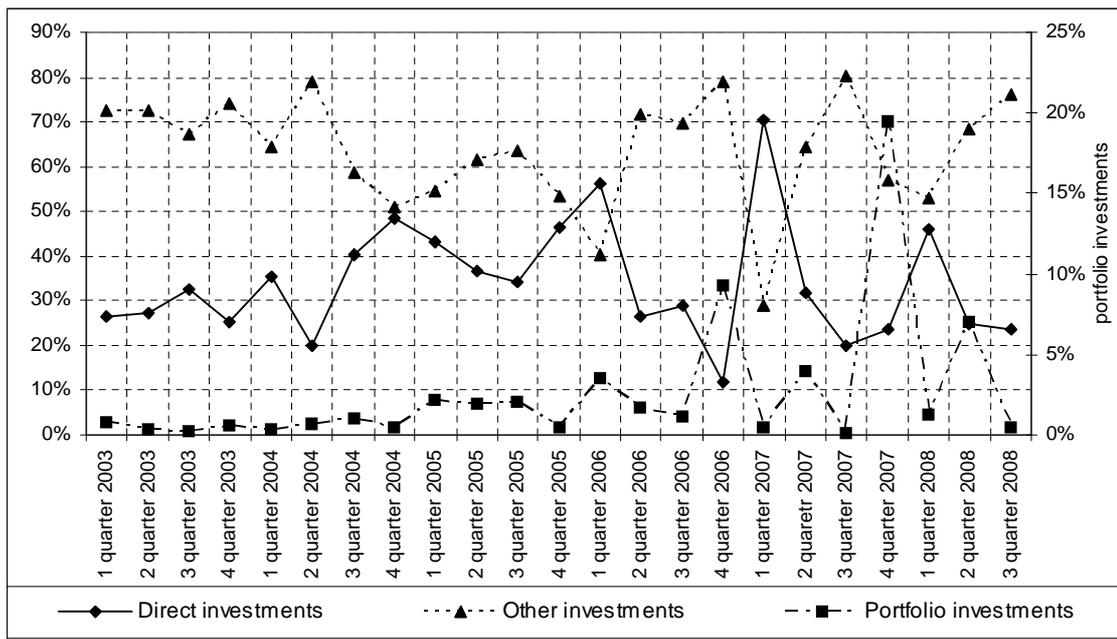
served. Foreign investors lost interest for the fossil fuels extraction in the first half of 2008, foreign investments in the field decreasing in the 1st and 2nd quarters by 79.0% and 48.1%, correspondingly, and growing in the 3rd quarter by 31.8%, according to the estimation. The reduction in investments in the chemistry industry is observed only for the 1st quarter (89.7% of the level of 1st quarter 2007), whereas in the 2nd and 3rd quarters they went up by 3.0 and 2.1 times, correspondingly.

Differences in the dynamics of the foreign investments by branches of industry were reflected in the quarter by quarter changes in the structure of foreign investments by branches of industry in the current year.



Source: Federal State Statistics Service

Fig. 4 Structure of Foreign Investments by Branches of Industry in 2008



Source: Federal State Statistics Service

Fig. 5 Structure of Foreign Investments in Industry in 2003-2008

The proportion of direct investments in the industry has reduced from 40.7% in January-September 2007 to 28.8% in January-September 2008, the share of other investments increasing over the same period from 57.5% to 68.4%. The quarter by quarter dynamics demonstrate the considerable changes

in the structure of foreign investments in the industry in the current year. Thus, the share of the direct investments has been gradually decreasing for 9 months from 46.0% in the 1st quarter 2008 to 23.4% in the 3rd quarter. The proportion of other investments, in contrast, has expanded from 52.8% to 76.2%.

Changes were also observed in the structure of foreign investments by kinds of economic activities. In January-September 2008 in the field of minerals extraction the proportion of direct investments reduced down to 53.7% (83.1% in January-September 2007). The volume of direct investments in this branch made USD 4.4 bln, being 2.8 times below the corresponding figure in January-September 2007. The share of other investments in the extraction, whose growth is estimated to be 47.9% (up to USD 3.8 bln), has increased up to 45.9% (16.8% in January-September 2007).

In contrast in 2008 in the processing industry, the same as in the previous year, the main share is accounted for by the other investments, which have increased by 18.0% as compared with January-September 2007, reaching the total of 83.2% in the resulting figures for the investments in the processing industry (86.4% in January-September 2007). Direct foreign investments in the processing industries over the period concerned have increased by 79.5%. The proportion of the direct investments in the processing industry went up to 16.1% (11.0% in January-September 2007).

As to the geographic structure of the foreign investments received by the Russian economy over 9 months of 2009, it is the Cyprus that holds the leading position, its share being USD 15.3 bln (USD 11.9 mln over 9 months of 2007), the second place is occupied by the Great Britain – USD 12.6 bln (USD 20.7 bln over 9 months of 2007), the third place – by the Netherlands – USD 8.9 bln (USD 17.3 bln over 9 months of 2007).

The biggest increase in the investments is observed for Germany – by 89.4% as compared with January-September 2007. Investments from the Cyprus went up by 28.8%, from France – by 15.3%, from the USA – by 5.5%. At the same time the investments from the Netherlands decreased by 48.4%, from Luxemburg – by 22.8%, from the Great Britain – by 39.5% and from Ireland – by 77.4%.

Table 3

**Inflow of Foreign Investments in Russian Federation
as Broken by Main Investing Countries in 2008**

| | Received as USD mln | | | As percentage to the corresponding period of 2007 | | | As percentage to the total | | |
|-----------------|-------------------------|-------------------------|--------------------------|---|-------------------------|--------------------------|----------------------------|-------------------------|--------------------------|
| | 1 st quarter | 2 nd quarter | 3 rd quarter. | 1 st quarter | 2 nd quarter | 3 rd quarter. | 1 st quarter | 2 nd quarter | 3 rd quarter. |
| USA | 421 | 1024 | 653 | 115.7 | 134.6 | 75.6 | 2.4 | 3.5 | 2.2 |
| Germany | 902 | 2411 | 3215 | 135.4 | 179.9 | 223.1 | 5.2 | 8.2 | 11.0 |
| UK | 3258 | 7053 | 2239 | 104.3 | 59.2 | 39.3 | 18.9 | 24.1 | 7.7 |
| Cyprus | 4008 | 6812 | 4484 | 142.1 | 130.9 | 116.3 | 23.2 | 23.3 | 15.3 |
| Netherlands | 3444 | 2280 | 3187 | 44.4 | 56.4 | 116.3 | 20.0 | 7.8 | 10.9 |
| Luxemburg | 254 | 2029 | 6267 | 6.3 | 75.4 | 452.8 | 1.5 | 6.9 | 21.4 |
| Other countries | 4968 | 7666 | 9217 | 85.0 | 78.4 | 103.8 | 28.8 | 26.2 | 31.5 |

Source: Federal State Statistics Service

The differences in the investment dynamics have resulted in the changes in the geographic structure of the foreign investments in the Russian economy. The proportion of the Cyprus has increased from 13.5% as a result of 9 months of 2007 to 20.2% in January-September 2008, that of Germany – from 3.9% to 8.6%, France – from 5.0% to 6.7%, the USA – from 2.3% to 2.8%. At the same time the proportion of the UK reduces over the period concerned from 23.6% to 16.6%, that of the Netherlands – from 19.6% to 11.8%, and of Luxemburg – from 9.2% to 8.3%.

As a result of 9 months of 2008, the same as in the previous year, the most attractive for the investors from the Cyprus were the operations with the real estate, trade, financial activity and construction, where they invested 26.9%, 25.8%, 7.7% and 6.8% of the total amount of the investments. As a result of January-September 2007 the mentioned spheres of the Russian economy accounted for 17.0%, 50.7%, 4.9% and 6.2% of the Cyprus investments, correspondingly.

Entrepreneurs from the Great Britain continue investing primarily in the trade, although they invested in this sphere as a result of 2008 by 3.3 times less finances than in January-September 2007. As a result of 9 months of 2008 the trade accounted for 38.5% of the total investments from the Great Britain in the Russian Federation (77.7% in January-September 2007). The share of the processing industries in the investments from the Great Britain has expanded from 18.0% in January-September 2007 to 33.6% as a result of 9 months of 2008.

As to the structure of the investments from the Netherlands in the Russian Federation there was a drop in the extraction of fossil fuels from 68.0% in January-September 2007 to 39.1% in January-September 2008. There was 23.9% of the investments directed in the Russian Federation from the Netherlands received by the Russian power industry in 2008.

As a result of January-September 2008 it is the Cyprus, the Netherlands, Luxemburg, the Great Britain and Germany that still lead as to the total volume of accumulated investments, their share being 71.7% (71.3% in 9 months of 2007). At the same time the share of the first five investing countries in the segment of the direct investments has reduced to 75.1% (76.7% in January-September 2007), and expanded in the structure of portfolio investments to 75.3% (51.3% in January-September 2007), and in the structure of other investments to 68.4% (67.3% in January-September 2007).

Against the background of the decrease of the foreign investments in the Russian economy, the volume of the outflow capital in the form of the foreign investors' profits transferred abroad as well as in the form of interest rates payments for the use of credits and credits settlements over 9 months of 2008 increased by 20.7% as compared with the corresponding period of 2007 and made USD 48.1 bln (63.4% of the foreign investments received in 9 months of 2008). The biggest outflow of the capital in real terms (USD 20 bln) was observed in the 2nd quarter 2008, the outflow capital in the 2nd quarter accounting for 68.3% of the investments received by the Russian economy over the period. In the 1st and 3rd quarters 2008 there was 82.6% and 47.2% of the received foreign investments that was taken out. As a result of 9 months of 2007 there was 45.3% of the total volume of the foreign investments received taken out.

Budgetary and Tax Policy

O. Kirillov

In November of the current year further amendments were introduced to the Law on the federal budget for 2008-2010. The Law has been amended for the fourth time. Moreover, the Government of the Russian Federation has adopted a new number of anti-crisis measures to stabilize the Russian economy.

Table 1

Parameters of the RF Federal Budget in 2006 – 2008 (% in GDP)

| | 2006 | January - November 2007 | 2007 | January - November 2008 |
|--------------------------|------|-------------------------------|------|----------------------------|
| Revenues | 23,5 | 23,7 | 23,9 | 22,0 |
| Expenditures | 16,2 | 17,5 | 18,4 | 15,7 |
| Deficit (-)/ Surplus (+) | 7,4 | 6,2 | 5,5 | 6,3 |

Source: RF Ministry of Finance, IET estimates

On November 8, the President of Russia Mr. Dmitry Medvedev has signed the recent amendments to the federal budget for 2008-2010. It should be noted, that this is already the fourth modification to the original law, adopted last summer, six months ahead of the regular schedule of the budget process. Never in recent years the federal budget has been amended so often.

The basic budget parameters are amended in the latest version of the Law on the federal budget. Therefore, the gross domestic product is estimated in the amount of RUR 42 240 billion against RUR 38 952 billion, preset in the previous version of the Law. Inflation rate is amended from 8.5 per cent to 10.5 per cent¹⁴.

The estimated level of the total federal budget revenues is increased by 2.2 percentage points and amounts to 21.2 per cent of GDP. It is not quite clear what this adjustment is based on, as at the background of the current economic situation, one can rather expect a decline in revenues versus the indicator, estimated earlier. The estimates for expenditures are increased slightly, by 0.3 percentage points of GDP.

As shown in *Fig. 1*, the level of federal budget revenues at the end of 2008, is lagging behind the average level of recent years by more than 1 percentage point of GDP. Herewith, in monthly terms, in November this year, the federal budget revenues have declined to 13.5 per cent of GDP, whereas in

¹⁴ December 2008 against December 2007.

recent years, the minimum monthly revenue level in the last quarter of the year amounted to 21 per cent of GDP.

One can assume in regard to the federal budget expenditures, that their level in December will not decline due to the firm government intention to execute the budget in full compliance with expenditure commitments. It was repeatedly stated earlier, that the Government will not reduce funding of prioritized areas of federal budget expenditures.

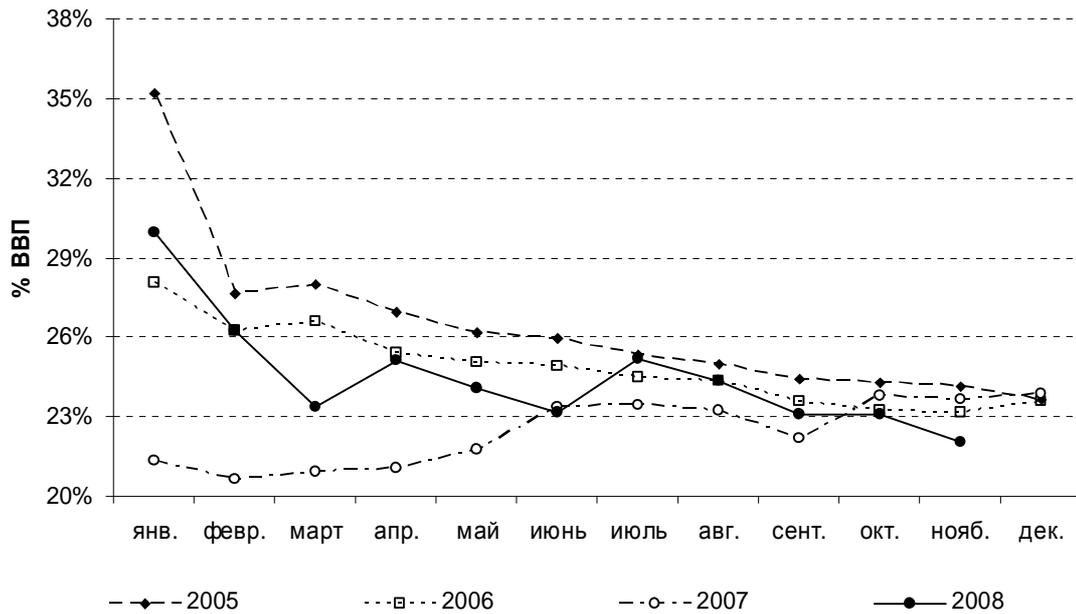


Fig. 1. RF Budget Revenue within 2005–2008, % in GDP

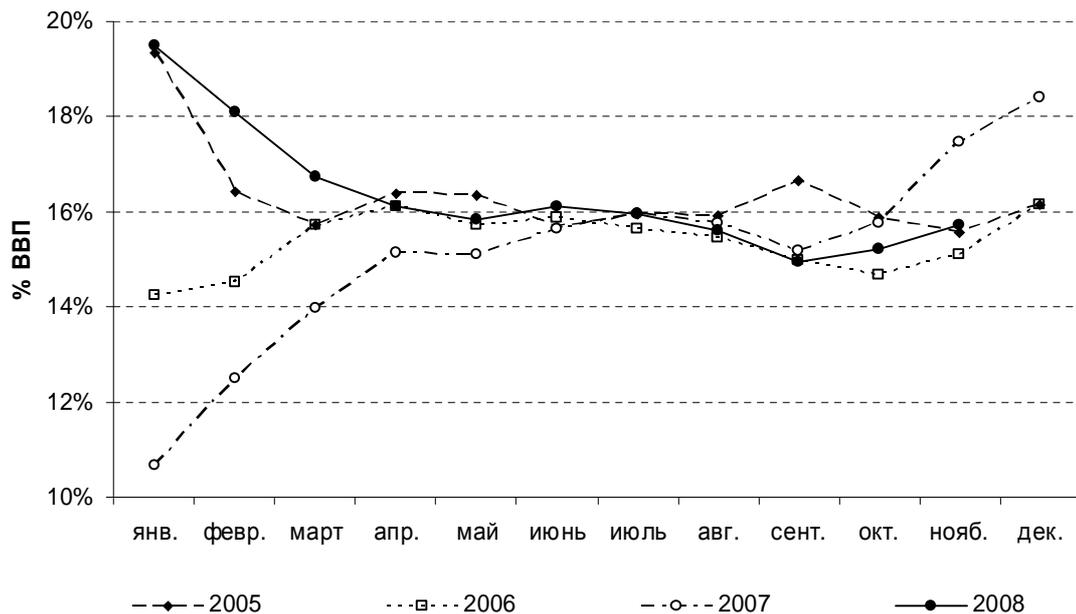


Fig. 1. RF Budget Expenditures within 2005–2008, % in GDP

Speaking of the approved amendments to the Law on the federal budget, we'd like to note, that the budget for 2008 was estimated basing on the price of the Russian oil of 55 dollars per barrel, whereas the budget for next year is estimated basing on the price of Urals oil at the level of 95 dollars. Now this level of price seems unlikely. As noted by a number of experts, oil prices have not yet reached its minimum level, and low oil prices are expected to be sustained for the major part of the next year.

Investments of budgetary funds in the authorized capital of some public corporations are significantly increased. The most significant changes have affected such companies as OAO «Agency for Housing Mortgage Credits» and OAO «Russian Railways». Investments in their authorized capital have increased from RUR 6 billion to 66 billion and from RUR 1.5 to 24 billion, respectively.

The balance of the federal budget funds, addressed to cover temporary cash gaps that arise during the implementation of the federal budget, can be used to reduce the budgetary borrowing of up to RUR 200 billion against RUR 100 billion in the previous version of the law.

The upper limit of public external debt of the Russian Federation as of January 1, 2009 up to USD 41.9 billion, or EURO 27.2 billion, which is less than in previous version of the law by USD 1.4 billion or EURO 4.9 billion, respectively.

In the framework of anti-crisis measures, the government is going to take the following additional actions:

The budgets of the Russian regions will additionally receive over RUR 100 billion to cover the lost revenue, associated with tax deductions. It is planned to transfer the taxes from the federal level to the subjects of the Russian Federation, in particular, to leave to the regions 0,5 per cent of the income tax and 40 per cent of the excise tax on petroleum products. The level of declining revenue from the subjects of the Russian Federation is estimated at 80 billion rubles.

Moreover, measures are being taken to improve crediting of the real sector of the economy. It is planned, that the state would share credit risks with businesses and banks, which in monetary terms exceeds RUR 300 billion.

Herewith, there will be two types of guarantees to be provided to the banks and businesses by the government: 70 per cent of the credit is guaranteed by enterprises of public defense sector, 50 per cent of credit is guaranteed by companies other economic spheres. However, 50 per cent of guarantees of credit will be granted only to the enterprises, enclosed in the list, which is currently compiled by the government.

With regard to agro-industrial complex, over 3 per cent of the largest agro-industrial enterprises will be able to imply such a system of credit, while other agricultural companies will be able to have budgetary subsidies.

The government also intends to introduce a simplified procedure for the financing of companies, working in the framework of approved targeted programs. In particular, ministers of industries will be empowered to take independent decisions on the continuation of funding of a successful enterprise, working in the framework of the targeted program.

Anti-crisis measures are extended to the banking sector as well. Delegated representatives of the RF Central Bank to commercial banks will have an access to all transactions of commercial banks, the value of which exceeds 1 per cent of the bank assets balance value.

Those anti-crisis measures will come into effect since January 1, 2009.

As of December 1, 2008, the aggregate volume of the Reserve Fund in rubles has amounted to RUR 3 661.37 billion, or 8.5 per cent of GDP, and the Fund of National Welfare made RUR 2 108.46 billion, or 4.9 per cent of GDP. In October-November 2008, the assets, transferred to the National Welfare Fund upon the National Reserve Fund has reached the established value, amounted to RUR 847.55 billion, or 2 per cent of GDP. In accordance with the Orders of the Minister of Finance of Russia, in October-November the National Welfare Fund assets in the amount of 365.00 billion rubles have been placed on deposit with the public corporation "Bank for Development and Foreign Economic Activities" (Vnesheconombank)".

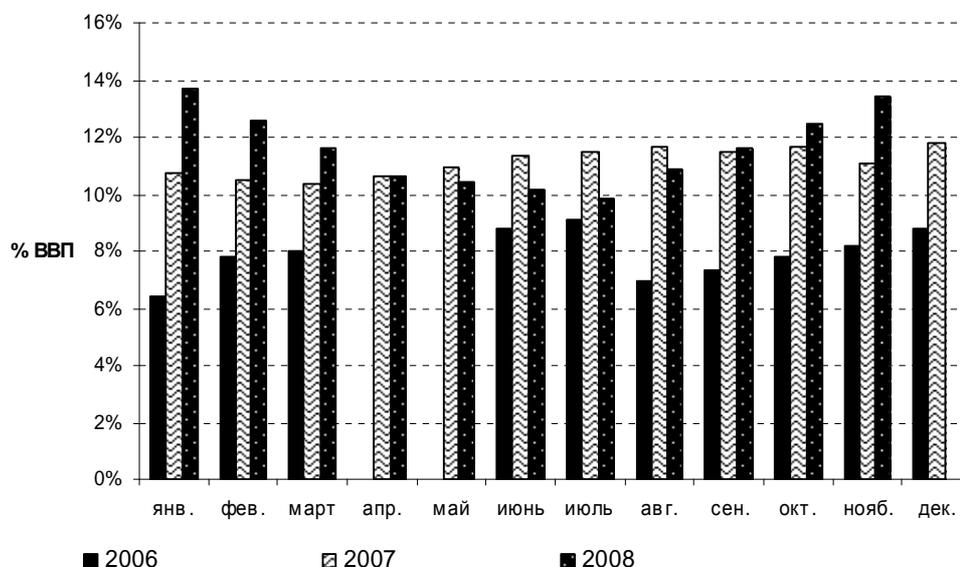


Fig. 3. Aggregate volume of the RF Reserve Fund and National Welfare Fund within 2006-2008, % in GDP

The crisis will test the financial stability of Russia's budget already in the nearest future

I. Sokolov

The statistical data based on the results of the past autumn have made it possible to believe that Russia is now only beginning to enter the crisis stage of the cycle, and so will "hit the bottom" no earlier than by the middle of next year. Apparently, the progressive worsening of the financial situation faced by economic actors is inevitably going to result in contraction of budget revenue, thus putting in question the financial stability of the entire budget system of Russia. Under these conditions, it is necessary for this country to pursue a very cautious budget policy. The policy makers should avoid any reductions in the rates of those taxes which are relatively less dependent on world oil prices.

At present, the financial crisis and its consequences are the most frequently discussed theme both in this country and abroad. Before autumn 2008, Russia's authorities and population alike had been cherishing hopes that the crisis would by-pass Russia, or at least that the impending reduction in the rate of business activity and decline in the incomes of citizens would be limited to export-oriented industries. However, the received statistics have indicated that Russia is just entering the crisis stage of the cycle, and will "hit the bottom" of it no earlier than by the middle of next year.

Over the first nine months of 2008, the share of the general government's revenues in GDP amounted to about 39.6 % against 40.4 % in 2007, and its decline is still continuing. During the period under consideration, the dynamic of revenue generation in the budgets of all levels was characterized by an increase in the amplitude of fluctuations of monthly tax receipts¹⁵, which was clearly attenuating in the process (see Fig. 1).

¹⁵ Tax revenues (receipts) are understood here as a sum total of taxes and levies collected in accordance with the RF Tax Code, and customs duties.



Fig 1. The dynamics of tax and non-tax revenues of the general government's budget, and of oil prices in 2007 – 2008.

The main reason for the dynamics of tax receipts to have changed by comparison with 2007 was the fact of internal VAT having been paid on a quarterly basis since the beginning of 2008. This circumstance explains the January, April, July and October upsurges in tax receipts, followed by two-month-long drops in revenues by comparison with the corresponding periods of 2007, when the absence of VAT receipts was repeatedly compensated for from the budget. However, in connection with the crisis, the RF Government took a decision that VAT payments in the third quarter of 2008 could be made by installments, and as a result there was a rather considerable drop in tax receipts in October.

The overall decline in tax revenues in January – October 2008 amounted to 0.7 percentage points of GDP by comparison with the level of the corresponding period of 2007.

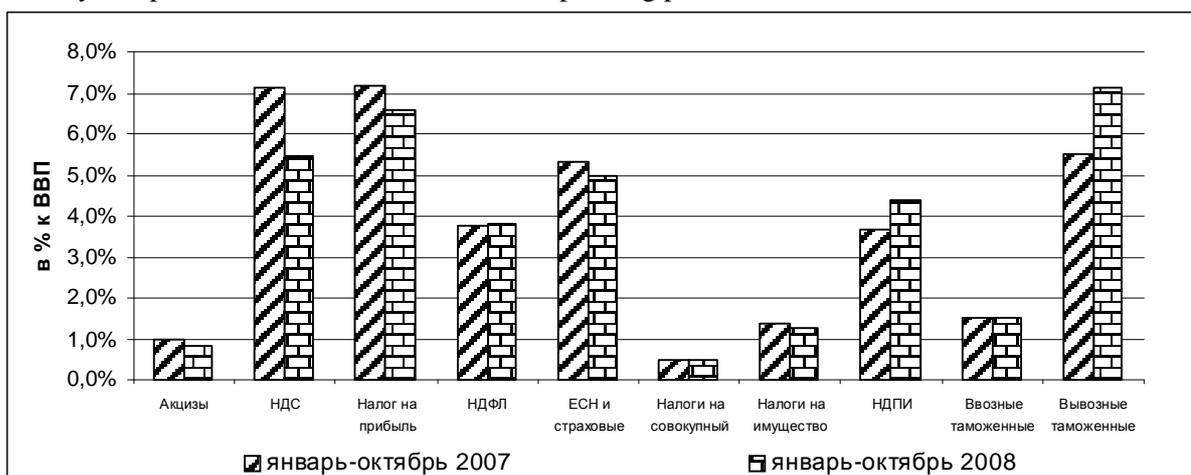


Рис. 2. The volume of tax and customs receipts of Russia's budget system in January – October 2007 and 2008.

As is seen from Fig. 2, the greatest decline was recorded in VAT collection; however, if the value equal to the repayment of "Ukos" tax arrears (approximately 0.7 p.p. of GDP) is excluded from the volume of VAT receipts, and if the quarterly nature of VAT incomings and the aforesaid decision to permit the payment of VAT by installments are taken into account, the amount of VAT receipts in the first ten months of 2008 will exceed that of the corresponding period of 2007 by 0.5 p.p. of GDP.

Nevertheless, it would have been very shortsighted to make any hasty conclusions as to the financial stability of the budget system being absolutely guaranteed even in the existing crisis conditions. Thus, according to the RF Ministry of Finance, as early as November 2008, the Federal Tax Service had a much smaller tax-take than in November 2007 – 204 billion rubles vs. 323 billion rubles. The sharpest fall was in revenues from Profits Tax: in November 2008 they amounted to only 38 % of the 2007 level. Because of the collapse in oil prices (see *Fig. 1*), the budget system received much less from Mineral Extraction Tax (in November 2007, the oil companies paid this tax on the basis of the estimated price of 80 USD per barrel; in November 2008, this price was estimated at 70 USD). To make matters worse, the part of VAT which was to be received by the budget in November within the framework of the three-month-installment turned out to be much smaller than expected because of the shortage of liquidity on the part of enterprises or of the shortfall in VAT having been compensated for from the budget at an accelerated rate.

As the financial situation of Russian enterprises is further worsening because of the contraction of business activity, it should be expected that the budget's receipts from Profits Tax, Personal Income Tax and the Single Social Tax will continue to shrink as a result of the inevitable rise in the numbers of unemployed and a drop in incomes from labor and entrepreneurial activity. Property taxes (Tax on the Property of Organizations, Land Tax, Transport Tax, etc.) will be more stable, but if the crisis phenomena in the economy are long-term, receipts from those taxes will shrink as well.

There can be no doubt that the budget system has had acquired a relatively significant margin of safety, and this is especially true of the federal budget. The record-high oil and gas revenues of the current year have made it possible to create a considerable financial reserve in the form of a budget surplus. Until now, the existence of this surplus permitted the State not only to fully implement its spending obligations, but also to replenish, on a monthly basis, the existing budget funds (see *Table 1*).

Table 1

The dynamics of the formation and use of the federal budget's oil and gas revenues in 2008

| Index | Feb | March | April | May | June | July | Aug | Sept | Oct | Nov |
|---|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Oil & gas revenues of federal budget, including: | 303.36 | 371.20 | 328.88 | 345.37 | 368.01 | 391.40 | 454.60 | 432.35 | 435.77 | 411.78 |
| Mineral Extraction Tax (imposed on extraction of hydrocarbon materials) | 122.62 | 123.54 | 120.14 | 135.82 | 136.24 | 159.77 | 166.82 | 173.36 | 150.57 | 131.43 |
| Export duty on oil | 111.41 | 146.63 | 123.80 | 137.79 | 160.01 | 151.49 | 179.79 | 168.41 | 196.74 | 188.75 |
| Export duty on natural gas | 32.23 | 59.91 | 43.33 | 35.10 | 28.48 | 37.14 | 46.89 | 42.44 | 36.11 | 44.28 |
| Export duty on goods based on petroleum products | 37.10 | 41.11 | 41.61 | 36.66 | 43.28 | 43.01 | 61.11 | 48.13 | 52.35 | 47.32 |
| Directions of use of oil & gas revenues: | 303.36 | 371.20 | 328.88 | 345.37 | 368.01 | 391.40 | 454.60 | 432.35 | 435.77 | 411.78 |
| For financing transfer of oil & gas | 303.36 | 371.20 | 328.88 | 345.37 | 368.01 | 391.40 | 26.77 | 0.00 | 0.00 | 0.00 |
| Allocations to Reserve Fund | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 420.60 | 0.00 | 0.00 | 0.00 |
| Allocations to National Welfare Fund | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 7.23 | 432.35 | 435.77 | 411.78 |

Nevertheless, the November data indicative of a drop in the tax revenues in the general government's budget have explicitly demonstrated that the state officials no more experience any euphoria, so characteristic of their past attitudes based on a stable budget surplus and high oil prices. Therefore, now is the time to resort to a more cautious budget policy, coordinating the volumes of obligations assumed by the government with the actual possibility of their financial backing.

However, it can be noted with some justice that the tax policy currently being implemented by the RF Ministry of Finance is quite correct, because it is aimed at diminishing the dependence of the budgetary system's tax revenues on international oil prices. In particular, the dispute between the Ministry of Finance and the Ministry of Economic Development on the issue of bringing down the rate of either of the two taxes – VAT or Profits Tax, that took place in summer 2008, was resolved in favor of the former Ministry, and thus the rate of Profits Tax: was decreased to 20 %. In the present situation, in view of the existing trend toward diminishing the structural component of the budgetary system's revenues (that is, the component that does not depend on estimated levels of world oil prices), it is necessary at least to maintain the quality of administering the base and rates of those taxes that are less directly depend on world oil prices (value added tax, excises).

Oil and Gas Sector

Yu. Bobylev

It was the slow-down of the world economic growth, decrease in demand for oil in the developed countries and outflow of the capital from the goods exchange markets that accounted for the dramatic drop of prices for oil. In December the price of the Russian oil at the world market fell by more than three times as compared with the level of July. For the first time over the recent years the reduction of oil production in Russia is observed. This testifies the exhaustion of reserves for the increase in the oil production in the country by the intensification of the exploitation of the oil fields currently in operation and the necessity of more active actions to develop new oil fields. In 209 the drop of world oil prices and the increase in capital, operation and transportation expenses will lead to the considerable reduction in the tax earnings from the oil sector and net profit of oil companies.

In 2008 world prices for oil were at a remarkably high level. In July 2008 average monthly prices for oil exceeded USD 130 per barrel and reached the figure of the historical records not only in nominal but also in real terms. It was the increased level of demand for oil, which was the result of high growth rates of the world economy, in particular the economies of China, India and other Asian countries, conservative policy of the OPEC concerning the increase in oil production by the organization's member-countries as well as low growth of oil production outside the OPEC that were the main factors of price growth. Decrease in oil production growth rates in Russia and the reduction in production in the oil fields of the Nordic Sea had a considerable effect on the dynamics of oil production. An important factor contributing in the increase of the world prices for oil was a considerable inflow of the capital to the goods exchange markets.

In September-December 2008 the slow-down of the world economic growth, decrease in demand for oil in the developed countries and outflow of the capital from the goods exchange markets accounted for the considerable decrease in world prices for oil. IN December the price for Russian oil at the world market dropped down to USD 41.3 per barrel (average from the first to the twenty-second of December 2008) or in other words fell by more than three times as compared with July level (*table 1*).

Table 1

World Prices for Oil in Nominal Terms in Second Half of 2008, as USD per barrel

| | 2008 July | 2008 August | 2008 September | 2008 October | 2008 November | 2008 December (1.12–22.12) |
|-----------------------------------|-----------|-------------|----------------|--------------|---------------|----------------------------|
| Price for oil grade Brent, the UK | 133.2 | 113.0 | 98.1 | 71.9 | 52.5 | 41.8 |
| Price for oil grade Urals, Russia | 130.1 | 111.9 | 97.5 | 70.8 | 51.5 | 41.3 |

Source: OECD International Energy Agency, OPEC.

In the environment of the sharp decrease in the world prices for oil the OPEC has adopted a number of resolutions on reduction of oil production by member countries in order to support prices for oil. In September 2008 the OPEC decided to adhere to the quota of September 2007 corrected taking into account the joining of Angola and Ecuador to the cartel but not including Iraq and Indonesia, which decreased the volume of oil production by the member countries by 520 thousand of barrels as compared with July 2008. In October 2008 the OPEC adopted the resolution on reduction of the production by 1.5 mln of barrels a day on the level of September 2008 starting with 1 November 2008.

These decisions did not, however, have any visible effect on the market. This is due to both the incomplete fulfillment of the liabilities taken by the OPEC member countries and the decrease in demand for oil in the developed countries in the environment of the started recession. In December 2008 the OPEC decided to reduce oil production by 4.2 barrels a day as compared with the level of 1 January 2009.

In the recent years the oil production growth rates in Russia have decreased considerably. Whereas in 2004-2006 increase in oil production made 8.9-11% a year, in 2006-2007 annual increase was equal only to 2.1%, and in 2008 there was a decrease in oil production observed for the first time. In January-November 2008 the oil production reduced by 0.7% as compared with the corresponding period of the previous year (*table 2*), which indicates the exhaustion of reserves for oil production at the expense of intensification of the exploitation of the oil fields in operation and testifies the necessity to develop new oil fields more actively.

Oil processing has been growing at higher rates than oil production in recent years, which was accounted for by the fast growth of oil products export. At the same time the extent of oil processing has increased but little and was equal to only 72.6% in January-October 2008, whereas in the leading industrial countries it reaches 90-95%. The efficiency of oil processing and quality of the oil products made in Russia remain substantially below the world level.

Table 2

**Oil, Oil Products and Natural Gas Production in 2002-2008,
as percentage on the previous year**

| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 (11 months) |
|------------------------------|-------|-------|-------|-------|-------|-------|---------------------|
| Oil, gas condensate included | 109.0 | 111.0 | 108.9 | 102.2 | 102.1 | 102.1 | 99.3 |
| Primary oil processing | 103.3 | 102.7 | 102.6 | 106.2 | 105.7 | 103.8 | 103.9 |
| Car petrol | 104.9 | 101.2 | 103.8 | 104.8 | 107.4 | 102.1 | 101.8 |
| Diesel oil | 104.7 | 102.0 | 102.7 | 108.5 | 107.0 | 103.4 | 104.5 |
| Furnace oil | 107.1 | 100.3 | 97.8 | 105.8 | 104.5 | 105.2 | 102.6 |
| Natural gas | 101.9 | 103.4 | 101.6 | 100.5 | 102.4 | 99.2 | 102.5 |

Source: Federal State Statistics Service.

Decrease in oil production growth rates is primarily accounted for by the objective worsening of the conditions for its production. A considerable part of the oil fields currently in operation as at the stage of the decreasing production and new oil fields in most cases are characterized by worse mining and geological conditions, their development requiring higher capital, exploitation and transportation costs. At the same time the existing taxation system does not provide necessary decrease in the taxation load when developing new fields with higher costs, which limits the investments in new projects. As a result the investments made do not provide the increase in oil production that would compensate the decrease in its production at "old" oil fields.

Against the background of production decrease in 2008, over the recent years there has occurred a reduction in physical volumes of oil export (*table 3*). According to the preliminary estimation net oil and oil products export was equal to 360.4 mln of tons in 2008 and decreased by 1.9% as compared with the previous year. The share of the net oil and oil products export in oil production was 73.9%. Net oil export in 2008 made 49.5% of its production. In 2008 the share of export in furnace fuel production was 84.1%, in diesel fuel production – 55.1%, in car petrol production – 12.9%. At the same time there was an increase in oil products import observed, though the share of import in the covering of the internal demand remained low. Thus, in 2008 the share of import in petrol resources was 0.7%, in diesel fuel and furnace fuel – only 0.4-0.5%.

The share of oil products in the structure of oil export increasing a bit, it was the crude oil export that still prevailed, making 67% of the total export of oil and oil products. As to the oil products export its main part was accounted for by the furnace oil used as a material for further processing in Europe and diesel fuel. At the same time one could notice the increase of oil products proportion in oil export, their share increasing from 24.3% in 2004 to 33% in 2008.

Increase in oil prices for oil in the first half of 2008 resulted in a considerable growth of incomes in the oil sector of the economy. Total profits from oil and main kinds of oil products export (car petrol, diesel fuel and furnace fuel) made USD 166.7 bln in January-August 2008, which exceed the annual

earnings in all the post-reform period. For reference it can be mentioned that the minimum level of earnings from the oil export was observed in the environment of the drop of oil prices in 1998 when the export earnings were only USD 14 bln.

Table 3

**Oil, Oil Products and Natural Gas Export from Russia in 2002-2008,
As Percentage on the Previous Year**

| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 (9 months) |
|------------------------------------|-------|-------|-------|-------|-------|-------|--------------------|
| Oil, total | 113.9 | 117.8 | 115.0 | 98.4 | 98.0 | 104.0 | 94.4 |
| including: to non-CIS countries | 109.9 | 118.9 | 116.3 | 99.1 | 98.0 | 104.8 | 92.7 |
| to CIS countries | 137.3 | 112.4 | 108.3 | 94.9 | 98.0 | 99.4 | |
| Oil products, total | 118.5 | 103.6 | 105.5 | 117.9 | 106.3 | 108.0 | 106.6 |
| including: to non-CIS countries | 119.1 | 102.6 | 104.9 | 119.1 | 104.5 | 107.6 | 103.9 |
| to CIS countries | 102.8 | 132.3 | 117.9 | 94.6 | 148.8 | 115.3 | |
| Gas, total | 102.4 | 102.0 | 105.5 | 103.7 | 97.6 | 94.6 | 110.8 |

Source: Federal State Statistics Service

Under the influence of world prices for oil during the biggest part of 2008 there was a considerable growth of prices observed at the internal market. In summer 2008 the producers' prices for oil, car petrol, diesel fuel and furnace fuel reached the figures that were the maximum for the whole post-reform period. In the recent months under the influence of decrease of oil prices at the world market there has been observed a decrease in the internal prices for oil and oil products. In November 2008 average producers' prices dropped in dollar terms beneath the level of December 2007. (table 4).

Table 4

**Internal Prices for Oil, Oil Products and Natural Gas in Dollar Terms
in 2006-2008 (average producers' prices as USD per ton)**

| | 2006 December | 2007 June | 2007 December | 2008 June | 2008 July | 2008 November |
|--------------------------|------------------|--------------|------------------|--------------|--------------|------------------|
| Oil | 168.4 | 230.3 | 288.2 | 360.4 | 410.2 | 150.7 |
| Car petrol | 416.5 | 491.7 | 581.2 | 763.6 | 810.3 | 471.5 |
| Diesel fuel | 426.1 | 442.0 | 692.5 | 850.7 | 902.8 | 489.0 |
| Furnace fuel | 148.8 | 181.6 | 276.5 | 337.2 | 392.8 | 182.8 |
| Gas, USD/1 thousand cu m | 14.4 | 15.6 | 17.6 | 20.0 | 23.8 | 18.0 |

Source: calculated on the basis of the Federal State Statistics Service data

In 2009 there are different scenarios for the development of the oil sector of the Russian economy depending on the prices of oil at the international market and the dynamics of the main macroeconomic indices, for instance, rube exchange rate. The differences in the scenarios to a high extent depend on the suppositions concerning the depth and the length of the crisis in the world economy and the scale of the capital outflow from the country. The result of the calculation of the tax load and profits of the oil sector made on the basis of the imitation model under different scenario conditions developed in the IET are presented in table 5.

As it is demonstrated by the calculations, in 2009 a considerable decrease in the world oil prices and increase in capital, operational and transport costs, dollar exchange rate remaining relatively low will lead to a substantial drop in the amount of both the tax earnings and the net profit of oil companies.

The price of oil grade Urals being USD 50 per barrel and dollar exchange rate being low, the oil sector has no possibility to pay dividends but still has an opportunity to finance investments at the necessary volumes. The price for oil being even lower and relatively low dollar exchange rate the figure of the net profit at the disposal of the oil companies becomes negative.

The scenario that is the most difficult for the oil companies is the one with the world price for the oil grade Brent at USD 40 per barrel (USD 39 per barrel for oil grade Urals) and low dollar exchange rate (34.1 RUR/USD). Under such conditions the oil sector loses an opportunity either to pay the dividends

or to finance investments to the full extent. At the expense of the sector's enterprises in 2009 the investments can be financed only by 80%. The funds deficit makes USD 6.2 bln or RUR 212 bln.

Table 5

**Main Indices of Tax Load and Profits of Oil Sector
in 2009 under Different Macroeconomic Scenarios**

| | 2008 (estimation) | 2009 Scenario 1 P=50 R=31,5 | 2009 Scenario 2 P=48,5 R=31 | 2009 Scenario 3 P=39 R=34,1 | 2009 Scenario 4 P=29 R=53,9 |
|--|----------------------|--------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|
| Taxes, USD bln | 205.96 | 84.43 | 80.06 | 60.01 | 34.78 |
| Net profit at the disposal of the enterprises, USD bln | 18.56 | 1.33 | -2..36 | -6.21 | 7.24 |
| Share of taxes in earnings, % | 63.4 | 49.5 | 48.4 | 45.1 | 35.1 |
| Share of taxes in the net profit, % | 91.7 | 98.4 | 103.0 | 111.5 | 82.8 |
| Net profit remaining at the disposal of the enterprises, RUR bln | 481.0 | 42.0 | -73.2 | -211.8 | 390.3 |

Note. P – price for oil grade Urals, USD per barrel, R - ruble exchange rate against US dollar, RUR/USD

Source: IET calculations

Deficit of funds can be compensated in various ways. For instance, the decrease in the export duty rate for oil by the reduction of the limit level of taxation from 65 to 35-40% the oil grade Urals being USD 39 per barrel enables provision of the investments financing to the full extent. The decrease in the ruble exchange rate against US dollar down to 37-38 RUR/USD also gives the opportunity of investment financing to full extent.

Additional decrease in ruble exchange rate provides the growth of oil companies' net profits. The exchange rate dropping below 50 RUR/USD even if the world prices for oil remain low the oil sector retains the opportunities of investments financing and the positive values of the net profit.

The scantiness of funds for investments can also be fully or partially overcome at the expense of the decrease in prices for services, materials and equipment, forming capital costs of oil companies. The deficit of funds for investment is overcome when the prices mentioned drop on average by 20%.

Countryside Development: from National Priority Project to State Program

G. Rodionova

Current results of the fulfilling of the state program for the agriculture development concerning the section of "Steady development of the countryside" are analyzed. The misbalance of the program executing regarding accelerated use of the budget funds insufficient attention being paid to the monitoring of the key social indices is emphasized. The solution of the housing problems in the countryside is limited by the low wages in the branch.

The main aim of the State program for agriculture development for 2008-2012 that substituted National Priority Project (NPP) was declared to be "the steady development of the countryside, increase in employment and living standard of the countryside population". By the end of the first year of the program fulfillment it seems appropriate to summarize some results on the way to the goal.

In accordance with the declared aim the sections of the State program are forestalled by the section "Steady development of the countryside". Such a placement of the problems of the countryside development may have considered revolutionary for the bodies governing agriculture in Russia, but if we turn to the allocated funds, target indices and reports on yje Program execution, we will find ourselves on familiar grounds measure by the thousands of square meters and the percentage of the used funds.

The provision of the resource funds for the countryside development planned for 2008 within the frameworks of the Program made less than 10% of the total funds for its execution. According to the section "Steady development of the countryside" the resources for the measures on improving the living conditions (61.3% of the funds for the section) and development of water supply and gasifica-

tion (30.4%) were envisaged for 2008. Thus, the main resources for the countryside development were directed to the solution of the housing problem. Will the mechanisms envisaged, including hypothecary crediting, be able to secure its solution? The experience gained during the NPP allows answering this question.

In the course of the NPP the countryside population had two opportunities to improve their living conditions – to use the subsidy or to get a credit. The obstacle for the credit usage was the low level of wages. One of the experts taking part in the monitoring of the execution of the National project commented it like this, “Today the most dramatic factor is not the absence of the housing but low wages. Wages are low in agriculture throughout all Russia. If there were wages there would be new houses. People cannot take credits with such wages. If you have salary of 30-50 thousand of rubles, you can take a credit, but it’s impossible if you’ve got 6-10 thousand. There are still the subsidies but this opportunity is much limited”. Agriculture productions, having difficult financial situation, usually refuse taking part in purchase or building housing for their workers. Another obstacle in the development of this direction of the NPP, according to the experts, is underestimated norm for the building of 1 sq m of the housing established by the Ministry for Regional Development of the Russian Federation, absence of the new housing market at the countryside and limited supply for the houses equip with the modern services and utilities at the secondary market.

The wages in the agriculture have been growing by anticipating rates for the third year in the row: over January-September 2008 its growth was equal to 37.3%, whereas on the whole in the economy the wages went up by 28.7%. However at the same time average accrued wages in January-September 2008 made RUR 7883, which is 47.4% of the average wages in the economy. Minister for agriculture, A. Gordeev, holds that “the wages in the agriculture remains unacceptably low”¹⁶, but this situation does not change for quite a long time (*fig. 1*). The wages in the agriculture remains the lowest as compared with other kinds of the economic activity.

At the same time real average day length of working hours for the employees on the books of the agriculture organizations is the longest in the kinds of the economic activities (7.63 hours in January-September 2008). However there are still few vacant positions in agriculture organizations: in January-September their number was 1.2% of the number of the employees on the books by the end of the period (there were fewer positions only in education and fishing). The situation in the countryside labor market gives no grounds to be optimistic: the level of employment at the countryside is still low – in August 2008 it made 59.3% against 66.3% in towns. In August 2008 the employment in the informal sector of the economy among the inhabitants of the countryside was 33% of the total number of the employed people at the countryside (16% of the employed urban population in the urban areas). The majority in the informal sector is occupied with the agriculture (30.3%) and trade (32.5%).

In August 2008 the share of the countryside inhabitants among the number of the unemployed made 39.4% (1.8 mln of people). In the total number of the unemployed in the countryside 0.7 mln of countryside inhabitants or 41.5% were in the situation of stagnant unemployment (looking for a job for 12 months and more).

The efficiency in the agriculture organizations growing the population able to work is forced out to the wood processing sector or to the informal sector. Under such conditions at the agriculture labor market the wages in the agriculture organizations cannot grow to a significant extent, which means the difficulties in the solution of the housing problem, since the low level of wages does not enable workers to get a credit for housing purchase. That is why it is the creation of the alternative employment that should be the focus of the countryside development policy, otherwise the outflow of the youth from the countryside will persist.

Out of 49 target indicators of the Program execution there are only three belonging to the sector “Steady development of the countryside”: “1. Housing put into commission and purchased by the citizens living in the countryside, including young families and young specialists, total, thousand sq m; 2. Provision of the countryside inhabitants with drinkable water, %; 3. the level of the houses (flats) gasification with the net gas”. The target indicators of Program fulfillment are at least rigidly connected with the envisaged funds, which one cannot say about its main target.

¹⁶ Theses of A. V. Gordeev’s speech at the session of the Federal Assembly of the Russian Federation “On execution of the State program for agriculture development and regulation of agriculture goods, raw materials and foodstuffs market for 2008-2012 in 2008 and the tasks in prospect”. Published: 05.11.2008. Site of the Ministry for Agriculture of the Russian Federation: www.mcx.ru

The report of the Minister of the Agriculture on the measures for the steady development of the countryside territories within the framework of the State program on 5 November 2008 considers the target indicators and the used funds. As to the first indicator over 9 months of 2008 was 50.2% fulfilled of that planned for the year, that is the countryside inhabitants purchased (or received on other grounds) 747.3 thousand sq m of housing. It is unknown however how many people or families improved their living conditions within the framework of the Program, though in the preceding National project such a figure was mentioned being however quite moderate of 32 thousand of people all over the country. The use of funds from all the sources proceeds quite successfully: over 9 months 101.4% of the volume of the investments for 2008 was used. The Minister regards the problem of “high growth rates of the costs for housing construction, deepening of the gap between the real and planned costs”, and the solution of the problem is either “to allocate additional funds of the federal budget to fulfill the target indices” or “to decrease the target indices the volume of funds from the federal budget sustaining”. Since the countryside inhabitants are not concerned with the papers turnover any solution is of main interests for the officials themselves.

The report on the Program fulfillment used the disposable resources of the households as an indicator of the living standard of the countryside population; the Program gives the forecast for 2008: RUR 7085 per a member of a household a month. Since in the first half of 2008 disposable resources, according to the estimation of the Federal State Statistics Service reached RUR 7468.6 the Minister reported that they “have already exceeded the planned figure by nearly 5%”¹⁷. However the mechanism of the Program measures influence on this indicator remains unclear. There are some more remarks to be added here.

First, though the average disposable resources of households in the countryside increased in the first half of 2008, reaching RUR 7429, the purchasing power of the average monetary incomes for the majority of the foodstuffs over the same period, according to the data of the Federal State Statistics Service, decreased, concerning milk, oil, butter, bread and flour, potato and rice. The purchasing power increased in regard to beef, frozen fish, sugar and cabbage. It is clear that in the environment of high inflation the nominal wages and other sources of incomes may grow the purchasing power decreasing

Second, estimating the changes in the level of the population incomes one cannot limit to the average figure (for instance the disposable resources) especially taking into account the increasing differentiation by the level of incomes. The monitoring of the countryside development and, consequently, the Program should register at least the level of the poverty in the countryside (the percentage of the countryside population with the incomes below the subsistence level). Unfortunately, when it comes to the incomes of the countryside inhabitants of the individual regions, the state statistics provides only the average figures. The same applies to the housing availability, which is only one of many characteristics of the living standards. It is completely unclear how the thousand square meters of the purchased housing are distributed among the population or at least what percentage of the countryside families have the square of living below 10 sq m per person – the dynamics of such a figure would better reflect the housing availability than the sums of the used funds of the federal budget. Otherwise, the regions appear to compete for the use of the budget funds to fulfill the measures on housing construction at the countryside and not for the efficiency of their use.

Third, the bigger transparency in the distribution of budget expenses would contribute into their efficiency. Instead of this in 2008 the Program envisages the contribution of the Russian Federation in the authorized capital stock of the open joint-stock company “Rosagroleasing” (State Agro-Industrial Leasing Company, RUR 8 bln) and the increase in the authorized capital stock of the open joint-stock company “RosSelkhozbank” (Russian Agricultural Bank, RUR 5.7 bln), which makes 18% of the total sum for all the measures fulfillment. Every year the budget funds are transferred to two corporations (within the framework of the National project they received, correspondingly, RUR 9.4 and 8.0 bln), which leads to the monopolization of the markets of material and technical as well as financial resources for the agriculture. That is why the inhabitants of the countryside cited as the main beneficiaries of the Project and the Program not the population or the young specialists and not the agriculture

¹⁷ Theses of A. V. Gordeev’s speech at the session of the Federal Assembly of the Russian Federation “On execution of the State program for agriculture development and regulation of agriculture goods, raw materials and foodstuffs market for 2008-2012 in 2008 and the tasks in prospect”. Published: 05.11.2008. Site of the Ministry for Agriculture of the Russian Federation: www.mcx.ru

organizations but the joint-stock company “Rosagroleasing” and the joint-stock company “RosSelkhozbank”.

Socio-economic express-analysis of the new federal target program designed to switch the Russian army to a contract recruitment basis

V. Tsymbal

The federal target program recently confirmed by the RF Government was announced primarily as a program of creating a NCO corps for the whole military organization of the RF. The brevity of its period of execution was explained by the necessity to accelerate the ongoing military reform, as well as by the crucial changes in the army personnel policy of the State. The content of this Program is satisfactory enough for us to say that the ice has been broken. However, it would certainly be necessary to considerably modify the Program, with the public taking a certain part in the process.

As was demonstrated in a number of the IET’s monthly issues of the year 2008, the previous federal target program (FTP) of switching the Russian army to a contract recruitment basis ended up in failure in 2007. Moreover, the August events in South Osetia confirmed that, after having spent almost 100 billion rubles in 2003 prices on this federal target program, we failed to achieve the most important goal – that of the manning the permanent combat-readiness units by contractees alone even the North Caucasus. As a result, the personnel engaged in fighting off the aggression included not only contractees but also poorly trained draftees recently conscripted into the army. It all happened despite the promises given by the highest-ranking state officials that no draftees would take part in the combat actions.

So, when analyzing the new FTP which, allegedly, builds on the previous one, we first of all wish to gain some understanding as to whether the errors of the previous stage of military reform have indeed been taken into account, and what should be expected from the new stage. In order to find answers to these questions, let us compare the programs by the major standard items of the FTP certificate.

1. Title. The title of the previous program was “The transition of a number of formations and military units to being manned by servicemen enlisted for military service under contracts, for the years 2004 – 2007”. The new program’s title is much longer and more ambitious – “The improvement of the system of filling the sergeant and private positions by servicemen switched over to military service under contract, and of carrying-out the switchover to filling the sergeant (petty officer) and private positions in the RF Armed Forces and in other troops, military formations and organs, and also the sailor positions on ships’ crews by military personnel serving under contracts (in the Years 2009-2015)”.

2. The justification of the necessity to improve the system of recruitment, as presented in the Concept of the FTP¹⁸, contains some sufficiently progressive ideas, for example: “...In the nearest future, it is planned that the Armed Forces of the Russian Federation should receive military equipment of the new generation which will be more efficient and, therefore, more sophisticated than that being used at present, which means that the qualification (the level of professional training) of the personnel that will be operating this equipment must be risen, which will require additional expenses on its training; the switchover to one-year-long service under contract means that the servicemen, after having been trained at junior specialists’ schools and having acquired the practical skills necessary for operating the new-generation equipment, will be discharged due to the expiration of the period of their service under contract as established by legislation, which means that despite the continual training of military personnel there will be no fully trained junior specialists”.

The authors of the concept draw a well - justified conclusion that “**switching over to contract recruitment is the only possible way out of the existing situation**”. However, as is known, some people in the Ministry of Defense have different views. Those views are convincingly rebuffed in the Concept by the argument that “if the mixed system of recruitment is preserved, there will be an inevitable decrease in the numbers of military personnel serving under contracts; a further reduction in

¹⁸ Decree of the RF Government of 15 July 2008, No 1016 r.

the attractiveness of military service in the Armed Forces of the Russian Federation; the loss of specialists capable of professionally operate military equipment and of fulfilling assigned missions; and the ineffectiveness of training of personnel belonging to the junior command element". With the period of military service under the draft set at one year, this will be certainly so.

The above-cited passage concerning the inadequacy of the mixed method of recruitment under conditions of one-year-long military service has been cut from the text of the approved FTP. The Program furtively materializes the alternative approach to "resolving" the problem. Demonstrating an astonishing degree of indifference to the above-listed consequences, the parameters entered into the FTP imply that the system of mixed recruitment to the regular forces is going to survive at least until 2016!

3. After all that was said above, it is not surprising that the aims of the two programs being compared are formulated differently. The main goals of the previous FTP were not only "to ensure the transition to a new system under which the military positions to be filled by soldiers, sailors, sergeants and petty officers will be filled by personnel enlisted for military service under contracts in the formations and military units of permanent readiness of the RF Armed Forces, military units of frontier troops and internal service troops being switched over to the new method of recruitment", but also "to improve the combat readiness of the aforesaid formations and military units". The new FTP keeps silent as to the issue of combat readiness, and its goal is limited to filling, by the year 2016, the sergeant (petty officer) positions in the RF Armed Forces and other troops, military formations and organs, and also the sailor positions on the ships' crews of the RF Navy by personnel serving under contracts".

4. Let us pay attention to the chronology: formally, the approval of the new FTP took place **after the military conflict in South Osetia and Abkhazia**. However, if we read it carefully, it will become apparent that the recent events were not taken into consideration. This bears witness to at least the enormous inertia in the activity of our bureaucracy. Even one moth later, when it became crystal clear to the country leadership that everything was not so good with the combat readiness of the RF Armed Forces, when the RF President had already issued his demand that "all combat units" should be transferred to the category of "permanent readiness" as quickly as possible, nobody recalled the FTP. Nevertheless, it is evident that the formal goal of the new FTP is inconsistent with the present-day situation and requirements.

5. This is also attested to by an analysis of the major goals of the FTP and of the character of the planned measures: 1) improvement of the housing conditions of NCOs and other ranks serving under contracts, including those switched to service under contracts under the previous [FTP 2004-07](#), and 2) making military service under contracts attractive and creating proper conditions for recruitment. Both goals are socially significant, but only with respect to housing conditions. The money incentives envisaged in the new FTP remain extremely unsatisfactory: the stimulating bonus for sailors on the ships' crews of the RF Navy is left at its the former, long devalued, level of 3,330 rubles per month. As regards sergeants and petty officers, it is set at an even lower level of 100% of pay for position, which presently amounts to 2,304 and 2,496 rubles per month respectively.

The task of improving the combat readiness of troops is not mentioned, and justly enough, because an army comprised of highly trained sergeants and untrained soldiers cannot be sufficiently combat ready, no matter how professional the former might be.

6. Same is true of the indicators designed to serve as benchmarks for tracing the progress of the FTP, as well as of the formulation of its final results.

Both the Concept and the certificate of the new FTP reflect the planned dynamics of increase in the number of the positions to be filled by contractees (by 64,169 all in all); they also reflect the number of the already recruited (under the previous FTP) and new contractees that should be provided with housing.

In particular, these data indicate that the total number of servicemen who became contractees in the period of 2004-7 and have not been provided with housing as yet amounts to more than 41.5 thousand. Equally indicative is the dynamic of growth in the numbers of sergeants serving under contracts, presented in *Table 1*. By comparison with the previous FTP, the Frontier Service of the FSS is omitted, and there are new entries: the Federal Agency for Special Construction (*Spetsstroï*), the Federal Protection Service (FPS), the Main Directorate for Special Programs (MDSP), and the External Intelligence Service (EIS). It is precisely in these services, as well as in the Ministry of Defense and the internal service troops of the Ministry of Internal Affairs, that the mixed system of recruitment and the

draft will be preserved for the next few years. According to the list of departments, there will be no conscription to the civil defense units of the Ministry for Emergency Situations.

Table 1

The planned dynamic of manning the corps of NCOs and other ranks by contractees under the new FTP, number of persons

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|--|--------|---------------|--------|------------|------------|--------|---------------|---------------|
| Ministry of Defense | 42,483 | 44,590 | 44,590 | 44,590 | 44,590 | 44,590 | 65,296 | 87,216 |
| Including sergeants, ships' crews (petty officers and sailors) of Navy | 23,517 | 23,517 | 23,517 | 23,517 | 23,517 | 23,517 | 44,223 | 66,143 |
| Ministry of Internal Affairs | 964 | 964 | 3,432 | 7,932 | 13,432 | 17,032 | 19,125 | 19,125 |
| Spetsstroï | 100 | 100 | 100 | 485 | 789 | 789 | 789 | 789 |
| FPS | 0 | 0 | 0 | 497 | 497 | 497 | 497 | 497 |
| MDSP | 0 | 0 | 0 | 25 | 55 | 55 | 55 | 55 |
| EIS | 1 | 1 | 1 | 35 | 35 | 35 | 35 | 35 |
| Total | 43,548 | 45,655 | 48,123 | 53,564 | 59,398 | 62,998 | 85,797 | 107,717 |

It follows from the FTP that the RF Armed Forces are planning to man the ships' crew of the Navy by contractees, while simultaneously bringing to full strength their military units of permanent readiness (in accordance with the plans of the previous FTP), and to begin replacing all draftee sergeants by contract personnel only in 2014.

The data on the dynamic of providing contract personnel with housing are no less indicative. Presented in Table 2, they characterize the growth in the number of contractees provided with housing. An analysis of these data shows that until 2014 the Ministry of Defense will be solving the housing problems of only the already recruited contractees and personnel of ships' crews, while sergeants will be provided with housing in 2014-15 as they are enlisted. We are left to guess how all this can be called "an accelerated recruitment of contractee sergeants" and how the title of such a program can begin with the word "improvement".

Table 2

The planned dynamic of growth in the number of NCOs and other ranks provided with housing

| Departments\ years | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|--|------|--------|--------|--------|--------|--------|--------|--------|
| <i>Provision of housing to the NCOs and other ranks switched over to service under contracts in 2004-07 (under previous FTP or outside it) not provided with housing before 2009</i> | | | | | | | | |
| Ministry of Defense | 0 | 1,230 | 8,438 | 16,793 | 28,293 | 38,236 | 38,236 | 38,236 |
| Ministry of Internal Affairs | 0 | 0 | 0 | 0 | 0 | 0 | 2,247 | 2,247 |
| FSS (under FTP) | 0 | 0 | 0 | 1,090 | 1,090 | 1,090 | 1,090 | 1,090 |
| FSS (in excess of FTP) | 0 | 0 | 1,798 | 1,798 | 1,798 | 5,478 | 16,759 | 26,610 |
| <i>Provision of housing to the NCOs and other ranks being switched over to service under contracts within the framework of the new FTP</i> | | | | | | | | |
| Ministry of Defense | 0 | 15,208 | 15,208 | 15,208 | 15,208 | 15,208 | 31,952 | 47,944 |
| Ministry of Internal Affairs | 0 | 0 | 2,468 | 6,968 | 12,468 | 16,068 | 19,125 | 19,125 |
| Spetsstroï | 0 | 0 | 485 | 789 | 789 | 789 | 789 | 789 |
| FPS | 0 | 0 | 497 | 497 | 497 | 497 | 497 | 497 |
| MDSP | 0 | 0 | 0 | 55 | 55 | 55 | 55 | 55 |
| EIS | 1 | 1 | 1 | 35 | 35 | 35 | 35 | 35 |

7. The planned total expenditures on the new FTP amount to 243,437.64 million rubles in current years' prices.

8. A lot of questions have risen as to the socio-economic efficiency of both FTPs and their significance to society and citizens, which in a sense is an issue broader than that of housing provision.

As regards the expected results of the previous FTP, it was stated that it would make it possible to 1) reduce society's dissatisfaction with the existing system of manning the RF Armed Forces and other troops, military formations and organs by conscripts, and with these servicemen being dispatched for military service in the "hot spots"; 2) to create preconditions for reducing, from the year 2008, the term of compulsory military service to one year. But even with that FTP completed, the said dissatisfaction remains. As we have already mentioned, conscripts are still being sent to the "hot spots" and are taking part in combat actions.

The new FTP contains a lot of statements of intentions expressed in trivial words, such as "the rising of the prestige of military service and the strengthening of the positive image of the RF Armed Forces and other troops, military formations and organs"; "the improvement of the moral and psychological climate by heightening the status and authority of junior commanders", etc.

Many questions remain unanswered in the FTP. Why are the authors of the Program so sure that it would be sufficient for the stated intentions to be fulfilled by merely providing housing to sergeants and petty officers, as well as to sailors on ships' crews? Who has assessed the moral and psychological consequences of a situation when a sergeant without higher education and with no money allowance worth mentioning is put in charge of a graduate of a higher educational establishment, who is a young father and is deprived of his average salary for the duration of one year (in the RF, the average salary is twice as large as the money allowance of a sergeant), and whose wife receives a compensation in the amount of 6 thousand roubles per month? What relations can we expect to develop between these two hapless servicemen? And how eagerly those two are going perform their service duties as a tandem?

9. Some concerns also arise with regard to the organizational and administrative aspect of the FTP. Judging from the text of the new FTP, it still contains all the main systemic drawbacks of the previous Program, which actually resulted in its failure in 2007. Non-departmental control, let alone public control, is totally missing. Bearing in mind that under the "control" which existed under the previous FTP, the funds allocated to its implementation, including to financing capital construction, were all spent, and contractees have nowhere to live, and so the situation has to be improved within the framework of the new FTP, who can guarantee that administering and fund spending will be efficient at the new stage?

Conclusions

1. If the FTP remains in its present form, no improvement of the recruitment system can be expected. The FTP is designed to provide solution to a single important and burning issue - that of improving the living conditions of contract military personnel and their families. And so it must be named accordingly. The FTP is useful only in this sense (see *Table 3*).

Table 3

Major material indicators of the FTP's results

| Objects under construction | Number of objects | Floor space, sq. meters | Designed for |
|-----------------------------------|-------------------|-------------------------|-----------------|
| Hostels for unmarried persons | 710 | 96,608 | 66,621 persons |
| Hostels for married persons | 1,258 | 3,679,663 | 69,475 families |
| Apartment-type hostels | 11 | 14140 | 532 families |
| Kindergartens | 293 | 307,773 | 25,755 persons |
| Schools | 110 | 201,585 | 24,900 persons |
| Recreational and cultural centers | 59 | 42,712 | ----- |

2. As the only issue contemplated in the FTP is capital construction, and the title chosen for this undertaking is "the improvement of the recruiting system", this means that the title serves as a cover for the unwillingness of some military leaders to get rid of the drawbacks of the existing recruitment system and to change the character of military service in our army, apparently because these deficiencies are very lucrative for the corruptioners.

3. The new FTP must be revised without delay so as to eradicate this shortcoming of the whole project. It is advisable that independent experts and representatives of non-governmental organizations should take part in revising the FTP.

In this conditions, it is very important for the non-governmental organization to recruit such influential allies as the former and the current RF Presidents, by making the situation with both FTPs clear to them, and then to push for an efficient and rapid solution of the army recruitment problem.

It should be remembered that it is V. V. Putin who confirmed a concept which contains an absolutely correct assessment of the necessity for RF regular forces to be switched entirely to contract service, and of the undesirability of keeping the current system of mixed recruitment. And it is D. A. Medvedev who has demanded that all the military units of the RF Armed Forces should be made permanently ready for action, which would be absolutely impossible without rapidly switching them to volunteer service under contracts and making military service highly attractive in the eyes of the public.

It is more likely than not, that the administrative command to revise the recently adopted FTP has already been given, as is attested to by one apparently sponsored publication¹⁹. This publication keeps silent of the fact of the new FTP having been approved, as well as of any decision to revise it. Instead, it is said that “the preparation of such FTP is in its final stage”. Also, the previous title of the program stated an absolutely different, and much closer, end-date for the program’s implementation: 2012 instead of 2015. But the former deadline was included not only in the FTP, but also in the Main Directions of the Activity of the RF Government until 2012. This means that the Main Directions should be adjusted as well.

A good thing is that the new FTP is being corrected not after but prior to the beginning of its implementation. A bad thing is that this is being done behind closed doors. And it will be extremely bad if all the “improvement of the recruitment system” is limited to merely accelerating the planned measures in the sphere of construction, which are actually incapable of providing a final solution to the existing problem, no matter how useful they might be.

Meetings of the Government of the Russian Federation in December 2008

M. Goldin

In December at the meetings of the Government of the Russian Federation an important issue of making amendments to the federal laws, considerably changing the budget legislation, including the rules for budget funds allocation and the procedure regulating interbudgetary relations aimed at the overcome of the crisis aftermaths in the budget sphere was considered among other issues.

On December, 10 At the meeting of the Government of the Russian Federation the report of Kudrin A.L., deputy Chairman of the Government of the Russian federation, Minister of Finance of the Russian Federation on the draft of the Federal Law “on making changes to the Budget Code of the Russian Federation and the Federal Law “On making amendments in the Budget Code of the Russian Federation concerning the regulation of the budget process and bringing some legislative acts of the Russian Federation into compliance with the budget legislation of the Russian Federation”.

The draft of the law envisages fulfilling a number of measures, including:

1. Compensation of the falling incomes of the budgets of the subjects of the Russian Federation as a result of the changes in the tax legislation.

Such a compensation is caused by the following tax novations of the Chairman of the Government of the Russian Federation, Putin V. V.: decrease from 6.5 to 2.5% of the rate of the company’s profit tax to be paid to the federal budget, increase of the amortization premium up to 30% as well as the increase of the limiting property deduction for the natural persons’ incomes tax, given at the sum the tax-payer spent on new construction or purchase of the housing in the territory of the Russian Federation from RUR 1 mln to RUR 2 mln that considerably decreased the tax load on the natural persons. At the same time the falling profits of the consolidated budgets of the subjects of the Russian Federation according to the estimation regarding the company’s profit tax (increase in the amortization premium) will make approximately RUR 44.5 bln, regarding natural persons incomes tax (increase in property deduction) – RUR 39.3 bln. In order to compensate for the falling incomes of the regions the share of excises on the car petrol, virgin petrol, diesel fuel, motor oils for diesel and carburetor (injector) engines, paid to the budgets of the subjects of the Russian Federation, according to the draft of the law, is increased from 60% to 100%. According to the estimation, in 2009 additional expenses of the budgets of the subjects of the Russian Federation will make RUR 59.4 bln.

¹⁹ S. Prokop’ev. K novomu obliku armii i flota. Zavershaetsa razrabotka novoi FTsP po komplektovaniu dolznoستي serzhantskogo sostava kontraktnikami (Towards the new image of the Army and the Navy. The development of the new FTP concerning the filling of sergeant positions by contract personnel). VPK, No 49, of 17 - 23 December 2008.

2. Liberalization of the conditions for the subsidies provision from the federal budget and the budgets of the subjects of the Russian Federation to the economic entities

At the moment according to point 2 article 78 of the Budget Code of the Russian Federation the subsidies to the economic entities can be granted only in cases and according to the procedure stated in the Federal Law on the federal budget and by the laws of the subject of the Russian Federation on the budget of the Russian Federation. At the same time according to part 6 article 25 of the Federal Law "On the federal budget for 2009 and for the planning period of 2010 and 2011" in 2009 the Government of the Russian Federation has the right to direct the means of the federal budget at the amount of up to RUR 175 bln to fulfill the measures supporting the financial market of the Russian Federation. Moreover, on 20 December 2008 the Government adopted the Decree No 964 "On the procedure for allocating subsidies to commercial banks to compensate for the costs and short-received profits concerning the credit deals with the airline companies to the part that is not compensated by the earnings from the sale of the property given to secure the credit according to the crediting agreement". In order to avoid collision between the norms mentioned the draft of the law in fact introduces moratorium concerning the effect of the first norm up to January, 1 2010.

3. Increase of the construction budget of the state property of the Russian Federation, decision on preparation and realization of the budget investments in which the superintendants of the federal budget funds have the right to get, from RUR 600 mln to RUR 2.5 bln, which, according to the authors of the project, will allow more effective use of the federal budget funds.

4. Introduction of the norm on the subsidy responsibility of the superintendent of the budget funds for the monetary liabilities of the recipients of the budget funds in his charge.

The duty of the superintendent of the budget funds to have subsidy responsibility for the monetary liabilities of the budget institution in his charge is one of his main responsibilities. And this is the fact that is suggested to be reflected in clause 1 article 158 of the Budget Code of the Russian Federation, in which the budget responsibilities of the superintendent of the budget funds are listed.

The inclusion of the responsibility mentioned above in clause 1 article 158 of the Budget Code of the Russian federation will remove the variety of the opinion in the judicial practice of the norms and regulations of the civil and budget legislation of the Russian Federation, concerning the subsidiary responsibility of the in the public organizations on the monetary liabilities of the budget institutions formed by them.

5. Change in the procedure for the registration of the operations with the oil and gas earnings of the federal budget

According to the new version of cause 2 article 9612 of the Budget Code of the Russian Federation in case in 2009 and forthcoming years the oil and gas transfer is below the volume established by the Federal Law "On the federal budget for 2009 and for the planning period of 2010 and 2011" all the means of the oil and gas profits are submitted initially to the oil and gas transfer until it reaches its volume established by the federal law on the federal budget for 2009 and for the planning period of 2010 and 2011 and only then will be directed to the Reserve Fund and the Welfare Fund.

6. Simplification of the procedure for the provision of the state guarantees of the Russian Federation

In order to make government support to the organizations more effective the draft of the law lifts the limitation existing in the Budget Code of the Russian Federation on the maximum volume (sum) of the government guarantees of the Russian Federation, the right of decision-making on which the Government of the Russian Federation may transfer to the Ministry of Finance of the Russian Federation.

Review of Economic Legislation

I. Tolmacheva

In December the following changes were introduced in the legislation: the amount of the social benefit for funerals as well as the volume of the compensation for the funeral costs to special organizations was increased; the technical regulations, concerning the development of the requirements for tobacco goods was developed; the Government of the Russian federation issued the Decree on the fund for the labor remuneration of the employees of the federal executive bodies; the maximum value of the unemployment compensation was raised for 2009; from 1 December 2008 the refinancing interest rate was increased up to 13%.

I. Federal Laws of the Russian Federation

1. "ON MAKING CHANGES TO ARTICLES 9 AND 10 OF THE FEDERAL LAW "ON FUNERALS AND UNDERTAKER SERVICES" from 03.12.2008 No 238-FZ

According to the amendments made to the Federal Law "On Funerals and undertaker services" the maximum volume of the social benefit paid to the marriage partner, relative, legal representative of the deceased or another person taking the responsibility to bury the deceased as well as the maximum volume of the compensation to the special service for the costs of the funeral services (according to the guarantee list) was raised from RUR 1000 to RUR 4000.

2. "ON MAKING CHANGES TO SOME LEGISLATIVE ACTS OF THE RUSSIAN FEDERATION IN ORDER TO INCREASE THE LEVEL OF THE MATERIAL WELL-BEING OF SOME CATEGORIES OF CITIZENS" from 22.12.2008 No 269-FZ

Comes into effect on 1 January 2009, excluding some statements which come into effect on other dates as stated

The amendments aimed at the increase of the basic rate of the retirement pension, the disability pension, survivor's pension as well as the volumes of monthly monetary payments were made to some legislative acts of the Russian Federation.

The changes are introduced, for instance, in Laws "On retirement pensions in the Russian Federation", "On social protection of the citizens exposed to the radiation as a result of the catastrophe at the Chernobyl nuclear power plant", "On veterans", "On social protection of the disabled in the Russian Federation". Thus, the basic rate of the retirement old-age pension is established at the rate of RUR 1950 per month (at present RUR 1794 per month), and from 1 December 2009 the basic rate of the old-age retirement pension will make RUR 2460 per month. The volume of the basic rate for the disability pensions is established at the following sums: for the disabled of the third extent – RUR 3900 per month (RUR 4920 per month from 1 December 2009), for the disabled of the second extent – RUR 1950 per month (RUR 2460 per month from 1 December 2009), for the disabled of the first extent – RUR 975 per month (RUR 1230 per month from 1 December 2009).

3. "TECHNICAL REGULATIONS FOR TOBACCO GOODS" on 22.12.2008 No 268-FZ

The regulations includes: the requirements for the tobacco goods, rules and forms for the estimation of the compliance of the tobacco goods with the requirements of the adopted Federal Law. For instance, the general requirements for the tobacco goods, the requirements for the tobacco ingredients, for the concentration of the tar, nicotine and carbon monoxide in the cigarette smoke are specified. The order of the information placement for the consumers of tobacco goods and its content is defined; the regulations for making the warning notifications on the harm of smoking are stated. The Federal Law comes into effect in a year after the day of its official promulgation excluding some statements.

II. Decrees of the Government of the Russian Federation

1. "ON THE FUND FOR LABOR REMUNERATION OF THE EMPLOYEES OF THE CENTRAL AND TERRITORIAL BODIES OF THE FEDERALEXECUTIVE BODIES" from 26.11.2008 No 893

For instance, in 2008 and 2009 the federal executive bodies are allowed to direct the existing savings of the budget allocations envisaged for labor remuneration above the established labor remuneration fund to the material simulation of the professional official operation (work) of the federal state civil officials and employees, working at the positions that are not the positions of the federal state civil service. Some decrees of the Government of the Russian Federation concerning the fund for labor remuneration of the federal executive bodies employees are declared invalid.

2. "ON MINIMUM AND MAXIMUM VOLUME OF THE UNEMPLOYMENT COMPENSATION" from 08.12.2008 No 915

Earlier the minimum unemployment compensation established for 2009 was equal to 850 rubles, and the maximum – to 3400 rubles. According to the Decree given the maximum volume of the compensation is increased by RUR 1500 and will now make RUR 4900.

3. "ON MAXIMUM VALUES AND THE PERIOD FOR DOWN PAYMENT FOR THE PROPERTY OF THE SUBJECTS OF THE RUSSIAN FEDERATION OR THE MUNICIPAL FORMATIONS RENTED BY THE SUBJECTS OF THE SMALL AND MEDIUM-SCALE BUSINESS APPLIED WHEN THEY FULFILL THEIR PRIVILEGE RIGTH FOR THE PURCHASE OF SUCH PROPERTY" from 18.12.2008 No 961

The Government of the Russian Federation has specified some conditions for purchase of the rented state or municipal property by the subjects of small and medium-scale business.

According to the Federal Law from 22.07.2008 No 159-FZ the privilege right of the subjects of small and medium-scale business (excluding subjects of small and medium scale business of some categories) to purchase the property of the subjects of the Russian Federation or municipal formations they rent in case of onerous alienation of such property. It should be noted that one of the conditions for the provision of the right mentioned is the compliance of the area of the rented premises with the maximum value established by the laws of the subjects of the Russian Federation. The laws of the subjects of the Russian Federation should also postulate the period for the down payment for the property purchased.

According to the federal Law mentioned the Government of the Russian Federation established the maximum areas of the rented premises (1000 sq m), which will be in effect from 1 January 2009 in the subjects of the Russian Federation that will not adopt such by their own laws.

III. Instructions, Orders, Letters

1. The Order of the Central Bank of the Russian Federation from 28.11.2008 No 2135-U "ON THE REFINANCING RATE OF THE BANK OF RUSSIA"

The Bank of Russia increases the refinancing rate up to 13% starting with 1 December 2008.

The decision on the increase of the refinancing rate was made as a part of the measures aimed at the reduction of the level of the capital outflow from Russia and the limitation of the inflation trends.

2. Order of the Ministry of Finance of the Russian Federation from 22.09.2008 No 99n "ON APPROVAL OF THE ADMINISTRATIVE REGULATIONS CONCERNING THE EXECUTION BY THE FEDERAL TREASURY THE FUNCTIONS OF THE ORGANIZATION OF THE COURT DECISIONS EXECUTION THAT ENVISAGE THE CONVERSION OF THE COLLECTION FOR THE FUNDS OF THE FEDERAL BUDGET CONCERNING THE MONETARY LIABILITIES OF THE FEDERAL BUDGET INSTITUTIONS"

Registered in the Ministry of Justice of the Russian Federation on 09.12.2008 No 12803

The regulations defining the procedure for the organization of the execution of court decisions by the bodies of the Federal Treasury are developed.

In accordance with the approved Regulations the state function of the execution of the court decisions is defined as the process of organization by a body of the Federal Treasury of the execution of the requirements of the court act to transfer monetary means for the benefit of the collector by the debtor in accordance with the procedure stated by the Budget Code of the Russian Federation. For instance the regulations stipulate the list of the necessary documents required from the collector, defines the procedure for the transfer of the monetary funds for the benefit of the collector, regulates the forms of control over the process of the organization of the state function fulfillment. The addresses, phone numbers and sites of the Federal Treasury administrations in the subjects of the Russian Federation as well as the forms for the collector's applications are presented in the appendix to the Regulations.

Review of Regulatory Documents Concerning Taxation over November-December 2008

L. Anisimova

1. According to the Decree of the Central Bank of the Russian Federation from 6 November 2008 No 2120-U, business reputation is introduced in the list of accounting registers for the banks as a special non-material asset. Moreover, the possibility for the balance cost of this non-material assets to be recalculated, difference regarded as losses (4.20), is envisaged.

The Tax Code of the Russian Federation (article 268.1) the difference between the price of purchase of the enterprise as a property complex and the cost of its net assets (assets minus liabilities) is to be regarded as expenditures (incomes) of the taxpayer.

The value of enterprise's selling price as a property complex exceeding the value of its net assets, according to the Tax Code of the Russian Federation, should be regarded as an extra payment made by the customer expecting future economic profits.

The value by which the cost of the enterprise's net assets as a property complex exceeds the selling price should be treated as a discount for the price, given to the customer there being no (little/few)

stable customers, quality reputation, marketing and selling skills, business relations, management experience, level of staff qualification and taking into account other factors.

The sum of the discount given can be taken off the books in five years.

The approach applied in the Tax Code of the Russian Federation and the approach, utilized according to the orders of the Central Bank of the Russian Federation, is not in accordance with the notion of the business reputation as stated in article 150 of the Civil Code of the Russian Federation, which refers the business reputation to the private non-material rights and other non-material goods, which cannot be alienated or transferred. However the order of the Central Bank of the Russian Federation from 6 November 2008 No 2120-U registered in the Ministry of Justice of the Russian Federation regards such an approach as applicable.

The problems connected with taking into account the business reputation for the purposes of taxation can arise when the object purchased as a separate property complex is to be divided and sold by parts. This issue is not regulated by the Tax Code of the Russian Federation. Practically, reselling of business reputation may become a profitable business and replace the operations on purchase and sale of the securities. As to the operations with securities buying and sale the losses are taken into account only within the limits of profits from the operations with the securities concerned, whereas there is no such restriction concerning the operations of reputation buying and sale in the Tax Code of the Russian Federation and the result is accounted as losses according to the general procedure. The specification included in paragraph 2 clause 2 article 268.1 does not exclude the possibility of the enterprise as a property complex sold without contest. In order to avoid creation of the channel for taxes evasion, in our opinion, there should be a compulsory reference included in article 268.1 stating that the sale of the enterprise as a property complex for the purpose of taxation is regarded as a market one only if there is an estimation of independent auditor available.

2. According to the letter of the Ministry of Finance of the Russian Federation and the Federal Tax Service of the Russian Federation from 13 November 2008 No ShS- 6-3/826@ the issue of the state cadastre estimation of the land for land tax calculation is clarified.

According to clause 1 article 391 of the Tax Code of the Russian Federation taxation base for the land tax is determined for each land plot as its cadastre value on 1 January of the year, which is the taxation period. It should be noted that the cadastre value of the land plot is defined in concordance with the land legislation of the Russian Federation. The results of the state cadastre estimation are approved by the executive bodies of the subjects of the Russian Federation on require of the territorial bodies of the Federal Real Estate Cadastre Agency.

Thus, taxation base is regulated by the land legislation.

Under these circumstances the Ministry of Finance of the Russian Federation and the Federal Tax Service of the Russian Federation clarify the principles for interaction of the land legislation and article 5 of the Tax Code of the Russian Federation, which regulates the application of the regulatory legislation acts on taxes and duties issued by the executive bodies of the subjects of the Russian Federation.

For instance, it is clarified that since the regulatory legislation acts of the executive bodies of the subjects of the Russian Federation on approval of the results of the state cadastre estimation of the land regulate land but not tax relations, the acts mentioned do not belong to the regulatory legislation acts on taxes and duties, and, consequently, the norms of article 5 of the Tax Code of the Russian Federation cannot be applied to them. This opinion is reflected in the resolution of the Supreme Court of the Russian Federation from 9 December 2002 No 18-G02-12.

On application of the results of the state cadastre estimation of the land plots for the purposes of taxation, one should take into account the duties of the bodies conducting the state land cadastre to submit the data on the land plots to the taxation bodies before 1 February of the year that is the taxation period and the right of the of the taxpayers to receive the information on the cadastre value of the land plots by the state of affairs on 1 January of the calendar year before 1 March of the calendar year. That is the changes in the taxation base are introduced only on the basis of such notifications.

3. The Federal Law from 24 November 2008 No 208-FZ introduces changes in article 346.14 of the Tax Code of the Russian Federation. It envisages the right of the taxpayer to change the taxation object annually in case the simplified taxation system is applied (incomes, or incomes with expenditures deduced).

Earlier it was permitted only once in three years.

4. According to the letter of the Federal Tax Service of the Russian Federation from 25 November 2008 No ShS-6-3/854@ and the Ministry of Finance of the Russian Federation from 10 November 2008 No 03-11-02/126 the issue on changes in the procedure of the taxation with the single tax on the imputed income is clarified. If the number of the organization's and (or) individual entrepreneur's staff average on the list makes more than 100 people as a result of 2008, and in case the share of other organizations' participation makes more than 25%, then such an organization and (or) individual entrepreneur cannot apply single tax on the imputed income from 1 January 2009. At the same time the Russian Federation, subjects of the Russian Federation and municipal formations are not considered to be economic entities according to the essence of the civil legislation and, consequently, are not included in the list of organizations for the purposes of the Tax Code of the Russian Federation.

That is why the limitations are not applied in cases when the Russian Federation, subjects of the Russian Federation and municipal formations are share-holders (participants, organizers) of the companies.

Such an explanation is valid for unitary enterprises, since their property is indivisible and belongs to the organizer.

According to the Federal Law from 22 July 2008 No 155-FZ "On making changes to Part Two of the Tax Code of the Russian Federation" starting with 1 January 2009 the limitation that does not allow organization having branches and (or) representatives to transfer to the single agriculture tax is cancelled. From now on such organizations wishing to transfer to payment of the single agriculture tax from 1 January 2009, from 20 October 2008 to 20 December 2008 should submit to the taxation bodies the applications on transfer concerning agriculture tax payment.

5. According to the letter of the Federal Tax Service of the Russian Federation from 28 November 2008 No ShS-6-3/862@ the issue on the procedure of the VAT deduction applications from 01.01.2006 while constructing the objects of the real estate, as well as when the fixed assets are purchased in case on these objects being put into commission the taxpayer starts using it simultaneously in the taxable and non-taxable operations is clarified.

Starting with 01.01.2006 a special procedure for the recovery of taxation sums that are not to be paid in the budget is applied for the construction of the objects of the immovable property (fixed assets).

Thus, according to paragraph 4 clause 6 article 171 of the Tax Code of the Russian Federation, the sums of the taxes that a taxpayer is charged with on construction of the objects of immovable property (fixed assets) carried out by the order executors, on purchasing immovable property, calculated by the taxpayer on carrying out the construction works for his own use, adopted as a deduction according to the procedure, envisaged by chapter 21 of the Tax Code, are to be recovered in case these objects of immovable property (fixed assets) are further used for the purposes not levied with VAT, namely: those mentioned in clause 2 article 170 of the Code (for instance when producing goods, works, services, exempted from the taxation, conducting operations, not recognized as sale in the territory of the Russian Federation etc.). Calculation of the tax sum to be recovered in the taxation base of the profit tax and to be paid to the budget is made taking as a basis 1/10 of the sum of the tax, multiplied by the value equal to the ratio of goods (works, services, property rights) value not levied with the tax to the total value of goods (works, services, property rights) over the calendar year. The sum of the tax to be recovered is not to be included in the value of the property sold and is to be accounted as a part of other expenditures of the organization in concordance with article 264 of the Code.

The special procedure for VAT deductions when constructing the objects of immovable property (fixed assets) is established. It envisages the possibility for taking to deduction value added tax sums, which the taxpayer is levied with by the order executors and other suppliers within the framework of construction works conduction, as well as the sums of the taxes, the taxpayer faces when buying the uncompleted objects of capital construction, before the construction of these objects of immovable property (fixed assets) is completed. In such a case VAT is recovered and paid to the budget within 10 years for the objects of immovable property (fixed assets) put into commission.

6. According to the letter by the Federal Tax Service of the Russian Federation from 28 November 2008 No ShS-6-3/868@ the issue of VAT payment when the debtor settles the liability of credit contract, earlier received in the monetary form, by transferring of the monetary means on charge of the lender to the third party (goods, works, services supplier), as well as when the debtor settles the liability of credit agreement by shipping to the lender goods (works, services).

According to the Tax Code of the Russian Federation, to define VAT sum to be deducted, the following conditions should be met simultaneously:

- Invoice for purchased goods (works, services) available;
- Corresponding primary documents, proving that they were taken into account, available;
- Use of purchased goods (works, services) in the operations regarded as objects of taxation.

If the contract of goods (works, services) buying and sale envisages that the payments with the supplier will be made in monetary form, then, regardless of the means the customer will use to pay (his own funds or borrowed funds at his account), the customer has a right for deduction in the taxation period when all the conditions mentioned above were fulfilled.

For goods exchange operations the sum of the tax, given to the customer by the taxpayer, is paid to the taxpayer on the basis of the invoice for monetary funds transfer and this sum is to be transferred to the budget by the taxpayer. The statement mentioned was put into effect on 1 January 2007 and applies to goods (works, services), purchased starting from 01.01.2007.

As to the credit contract, the objects of taxation in this case are the monetary means, received by the borrower in accordance with the credit contract, which are to be regarded for the date of the mentioned agreement signing as a pre-payment for the forthcoming goods (works, services) supply. In accordance with clause 1 article 154 of the Tax Code of the Russian Federation, taxation base is determined from the sum, received by the borrower VAT included. That is borrowing 118 rubles, the borrower can use only 100 rubles, because he is to pay 18 rubles to the budget.

7. According to the letter of the Ministry of Finance of the Russian Federation and the Federal Tax Service of the Russian Federation from 1 December 2008 No MM-6-1/873@ the mechanism of the operations for set-off (return) making the excessively paid (levied) sums of insurance fees for the compulsory pension insurance (the procedure of interaction between the insurer, Pension Fund of the Russian Federation, Federal Tax Service of the Russian Federation and Federal Treasury of the Russian Federation) is clarified.

8. Federal Law from 4 December 2008 No 251-FZ makes changes to article 154 and 164 of the Tax Code of the Russian Federation.

VAT is introduced for resale of the second-hand cars, purchased from the natural persons, who do not pay this tax. The taxation base is defined as a difference between the market price (article 40 of the Tax Code) the tax included and the price for these cars purchase.

9. According to the Letter of the Federal Tax Service of the Russian Federation from 8 December 2008 the mechanism for the organizations' and individual entrepreneurs' transfer to the single tax on the imputed income from 1.01.2008. Starting with 01.01.2009 the organizations and single entrepreneurs, the average number of whose staff on the books over the preceding calendar period exceeds 100 people, are not to apply the single tax on the imputed income.

If as a result of the taxation period (quarter is referred to as a taxation period) the taxpayer violates the limitation concerning the number (average number of the staff on the list exceeds 100 people), he is considered to lose the right to apply single tax on the imputed income and to have transferred to the general regime of the taxation from the beginning of the taxation period in which the violation of the requirements mentioned took place.

In case the taxpayer has not violated the restrictions regarding the number of staff for a quarter, he can transfer to single tax on the imputed income payment from the beginning of the quarter after the quarter in which the taxpayer eliminated violations of the established requirements.

Thus, in case as a result of the first taxation period of 2009 the average number of the staff on books of the taxpayer, who has lost the right to apply the single tax on the imputed income, will not exceed 100 people, such a taxpayer can transfer to single tax on the imputed income payment starting with the second quarter.

10. The letter of the Ministry of Finance of the Russian Federation from 11 December 2008 No 03-03-05/166, the Federal Tax Service of the Russian Federation from 1 December 2008 etc the procedure for the transfer to payment of the monthly advance payments for profit tax is clarified in connection with article 3 of the Federal Law from 26.11.2008 No 224-FZ coming into effect from 27 November 2008. It is clarified that organizations having decided to change at the end of 2008 the procedure for payments to the budget (and informed the taxation bodies on time about this) and to transfer from the general procedure of the tax payment by the advance payments, envisaged by the Tax Code of the Russian Federation, to the procedure of tax payment by advance payments on really existing profit over the period from the beginning of the year till the end of the month before the month when

the advance payment is made can apply the procedure introduced by the Federal Law No 22-FZ. Thus, the procedure introduced by the Federal Law No 224-FZ is a transitional for those who want to transfer from the advance payments, calculated according to the general scheme, to the scheme of advance payments calculation according to really received profit.

The tables below illustrate the attempt to compare two schemes: the usual one, envisaged by article 286 of the Tax Code of the Russian Federation, and the scheme introduced specifically for the 4th quarter 2008.

Review of Budgetary Legislation

M. Goldin

In December 2008 the following events took place in the field of the budget legislation: the Government of the Russian Federation established the limiting values of the rent areas that are subject to privatization according to the simplified procedure by small and medium-scale enterprises, as well as the maximum period for the down payment; the procedure for the conclusion of agreements on transfer of authority between the federal and regional executive bodies; prolonged the effect of the Methods for the calculation of the normative for expenses formation for maintenance of the public authorities of the subject of the Russian Federation; established the procedure for the conduction of the measures and projects selection concerning the fulfillment of the administrative reform in 2009.

The Federal Law from 22.07.2008 “On special features of the buying-out of the immovable property being the state ownership of the subjects of the Russian Federation or the municipal ownership and rented by the subjects of small and medium-scale business, and on making amendments to the separate legislative acts of the Russian Federation”. Law No 159 envisages the procedure for the mechanism for the alienation of the property that is the state or the municipal ownership and is rented by the subjects of small and medium-scale business for more than three years with the use of the privilege right without conducting an auction (contest) at a market price with the down payment. It should be noted that one of the conditions on which the privilege right for the buying-out of the premises is granted is the compliance of the area of the premises rented with the maximum values established by the laws of the subjects of the Russian Federation. Besides, according to the laws of the Russian Federation there must be a period set for the down payment for the property purchased. In accordance with the Federal Law by the Decree from 18.12.2008 No 961 “On the maximum values and the period of the down payment for of the immovable property being the state ownership of the subjects of the Russian Federation or the municipal ownership and rented by the subjects of small and medium-scale business, applied when they execute their privilege right for the buying-out of such a property” the Government of the Russian Federation established the maximum figures for the area of the rented premises (1000 sq m) and the maximum period for the down payment (3 years), which will be in effect from January 1, 2009 in the subjects of the Russian Federation that will not adopt there own laws till the date mentioned.

In accordance with clause 6 article 1 and article 28.8 of the Federal Law “On general principles for organization of the legislative (representative) and executive bodies of the public authority of the subjects of the Russian Federation” from 06.10.1999 No 184-FZ, federal executive bodies acting in accordance with the agreement with the public authorities of the subjects of the Russian Federation can transfer to them the execution of a part of their authorities. In their turn, executive bodies of the public authorities of the subjects of the Russian Federation on agreement with the federal executive bodies can pass execution of the part of their functions with the transfer of the necessary material and financial means. In order to implement these statements of the federal law there was a Decree of the Government of the Russian Federation adopted on 08.12.2008 No 924 “On the procedure for conclusion and coming into the effect of the agreements between the federal executive bodies and executive bodies of the public authority of a subject of the Russian Federation on their passing each other a part of their authority execution” (further referred to as the Procedure).

As it is clear from the heading of the regulatory legislative act the Procedure mentioned defined the order for the conclusion of the agreements between the federal executive bodies and executive bodies of the public authority on their passing each other a part of their authority.

The procedure also establishes such special features of the conclusion of the agreements on the authority transfer as to the objects of the capital construction being the federal ownership.

Attention should be paid to the fact that the Procedure does not indicate clearly who in the system of the public authorities of the region has a right to conclude the agreement with the federal executive bodies and executive bodies of the public authority on their passing each other a part of their authority. In article 28.8 it is stated that the agreement can be signed (or, in other words, concluded) by a head of the federal executive body and the highest authority of the subject of the Russian Federation (the head of the highest executive body of the public authority of this subject of the Russian Federation). There should have been specified in the Procedure that the right to conclude the agreement between the federal executive bodies and the executive bodies of the public authority on their passing each other a part of their authority belongs only to the competence of the highest executive body of the public authority of the region.

According to the Decree of the Government of the Russian Federation from 08.12.2008 No 925 “On making changes to the decree of the Government of the Russian Federation from 29 December 2007 No 990” the effect of the Method for the calculation of the normative for the formation of the regional budget expenses, establishing the share of expenditures for the maintenance of the public authority of the subject of the Russian Federation in the total amount of tax and non-tax earnings, as well as subsidies for the equalization of the budget provision in the subject of the Russian Federation is prolonged for 2009.

The Order of the Ministry for Economic Development and Trade of the Russian Federation from 01.10.2008 No 306 adopted the Procedure for the selection as a result of the fulfillment by the federal executive bodies and the supreme executive bodies of the public authority of the subjects of the Russian Federation of the programs and plans of measures to conduct the administrative reform and the projects for fulfillment of the administrative reform in 2008 as well as the guidelines for the estimation of the results of the fulfillment by the federal executive bodies and the supreme executive bodies of the public authority of the subjects of the Russian Federation of the programs and plans of measures to conduct the administrative reform and the projects for fulfillment of the administrative reform in 2008.

The Procedure defines the methods for organization of the estimation of the reports of the mentioned bodies that are the participants of the contest on the support for the administrative reform conduction in 2009. According to the Procedure established the conduction of the estimation is entrusted to the Commission on conduction of the contest selection of programs and plans of measures to fulfill the administrative reform at the Ministry for Economic development and Trade of the Russian Federation. As a result of the estimation the participants of the contest will be attributed with the rating corresponding to their total estimation mark. As a result of the selection the participants of the contest will be allocated the funds from the federal budget to finance the main directions of the administrative reform, which includes the preparation of the method basis, conduction of the monitoring of the quality of the public administration, for the projects on implementation of the administrative regulations concerning state services rendering, for labor remuneration of employees participating in the fulfillment of the administrative reform.

Notification of foreign creditors of financial institutions concerning the initiation of insolvency (bankruptcy) proceedings against their debtor

E. Velikova

In Russia, in order to properly regulate the relations arising in connection with cross-border insolvency of financial institutions, and in particular the procedure for notifying foreign creditors, it will be necessary to adopt a separate federal law and to introduce appropriate amendments to the existing laws on the basis of the provisions of the UNCITRAL Model Law on Cross-Border Insolvency, as well as a more detailed elaboration of cross-border bankruptcy issues in the RF Civil Code.

In many countries, foreign creditors for a long time have been and sometimes even now are treated differently from those locally based, the situation of the former being less advantageous, including with regard to their notification of the initiation of an insolvency (bankruptcy) proceeding against their debtor, because more often than not they receive the notification at a later date, or are altogether ex-

cluded from any participation in the proceeding²⁰. The later arrival of the notification that an insolvency (bankruptcy) proceeding has been initiated against their debtor may result in their failure to present their claims within the established timelines. Even when a country's legislation formally grants to foreign creditors equal rights in terms of their notification as to the initiation against their debtor of an insolvency (bankruptcy) proceeding and the timelines for presenting their claims, the existing procedure actually places foreign creditors at a disadvantage.

Neither Federal law of 26 October 2002, No 127-FZ "On insolvency (bankruptcy)", nor Federal Law of 25 February 1999, No 40-FZ, "On insolvency (bankruptcy) of credit institutions" provides any proper regulation of the relations arising between Russian debtor companies or financial institutions and their foreign creditors. Besides, no proper procedure is determined for the bankruptcy of companies whose assets are situated not only in Russia but elsewhere. Federal Law No 127-FZ grants equal rights both to Russian and foreign creditors participating in a bankruptcy proceeding.

In Article 63 of the Civil Code of the Russian Federation it is determined that the liquidation commission should take adequate measures in order to identify creditors and recover receivables, by notifying creditors in writing as to the liquidation of a legal entity, and by placing in the press organs nominated for publishing information concerning State registration of legal entities the announcement of its liquidation and of the procedure and timelines for the presentation of creditors' claims. The RF Civil Code does not distinguish creditors into domestic and foreign ones. Equality of rights enjoyed by local and foreign creditors is also reflected in Russia's judicial practice, which recognizes that it is indeed difficult for foreign creditors to receive in due time the information concerning the initiation of an insolvency (bankruptcy) proceeding against their debtor, which is fraught with the risk of their failure to present their claims and be entered into a creditors' register, since some of them may not have their representative offices in Russia.

In order to promote the adoption of modern and well-balanced legislation designed to regulate the cases when an insolvent debtor has assets in several states, in 1997 the UNCITRAL Model Law on Cross-Border Insolvency came into force. Naturally, this law is by no means the only international legal act regulating the issues of cross-border insolvency; however, it offers a sufficiently detailed description of the process of information exchange courts of justice and other competent bodies, as well as the granting of information to foreign creditors. The UNCITRAL Model Law on Cross-Border Insolvency has already provided the foundation for new legislative acts on insolvency (bankruptcy), or for amendments to the existing ones, in the following 16 countries: Japan, Mexico, South Africa, Eritrea (2000), Montenegro (2002), Poland, Romania (2003), Serbia (2004), the British Virgin Islands, the USA (2005), the UK, Columbia, New Zealand, South Korea (2006), Austria, Australia (2008),

The issue of notification of foreign creditors is addressed in Article 14 of the UNCITRAL Model Law on Cross-Border Insolvency. Whenever notification should be given to creditors in a given State, such notification should also be given to the known creditors that do not have addresses in that state. A court may order that appropriate steps be taken with a view to notifying any creditor whose address is not yet known. Such notification is made to the foreign creditors individually, unless the court considers that, under the circumstances, some other form of notification would be more appropriate. No rogatory letters or other similar formality is required. The notification indicates the following:

- a reasonable time period for filing claims and a specified place for their filing;
- whether secured creditors need to file their secured claims;
- any other information required to be included in such a notification to creditors pursuant to the law of that State and the orders of the court.

The law contains no references to the timelines for notifying foreign creditors, and even the notification procedure is not determined in any specific way, despite the fact that other procedures can also be possible. At the same time, the mandatory minimum of information to be related in a notification is indicated, as well as the possibility to add to the notification some additional information in accordance with the legislation of a given State and orders of a court.

In October 2005, the introduction of Chapter 15 of US Bankruptcy Code became effective. The provisions stipulated in the sections of this chapter concerning the notification of foreign creditors vary only slightly from the wording applied in the UNCITRAL Model Law on Cross-Border Insol-

²⁰ The new threat to international commercial transactions: cross-border insolvency and its impact on the standby letter of credit regime, Roland Lechner, <http://www.natlaw.com/pubs/spacbk1.htm>

veny, in that different timelines are established for notifying foreign creditors and the presentation of their claims. The timelines for the notification of foreign creditors and the presentation of their claims are not determined precisely, but in any event the period is longer than that established for domestic creditors and is determined by a court of justice.

In France creditors are notified concerning the need to present their claims within 2 months from the moment of publication of the bankruptcy court decision in *Bulletin Officiel des annonces Civiles et Commerciales*; foreign creditors have two additional months to submit their claims²¹. In Italy, within the duration of one month from the moment of onset of the liquidation procedure, the commissioner in bankruptcy is obliged to notify thereof all the creditors in writing, the creditors having an opportunity to submit their comments and requests within 15 days from the moment of being notified. Those creditors that have not been notified must present their claims within 6 days from the moment of the publication of the decision as to the liquidation of their debtor in the official press organ (*Gazzetta Ufficiale*)²².

The UK introduced changes in its insolvency law²³ in April 2006, which differs only slightly from the stipulations in Article 14 of the UNCITRAL Model Law on Cross-Border Insolvency. The difference is that while UK creditors are notified through publications in the local press, foreign creditors can be notified through such foreign publications as 'British insolvency officeholder'. The standpoint reflected in Article 14 of the UNCITRAL Model Law on Cross-Border Insolvency that notification should be made to foreign creditors individually has already been incorporated in UK legislation prior to the coming in force of the UNCITRAL Model Law.

The insolvency regime currently existing in the EU with regard to financial institutions is determined, beside other documents, by the 2001 EU Directive 2001/24/EC on the reorganization and winding-up of credit institutions. Article 13 of the Directive stipulates that a liquidator or another administrative or judicial body must place a notification concerning the decision that a liquidation procedure be initiated by publishing an extract from that decision in the Official Journal of the European Communities and at least in two nationally circulating newspapers in each of the receiving countries. The procedure for providing all known creditors with relevant information is described in the Directive's Article 14. When initiating a liquidation procedure, an administrative or judicial body in the receiving country must inform individually all known creditors who have legal addresses, places of location or head offices in other EU countries. The informing is done by means of sending a notification containing indications of the timelines for presenting claims and the place of their presentation. The language of notification is determined in Article 17, whereby it is stipulated that information should be presented in the official language or one of the official languages of the receiving country, the title of the notification, "Invitation to present a claim. Timelines", in all the official languages of the EU, being mandatory.

Thus, in order to properly regulate the relations arising in cases of cross-border insolvency of financial institutions, and in particular the procedure for notifying foreign creditors, it is necessary to adopt in Russia a separate federal law based on the provisions of the UNCITRAL Model Law on Cross-Border Insolvency, to introduce amendments into the existing laws on the basis of the UNCITRAL Model Law on Cross-Border Insolvency, and to determine in more detail the issues of cross-border bankruptcy in the RF Civil Code.

The proposals concerning the procedure for the notification of the foreign creditors of financial institutions as to the initiation against their debtor of an insolvency (bankruptcy) proceeding may be presented as follows:

1. The adoption of a separate federal law based on the UNCITRAL Model Law on Cross-Border Insolvency;
2. The introduction of changes into RF bankruptcy legislation, designed to address the following issues:

²¹ Ordonnance n° 2004-1127 du 21 octobre 2004 portant transposition de la directive 2001/24/CE du Parlement européen et du Conseil du 4 avril 2001 concernant l'assainissement et la liquidation des établissements de crédit (France).

²² Legislative Decree of 9 July 2004, No 197 (Italy)

²³ UK Insolvency Enterprise Act 2002, The Credit Institutions (Reorganization and Winding up) Regulations 2004

- a. similarity of the methods of notifying creditors situated outside Russia and those inside Russia;
 - b. the mandatory indication in the notification of a reasonable period for the presentation of claims by foreign creditors and the place of their presentation;
 - c. an extended period for the presentation of claims by foreign creditors as compared for that established for Russian creditors; in this connection, legislation may determine, instead of a precise period, only the fact of that period being extended; the precise timelines may be determined individually in each specific case by a court of justice, but be no shorter than those established for Russian creditors;
 - d. the press organs for publishing the notification of foreign creditors concerning the initiation of insolvency (bankruptcy) proceedings against their debtor in RF territory. These press organs may be: *Rossiiskaia gazeta* [The Russian Newspaper]; *Vestnik Banka Rossii* [The Bank of Russia's Herald]; the Deposit Insurance Agency's website (www.asv.org.ru); or other websites, according to the type of a given financial institution. These press organs are obliged to place the relevant information both in the Russian and English languages.
3. Within the framework of the CIS and/or EurAsEC, the information as to the initiation of an insolvency (bankruptcy) proceeding against a debtor must be presented in the receiving country's official language, while the title of the notification, "Invitation to present a claim. Timelines", - in all the official languages of the CIS and/or EurAsEC respectively. In this connection, within the framework of the CIS and/or EurAsEC, a special additional press organ may be determined for placing notification for foreign creditors.

Restrictions to economic growth in industry on the eve of crisis (results of polls of industrial enterprises)

A. Kaukin, L. Freinkman

Results of the IET's polls recorded the estimates offered by enterprises as to the restrictions existing to their development at the time of the onset of the financial crisis. On the whole, the economic environment can be characterized moderately satisfactory. The resource-linked (labor, power supply) and macroeconomic (inflation, lack of stable policy) factor are perceived by enterprises as key restrictions to their growth. Most of the administrative barriers (including corruption) are not regarded as serious obstacles to development. There are grounds to believe that, by comparison with this decade's first half, the administrative restrictions to the development of enterprises have become more lax. However, this improvement by no means apply equally to all the groups of enterprises.

In September 2008, the IET's Department for Economic Situation Surveys conducted a poll among Russian industrial enterprises aimed at identifying the existing obstacles to successful economic development. Within the poll's framework the directors of enterprises were offered questions concerning their assessment of the influences of various factors on their enterprises' development. The factors potentially restrictive to development were subdivided into 3 groups: resource-linked restrictions, administrative restrictions and macroeconomic restrictions. These questions were fully or partly answered to by the directors 545 enterprises. In this connections, the questions concerning the first group of restrictions were answered on the average by 97.7 % of respondents; those concerning the second group – by 96.7 %; and those concerning the third group – by 97.4 %.

It should be emphasized that the poll took place in September, i.e. during the period when the real sector of the national economy was still faced with only minimum negative effects produced by the global financial crisis. Evidently, as the crisis aggravated, the perception of obstacles to production development underwent rapid changes, and so towards the end of 2008 it, most probably, already became markedly different from that demonstrated by the poll's results. Nevertheless, the analysis of the "pre-crisis" answers of enterprises is still of significant interest, since it reflects the ways the obstacles to growth industry were viewed at the end of the period of relatively successful economic development of 2000 – 2008, and also in a certain sense determines the structure of obstacles as it emerged in the framework of a certain specific development model (characterized by high prices of raw materials, relatively easy access to external financing, and the State's increasing participation in economic life).

The distribution of enterprises' answers by each factor included in the poll is shown in *Fig. 1* and in *Table 1*. *Fig. 2* presents the balance (as %) of the answers relative to each factor, i.e. the difference between the number of enterprises pointing to a given factor as a significant obstacle to the development of their production and the number of those not regarding that factor as an obstacle.

On the whole, the economic environment in September 2008 can be described as moderately satisfactory. Among the 16 factors included in the poll, five were named as significant obstacles to production development by more than half of the enterprises participating in the poll. Another seven factors represent either significant or insignificant obstacles more than half of the enterprises across the sample. Only one factor out of 16 (prevailing labor legislation) is described as no obstacle to development by more than half of the sample. At the same time, the significance of the three different groups of factors is by no means similar: according to the respondents, resource-linked and macroeconomic restrictions were producing much stronger influence on the development of enterprises than administrative (institutional) restrictions did. This latter finding is rather unexpected. Traditionally, it has been believed that it is the institutional restrictions, linked to the State exercising its regulating and supervisory functions, that are the most restrictive to the development of the real sector of Russia's national economy²⁴.

Among the factors of the first group, which are associated with resource-linked restrictions, the majority represented significant obstacles to the development of enterprises. The strongest concern of the directors of enterprises was the shortage of labor resources: 59.1 %²⁵ of the respondents named it as a significant obstacle to growth; 24.6 % - as an insignificant obstacle; and only 13.4 % of the respondents regarded it as no problem at all. Next in importance²⁶ among the restrictions to growth, according to most of the enterprises, were problems with power supply and the cost of energy resources – in 55.0 % and 28.1 % respectively of all answers this factor was described as a significant or insignificant obstacle, and only 14.3 % of the enterprises has no problems with power supply. The quality and cost of transport services, the cost of attracted financial resources and difficult access to these resources were also restricting production development at a majority of the enterprises being surveyed, although with regard to these three factors the difference between the answers “significant obstacle” and “no obstacle” is smaller than in case of the first two factors. It is also noteworthy that a considerable portion of the respondents could not assess the effect on their production of the cost of attracted financial resources and difficult access to them (14.1 % and 12.1 % respectively). The only factor in the group of resource-linked restrictions that presented no obstacle for the development of a majority of the enterprises in September 2008 was the quality and cost of communications services.

In contrast to the first group, administrative restrictions are not regarded by the majority of the enterprises surveyed as a serious obstacle. The most important factors in this group were the size of the tax burden and the supervision and audits conducted by tax agencies. The shares of enterprises estimating the first of these factors as an obstacle - either a significant or an insignificant one - are 66.6 % and 24.0 % respectively, and only 5.1 % respondents did not see any problems in their taxation level. Tax audits were regarded as a source of serious worries by a somewhat smaller number of enterprises – 28.1%; nevertheless, the fact that the estimation “insignificant obstacles” constituted nearly half (47.9%) of all the answers to that question demonstrates that this factor was also restricting development to a significant degree. It is necessary to note that the much higher significance for enterprises of the obstacles associated with the actual level of tax burden, as compared to the problems of tax administration, was one of the unexpected findings resulting from that poll. This finding differs from the results of earlier polls among Russian enterprises and therefore, no doubt, requires further monitoring.

²⁴ V. V. Dashkeev, L. M. Freinkman. *Rossia v 2007 godu: riski zamedleniia ekonomicheskogo rosta na fone sokhraniiaushcheisii institutsional'noi stagnatsii*. [Russia in 2007: risks of slowdown in economic growth against the background of persistent institutional stagnation.] *Voprosy ekonomiki* [Issues of Economics] , 2008: 4: 75 – 93.

²⁵ The statistical significance of the shares of respondents that gave certain specific answers to the questions concerning different factors is sufficiently high in all the cases, if not stated otherwise in the text. We applied the standard test for the difference between two population proportions.

²⁶ It should be noted that the statistical significance of the differences between the shares of enterprises that gave the answers “significant obstacle” and “no obstacle” in regard to various pairs of factors is also sufficiently high in the majority of cases.

We think it rather unlikely that any dramatic improvements could have occurred lately in the quality of tax administration in the Russian economy.

The other administrative restrictions were not regarded by the majority of respondents as serious obstacles to the development of their enterprises. The most favorable, from this point of view, were the administrative procedures reflecting the situation with labor legislation and the procedures registration and liquidation of enterprises. A total of 6.4 % and 7.2 % of enterprises respectively encountered serious problems caused by the effect of these factors; on the contrary, 57.1 % and 46.1 % of the respondents experienced no difficulties in these spheres. At the same time, it is important that an unexpectedly high percentage of directors of enterprises failed to offer any estimates of the influence on production of many administrative factors, such as the necessity to make informal deductions for the benefit of government officials (33.2 % of answers), actions undertaken by other enterprises in order to eliminate competition (30.1 %), the procedures of registration and liquidation of enterprises (25.7 %), the obtaining of construction permits (24.2 %), and the activity of law enforcement (16.5 %) and judicial agencies (15.8 %).

In the group of macroeconomic restrictions the topmost place, by its negative effect on the development of enterprises, is inflation: 73.4 % of the respondents pointed to rapid growth of domestic prices as being a significant obstacle, and only 2.2 % did not consider inflation to be a restricting factor. Next came the factor of “unpredictability of the government economic policy” (53.2 % и 5.0 % respectively), followed by competition with cheap imports (45.3 % and 21.7 %). In this group only the ruble’s exchange rate was named by the majority of respondents either as an insignificant obstacle to their development (32.8 % of the answers) or as no obstacle at all (27.3 %).

Also of interest are the differences between the answers offered by directors of enterprises depending on how they estimated their prospects for increasing output (*Table 2*). Significant²⁷ differences are noted in the estimations of the effects of many of the factors in all the three groups of restrictions (resource-linked, administrative and macroeconomic). On the whole, the optimistically-minded directors (i.e. those expecting an increase in their production) gave more positive estimations of their economic environment and noted less restricting factors with regard to their production development than those pessimistic counterparts (i.e. those expecting a fall in output). The difference in the corresponding balances of answers was between 8 and 20 p. p.

Thus, among the optimistic directors the balance of answers with regard to the factor “quality and cost of transport services” was 4.9 %, whereas among the pessimistic ones – 18.1 %. The optimistic directors also have noticeably less complaints concerning problems with obtaining construction permits (the balance answers: – 9.9 % against – 1.7 %), with the actions undertaken by other enterprises in order to eliminate competition (– 11.1 % against + 8.6 %), and with the unpredictability of the government’s economic policy (43.2 % against 59.5 %). Probably, these differences can be explained by the fact that pessimistically-minded directors are inclined to blame external factors for the intrinsic problem of their enterprises.

At the same time, the directors of enterprises expecting an increase in their output were confronted by a more acute shortage of labor resources: the balance of their answers with regard to that factor is 50.0 %, while the corresponding index of the pessimistically-minded ones is only 36.2 %.

Similar differences were also noted in the answer received from enterprises with different forms of ownership, of different size and belonging to different sectors (*Tables 3, 4 and 5* respectively). Thus, state-owned companies complain less often than private companies of the problems associated with power supply, transport and personnel, as well as with relations with tax, judicial and law enforcement agencies. Bigger enterprises, on the whole, complain less often than smaller ones (with total number of staff less than 100 persons) of their economic environment. In particular, small-sized enterprises feel as more problematic the issues of credit accessibility, as well as of obtaining licenses and construction permits. Besides, small-sized enterprises believe more often than big ones that the development of their activity is suppressed by the unpredictability of government policy and competition with imported commodities. At the same time, small-sized enterprises voice far less complaints relating to the level of tax burden which, quite evidently, can be explained by their opportunities for applying simplified taxation regimes.

²⁷ At significance level of 5 %.

There are also some differences with regard to several factors between enterprises belonging to extracting and processing industries. However, in all these cases any interpretation of the obtained results must be done with caution, because the groups of enterprises differ vary considerably in number (the poll encompassed 32 state-owned and 513 private companies, 29 small-sized and 515 big enterprises, 19 enterprises in the extracting and 523 in the processing industries).

Of separate interest in the comparison of the results of the IET's poll with those of similar surveys conducted by the World Bank in 2002 and 2005²⁸ (*Table 6*). This comparison points to significant improvement of the economic conditions in industry: as compared to the years 2002 and 2005, in 2008 a number of factors were producing a far less marked negative influence on the development of Russian enterprises. These factors are: the quality and cost of communications services; difficult access to financial resources and the cost of their attraction; the functioning of tax, judicial and customs agencies; the actions undertaken by other enterprises in order to eliminate competition; too complicated licensing procedures; bribe-extolling by officials; and unpredictability of government economic policy.

On the contrary, if we take some resource-linked factor, there was a dramatic deterioration of the existing situation – in terms of the quality and cost of transport services, availability of labor resources and power supply. By comparison with 2005, the share of enterprises noting a growing number of obstacles represented by these factors increased by 19.1, 21.7 and 43.5 p. p. respectively.

Of special interest is the fact that the IET's poll has revealed a significantly lower level of dissatisfaction on the part of enterprises by the existing administrative restrictions than that demonstrated by BEEPS' results. For example, the share of enterprises viewing as a serious obstacle in the way of their development the factor represented by the supervision and audits conducted by tax agencies decreased by 31.5 p.p. by comparison with 2005; the factor of bribes to officials - by 28.5 p.p.; the factor of the activity of judicial agencies – by 16.8 p.p., the factor of the actions undertaken by other enterprises in order to eliminate competition – by 15.5 p.p., and the factor of the activity of customs agencies – by 12.7 p.p. This is a rather unexpected finding, for which we can offer several mutually supplementing explanations.

Firstly, it should be recognized that in the past 4 or 5 years there have occurred some evident improvements in the quality of economic environment. This, in particular, was demonstrated by the results of monitoring of the administrative barriers in the way of the development of small businesses conducted by the Center for Economic and Financial Research (CEFIR)²⁹. Some of these improvements were directly linked to the adoption, in 2002 – 2003, of federal laws on registration, licensing, inspections and simplified taxation. The slight improvements that took place after 2003 were explained by the CEFIR's researchers with better enforcement of these laws, with the resulting gradual reduction in direct violations of prevailing legislation – such as, for example, unlawful demands that enterprises should license their activity. Below we present more detailed comparisons between our results and those obtained by the CEFIR.

However, the improvements that actually occurred in economic environment are obviously insufficient. This is testified to by the following facts:

- The scale of improvements in Russia falls behind that characterizing the business climate of the majority of East European countries, which is confirmed by studies across countries. In the prestigious international rankings on the ease of doing business published by the World Bank, Russia ranks low, and does not seem to be able to change it in any marked degree (106th out of 178 countries in 2007)³⁰,
- Improving economic conditions had different effects on different groups of enterprises. The greatest benefit from the improvements was gained by bigger and well-established enterprises, which have for many years been operating on their relevant markets and learned how to effectively deal with the administrative problems they are now and then have been confronted with.

²⁸ World Bank Business Environment and Enterprise Performance Survey – BEEPS. Additional information concerning BEEPS can be found, e. g., in: Raj M. Desai and Itzhak Goldberg, Eds. 2007. *Enhancing Russia's Competitiveness and Innovative Capacity*. The World Bank. Washington, DC.

²⁹ Monitoring administrativnykh bar'erov na puti razvitiia malogo biznesa v Rossii. [Monitoring of the administrative barriers in the way of small-sized business development in Russia.] Round 6. CEFIR. June 2007.

³⁰ Doing Business 2008. World Bank. 2007

The economic conditions for the functioning of small-sized enterprises, as follows from the poll's results, are noticeably less favorable. Besides, we assume that the terms for the entry on the market of new players are very hard, just as before. That is why we see so few newly emerging enterprises and such a low level of competition. However, this latter assumption cannot be verified on the basis of only the data obtained through our polls, because those failing to get through the "entry" barriers do not participate in them.

- In 2007 – 2008 Russian industrial enterprises were confronted with relatively new resource-linked restrictions to their growth (first of all, shortages of labor and energy resources). Against this background it appears rather natural that the estimations of traditional administrative restrictions became less prominent. The changes in the level of administrative obstacles to development might have actually been rather moderate, but in face of the new problems their significance for the enterprises noticeably diminished. It seems that the results of the IET's poll have demonstrated only a relative, and not absolute (as compared to the effects produced by other factors) decrease in administrative barriers.

Secondly, the differences between the results obtained by the IET and BEEPS are linked also to the differences in the properties of relevant samples. The BEEPS' poll encompasses a greater number of small-sized enterprises (only 34 % of them having their staff in excess of 50 persons), while the IET's sample displays a strong shift towards big enterprises (94 % of enterprises with staff of more than 100 persons). Besides, all the 545 enterprises in the IET's panel are industrial ones, whereas in the BEEPS' 2005 poll only 40 % were in industry. Therefore, the much lower level of complaints concerning administrative restrictions revealed by the IET can largely be explained by the fact that among the respondents there are too few small-sized enterprises, such restrictions being much more important for the latter category. This means that the scale of the actual reduction in administrative barriers in the Russian economy in the period of 2005 – 2008 was, most probably, markedly lower than that displayed in *Table 6*. In other words, the results of the IET's poll, because of the sample's structure, underestimate the problems relating to the still existing administrative restrictions.

Thirdly, as has been mentioned earlier, the unexpectedly high share of respondents in the IET's poll failed ("found it difficult") to answer the questions concerning the influence of administrative factors on the development of their enterprises. This has led us to the assumption that administrative restrictions actually represent a more serious problem in industry than it can be concluded on the basis of the poll's results, but in the present situation the directors of enterprises are by far not so ready to openly discuss it than they did back in 2002 or 2005. This, in our opinion, also attests to the fact that the poll's results indeed underestimate the scope of problems associated with administrative restrictions.

Of some interest also is the comparison between the results of the IET's poll and those of the CEFIR's monitoring. It is worth emphasizing that, with regard to a number of factors, there exist considerable discrepancies in the estimates as to the direction of the changes observed: the CEFIR's monitoring recorded an improvement in the situation over time (between 2004 and 2006), while the IET's poll (2008) points to an improvement by comparison with the BEEPS' results (2005). These factors are as follows:

- taxation level (the average estimate of negative effect in the CEFIR's monitoring decreased from 2.78 to 2.65 by five-point scale),
- lack of economic stability (from 2.89 to 2.54),
- tax administration (from 2.59 to 2.34),
- difficulties in attracting capital (from 2.42 to 2.25),
- formalization of lease of land (from 2.68 to 2.52),
- licensing (from 2.22 to 2.13).

Besides, the presence of considerable differences should also be noted in the results of polls conducted by the IET and the CEFIR. In *Fig. 3* the different factors applied in these two polls are ranked in accordance with the strength of their negative effect on the development of enterprises (in terms of per cent, 100% represents the most unfavorable factor). The important quality-linked similarities of the results of the two polls are as follows:

- Tax issues are considerably more significant for the development of enterprises than the problems associated with corruption or licensing. The last two factors are not perceived by enterprises as significant restrictions to their development.
- The level of tax burden is perceived as more negative than the quality of tax administration.

- The factor of uncertainty (unpredictability of economic policy) appears to be very significant in both the polls.

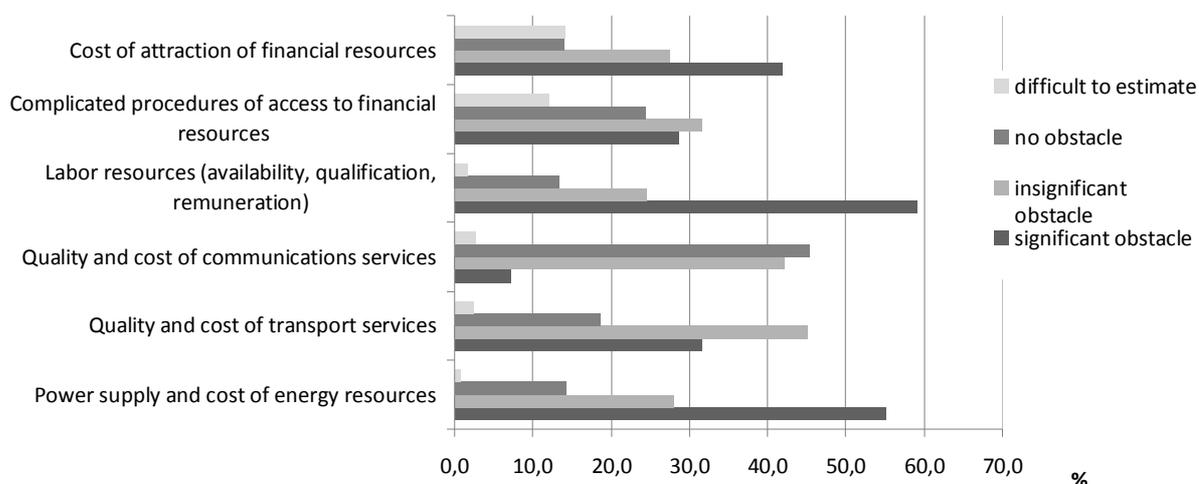
At the same time, the estimations of the other three factors are fundamentally different. The complicated procedure of land acquisition and the character of competition with other enterprises appear to be very important for the participants of the CEFIR's poll, but are not regarded as significant restrictions to growth in the IET's poll. A directly opposite picture emerges in respect of the factor "terms for the attraction of financial resources".

Just as in the case of the BEEPS' poll, certain departures from the results obtained by the CEFIR can be explained by differences between the samples studied. As mentioned earlier, in the IET's poll all respondents are industrial enterprises, and predominantly big ones. As for the CEFIR's poll, it encompasses only small-sized enterprises, mainly in the services sector (those producing industrial goods constitute only 9.9 % of the sample).

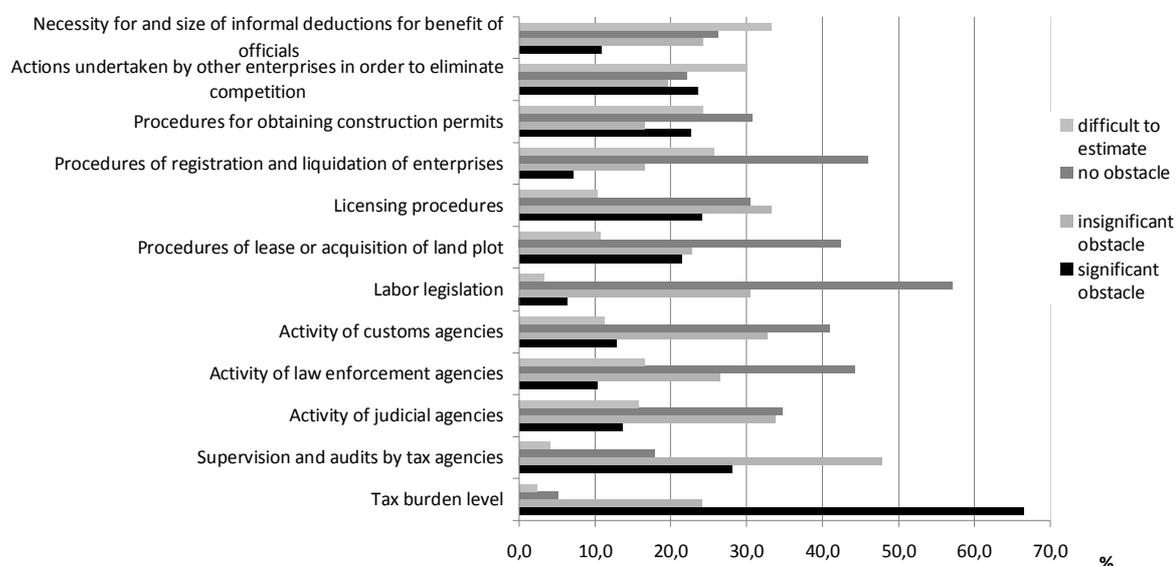
Principal conclusions

- The results of the IET's poll recorded the estimates offered by enterprises in regard of the existing restrictions to their development as of the moment of onset of financial crisis. Thus, these results represent a useful baseline for monitoring further development of the situation involving the barriers in the way of growth during the impending period of crisis.
- On the whole, the economic environment can be characterized as moderately satisfactory. Resource-linked (labor, energy) and macroeconomic (inflation, lack of policy stability) factor are perceived by enterprises as key restrictions to growth. Most of the administrative barriers (including corruption) are not regarded by enterprises as serious obstacles to their development.
- There are grounds to believe that, by comparison with the earlier half of this decade, the administrative obstacles to the development of enterprises have become weaker. At least, operating enterprise shaver learned how to effectively deal with them. However, this improvement does not apply equally to all the groups of enterprises. Small-sized enterprises have a higher level of complaints concerning their economic environment. Besides, the poll's results have provided no grounds for a statement that there are presently less barriers in the way of new enterprises' entry into business.

Resource-linked restrictions



Administrative restrictions



Macroeconomic restrictions

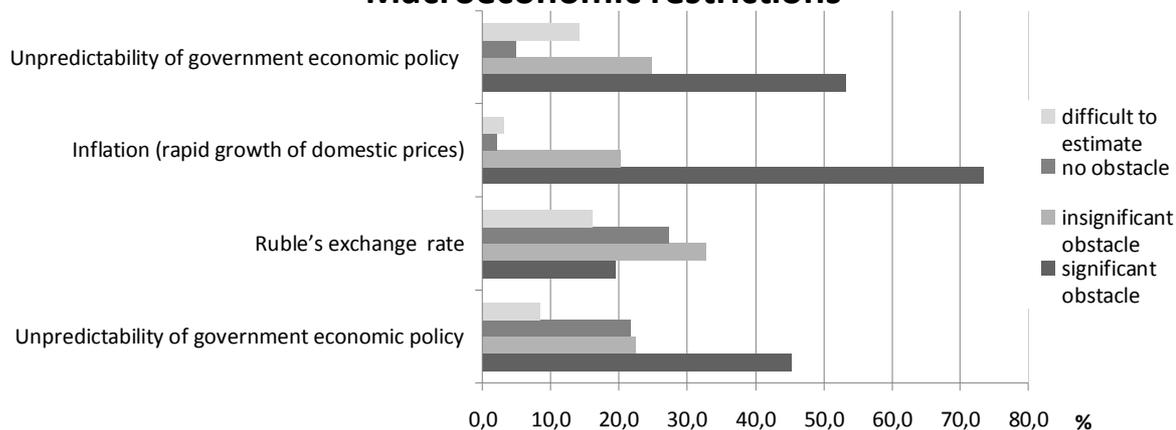


Fig. 1. Restrictions to production development, as % of the number of enterprises participating in the poll

Table 1

Results of the poll concerning restrictions to production development

| How serious, at present, as obstacles for development of enterprise are: | | Distribution of answers across groups, as % of sample: | | | | % of enterprises that have answered this questions |
|--|---|--|------------------------|-------------|-----------------------|--|
| | | significant obstacle | insignificant obstacle | no obstacle | difficult to estimate | |
| Resource-linked restrictions | Power supply and cost of energy resources | 55.0 | 28.1 | 14.3 | 0.7 | 98.2 |
| | Quality and cost of transport services | 31.6 | 45.1 | 18.5 | 2.4 | 97.6 |
| | Quality and cost of communications services | 7.2 | 42.2 | 45.3 | 2.8 | 97.4 |
| | Labor resources (availability, qualification, remuneration) | 59.1 | 24.6 | 13.4 | 1.8 | 98.9 |
| | Complicated procedures of access to financial resources | 28.6 | 31.7 | 24.4 | 12.1 | 96.9 |
| | Cost of attraction of financial resources | 41.8 | 27.5 | 13.9 | 14.1 | 97.4 |
| Administrative restrictions | Tax burden level | 66.6 | 24.0 | 5.1 | 2.4 | 98.2 |
| | Supervision and audits by tax agencies | 28.1 | 47.9 | 17.8 | 4.0 | 97.8 |
| | Activity of judicial agencies | 13.6 | 33.8 | 34.7 | 15.8 | 97.8 |
| | Activity of law enforcement agencies | 10.3 | 26.4 | 44.2 | 16.5 | 97.4 |
| | Activity of customs agencies | 12.8 | 32.7 | 40.9 | 11.2 | 97.6 |
| | Labor legislation | 6.4 | 30.5 | 57.1 | 3.3 | 97.2 |
| | Procedures of lease or acquisition of land plot | 21.5 | 22.8 | 42.4 | 10.6 | 97.2 |
| | Licensing procedures | 24.0 | 33.2 | 30.5 | 10.3 | 98.0 |
| | Procedures of registration and liquidation of enterprises | 7.2 | 16.5 | 46.1 | 25.7 | 95.4 |
| | Procedures for obtaining construction permits | 22.6 | 16.5 | 30.6 | 24.2 | 93.9 |
| | Actions undertaken by other enterprises in order to eliminate competition | 23.5 | 19.6 | 22.2 | 30.1 | 95.4 |
| | Necessity for and size of informal deductions for benefit of officials | 10.8 | 24.2 | 26.2 | 33.2 | 94.5 |
| Macroeconomic restrictions | Competition with cheap imports | 45.3 | 22.4 | 21.7 | 8.4 | 97.8 |
| | Ruble's exchange rate | 19.4 | 32.8 | 27.3 | 16.1 | 95.8 |
| | Inflation (rapid growth of domestic prices) | 73.4 | 20.2 | 2.2 | 3.1 | 98.9 |
| | Unpredictability of government economic policy | 53.2 | 25.0 | 5.0 | 14.1 | 97.2 |

Table 2
Distribution of answers depending on prospects of increasing output³¹

| How serious, at present, as obstacles for development of enterprise, are: | | Significant obstacle, as % of sample | | No obstacle, as % of sample | | Balance of answers, as % of sample | | Significance of differences | |
|---|---|--------------------------------------|-------------------------|-----------------------------|-------------------------|------------------------------------|-------------------------|-----------------------------|---------|
| | | expect increase in output | expect declining output | expect increase in output | expect declining output | expect increase in output | expect declining output | z-statistics | p-value |
| Resource-linked restrictions | Power supply and cost of energy resources | 52.47 | 53.45 | 12.96 | 16.38 | 39.51 | 37.07 | 0.41 | 0.6808 |
| | Quality and cost of transport services ³² | 27.16 | 37.07 | 22.22 | 18.97 | 4.94 | 18.10 | -3.54 | 0.0005 |
| | Quality and cost of communications services | 8.02 | 10.34 | 49.38 | 45.69 | -41.36 | -35.34 | 1.01 | 0.3113 |
| | Labor resources (availability, qualification, remuneration) | 61.73 | 51.72 | 11.73 | 15.52 | 50.00 | 36.21 | 2.28 | 0.0232 |
| | Complicated procedures of access to financial resources | 28.40 | 33.62 | 21.60 | 24.14 | 6.79 | 9.48 | -0.82 | 0.4129 |
| | Cost of attraction of financial resources | 40.74 | 43.97 | 11.11 | 12.93 | 29.63 | 31.03 | 0.25 | 0.8016 |
| Administrative restrictions | Tax burden level | 63.58 | 68.97 | 3.70 | 7.76 | 59.88 | 61.21 | -0.22 | 0.8232 |
| | Supervision and audits by tax agencies | 24.69 | 30.17 | 14.20 | 18.10 | 10.49 | 12.07 | -0.41 | 0.6811 |
| | Activity of judicial agencies | 11.73 | 12.93 | 32.72 | 39.66 | -20.99 | -26.72 | 1.11 | 0.2661 |
| | Activity of law enforcement agencies | 7.41 | 8.62 | 45.68 | 45.69 | -38.27 | -37.07 | 0.20 | 0.8385 |
| | Activity of customs agencies | 8.64 | 12.93 | 40.12 | 47.41 | -31.48 | -34.48 | 0.53 | 0.5994 |
| | Labor legislation | 8.02 | 6.03 | 53.09 | 60.34 | -45.06 | -54.31 | 1.52 | 0.1294 |
| | Procedures of lease or acquisition of land plot | 19.14 | 25.00 | 41.36 | 42.24 | -22.22 | -17.24 | 1.02 | 0.3081 |
| | Licensing procedures | 24.07 | 19.83 | 35.19 | 33.62 | -11.11 | -13.79 | 0.67 | 0.5015 |
| | Procedures of registration and liquidation of enterprises | 6.17 | 6.90 | 47.53 | 50.00 | -41.36 | -43.10 | 0.29 | 0.7715 |
| | Procedures for obtaining construction permits | 22.22 | 26.72 | 32.10 | 28.45 | -9.88 | -1.72 | 2.72 | 0.0069 |
| | Actions undertaken by other enterprises in order to eliminate competition | 17.28 | 25.00 | 28.40 | 16.38 | -11.11 | -8.62 | 5.39 | 0.0000 |
| | Necessity for and size of informal deductions for benefit of officials | 9.88 | 10.34 | 29.01 | 31.03 | -19.14 | -20.69 | 0.32 | 0.7487 |
| Macroeconomic restrictions | Competition with cheap imports | 40.12 | 47.41 | 24.07 | 25.86 | 16.05 | 21.55 | -1.17 | 0.2435 |
| | Ruble's exchange rate | 18.52 | 22.41 | 25.93 | 32.76 | -7.41 | -10.34 | 0.86 | 0.3906 |
| | Inflation (rapid growth of domestic prices) | 74.07 | 73.28 | 3.70 | 0.86 | 70.37 | 72.41 | -0.37 | 0.7108 |
| | Unpredictability of government economic policy | 49.38 | 62.93 | 6.17 | 3.45 | 43.21 | 59.48 | -2.68 | 0.0079 |

³¹ Answers were received from 162 enterprises expecting increase in their output and from 116 enterprises expecting drop in their output.

³² Hereinafter the rows are marked where differences are significant for two groups of enterprises.

Table 3

Distribution of answers depending on enterprise's form of ownership³³

| How serious, at present, as obstacles for development of enterprise are: | | Significant obstacle, as % of sample | | No obstacle, as % of sample | | Balance of answers, as % of sample | | Significance of differences | |
|--|---|--------------------------------------|-------------------|-----------------------------|-------------------|------------------------------------|-------------------|-----------------------------|---------|
| | | State-owned companies | Private companies | State-owned companies | Private companies | State-owned companies | Private companies | z-statistics | p-value |
| Resource-linked restrictions | Power supply and cost of energy resources | 34.38 | 56.34 | 18.75 | 14.04 | 15.63 | 42.30 | -2.98 | 0.0030 |
| | Quality and cost of transport services | 25.00 | 31.97 | 31.25 | 17.74 | 6.25 | 14.23 | 3.26 | 0.0012 |
| | Quality and cost of communications services | 6.25 | 7.21 | 40.63 | 45.61 | 34.38 | 38.40 | 0.45 | 0.6494 |
| | Labor resources (availability, qualification, remuneration) | 46.88 | 59.84 | 18.75 | 12.87 | 28.13 | 46.98 | -2.08 | 0.0383 |
| | Complicated procedures of access to financial resources | 34.38 | 28.27 | 25.00 | 24.37 | 9.38 | 3.90 | 1.49 | 0.1355 |
| | Cost of attraction of financial resources | 37.50 | 42.11 | 15.63 | 13.84 | 21.88 | 28.27 | 0.78 | 0.4345 |
| Administrative restrictions | Tax burden level | 65.63 | 66.67 | 6.25 | 5.07 | 59.38 | 61.60 | -0.25 | 0.8021 |
| | Supervision and audits by tax agencies | 18.75 | 28.65 | 21.88 | 17.54 | 3.13 | 11.11 | 2.53 | 0.0116 |
| | Activity of judicial agencies | 12.50 | 13.65 | 50.00 | 33.72 | 37.50 | 20.08 | 2.34 | 0.0195 |
| | Activity of law enforcement agencies | 6.25 | 10.53 | 59.38 | 43.27 | 53.13 | 32.75 | 2.36 | 0.0185 |
| | Activity of customs agencies | 0.00 | 13.65 | 59.38 | 39.77 | 59.38 | 26.12 | 4.06 | 0.0001 |
| | Labor legislation | 0.00 | 6.82 | 75.00 | 55.75 | 75.00 | 48.93 | 2.86 | 0.0044 |
| | Procedures of lease or acquisition of land plot | 12.50 | 22.03 | 56.25 | 41.33 | 43.75 | 19.30 | 3.31 | 0.0010 |
| | Licensing procedures | 21.88 | 24.17 | 40.63 | 29.63 | 18.75 | 5.46 | 3.02 | 0.0027 |
| | Procedures of registration and liquidation of enterprises | 9.38 | 7.02 | 37.50 | 46.59 | 28.13 | 39.57 | 1.29 | 0.0981 |
| | Procedures for obtaining construction permits | 15.63 | 23.00 | 43.75 | 29.82 | 28.13 | 6.82 | 4.29 | 0.0000 |
| | Actions undertaken by other enterprises in order to eliminate competition | 25.00 | 23.39 | 25.00 | 22.03 | 0.00 | 1.36 | -0.67 | 0.5063 |
| | Necessity for and size of informal deductions for benefit of officials | 3.13 | 11.31 | 21.88 | 26.51 | 18.75 | 15.20 | 0.54 | 0.5902 |
| Macroeconomic restrictions | Competition with cheap imports | 46.88 | 45.03 | 34.38 | 20.86 | 12.50 | 24.17 | 1.51 | 0.1313 |
| | Ruble's exchange rate | 18.75 | 19.49 | 25.00 | 27.49 | 6.25 | 7.99 | 0.35 | 0.7230 |
| | Inflation (rapid growth of domestic prices) | 65.63 | 73.88 | 3.13 | 2.14 | 62.50 | 71.73 | 1.12 | 0.2636 |
| | Unpredictability of government economic policy | 34.38 | 54.19 | 9.38 | 4.68 | 25.00 | 49.51 | -2.69 | 0.0073 |

³³ Answers were received from 32 state-owned and 513 private companies.

Table 4³⁴

Distribution of answers depending on enterprise's size

| How serious, at present, as obstacles for development of enterprise, are: | | Significant obstacle, as % of sample | | No obstacle, as % of sample | | Balance of answers, as % of sample | | Significance of differences | |
|---|---|--------------------------------------|-----------------------|-----------------------------|-----------------------|------------------------------------|-----------------------|-----------------------------|---------|
| | | personnel number <100 | personnel number >100 | personnel number <100 | personnel number >100 | personnel number <100 | personnel number >100 | z-statistics | p-value |
| Resource-linked restrictions | Power supply and cost of energy resources | 65.52 | 54.56 | 10.34 | 14.56 | 55.17 | 40.00 | 1.62 | 0.1063 |
| | Quality and cost of transport services | 31.03 | 31.65 | 13.79 | 18.83 | 17.24 | 12.82 | 0.69 | 0.4915 |
| | Quality and cost of communications services | 10.34 | 6.99 | 37.93 | 45.83 | 27.59 | 38.83 | 1.21 | 0.2257 |
| | Labor resources (availability, qualification, remuneration) | 48.28 | 59.81 | 17.24 | 13.01 | 31.03 | 46.80 | -1.66 | 0.0981 |
| | Complicated procedures of access to financial resources | 37.93 | 28.16 | 24.14 | 24.47 | 13.79 | 3.69 | 2.63 | 0.0088 |
| | Cost of attraction of financial resources | 37.93 | 42.14 | 13.79 | 13.98 | 24.14 | 28.16 | -0.47 | 0.6392 |
| Administrative restrictions | Tax burden level | 41.38 | 68.16 | 3.45 | 5.24 | 37.93 | 62.91 | -2.69 | 0.0073 |
| | Supervision and audits by tax agencies | 24.14 | 28.35 | 24.14 | 17.48 | 0.00 | 10.87 | -1.87 | 0.0613 |
| | Activity of judicial agencies | 17.24 | 13.40 | 34.48 | 34.76 | 17.24 | 21.36 | 0.53 | 0.5974 |
| | Activity of law enforcement agencies | 13.79 | 10.10 | 37.93 | 44.66 | 24.14 | 34.56 | 1.15 | 0.2494 |
| | Activity of customs agencies | 10.34 | 13.01 | 44.83 | 40.78 | 34.48 | 27.77 | 0.78 | 0.4342 |
| | Labor legislation | 10.34 | 6.21 | 65.52 | 56.50 | 55.17 | 50.29 | 0.51 | 0.6092 |
| | Procedures of lease or acquisition of land plot | 20.69 | 21.55 | 37.93 | 42.52 | 17.24 | 20.97 | 0.48 | 0.6302 |
| | Licensing procedures | 37.93 | 23.30 | 24.14 | 30.68 | 13.79 | 7.38 | 4.16 | 0.0000 |
| | Procedures of registration and liquidation of enterprises | 10.34 | 6.99 | 44.83 | 46.21 | 34.48 | 39.22 | -0.51 | 0.6107 |
| | Procedures for obtaining construction permits | 27.59 | 22.33 | 24.14 | 31.07 | 3.45 | 8.74 | 2.29 | 0.0221 |
| | Actions undertaken by other enterprises in order to eliminate competition | 20.69 | 23.69 | 17.24 | 22.52 | 3.45 | 1.17 | 1.06 | 0.2889 |
| | Necessity for and size of informal deductions for benefit of officials | 6.90 | 11.07 | 10.34 | 27.18 | 3.45 | 16.12 | 1.84 | 0.0668 |
| Macroeconomic restrictions | Competition with cheap imports | 65.52 | 44.08 | 3.45 | 22.72 | 62.07 | 21.36 | 5.03 | 0.0000 |
| | Ruble's exchange rate | 10.34 | 20.00 | 13.79 | 28.16 | 3.45 | 8.16 | 0.91 | 0.3611 |
| | Inflation (rapid growth of domestic prices) | 72.41 | 73.59 | 0.00 | 2.33 | 72.41 | 71.26 | 0.13 | 0.8939 |
| | Unpredictability of government economic policy | 72.41 | 52.04 | 0.00 | 5.24 | 72.41 | 46.80 | 2.69 | 0.0074 |

³⁴ Answers were received from 29 enterprises with personnel of no more than 100 persons and from 515 enterprises with personnel of more than 100 persons.

Distribution of answers depending of enterprises' types of activity

| How serious, at present, as obstacles for development of enterprise, are: | | Significant obstacle, as % of sample | | No obstacle, as % of sample | | Balance of answers, as % of sample | | Significance of differences | |
|---|---|--------------------------------------|---------------------|-----------------------------|---------------------|------------------------------------|---------------------|-----------------------------|---------|
| | | extracting industry | processing industry | extracting industry | processing industry | extracting industry | processing industry | z-statistics | p-value |
| Resource-linked restrictions | Power supply and cost of energy resources | 52.63 | 55.45 | 15.79 | 14.34 | 36.84 | 41.11 | -0.37 | 0.7104 |
| | Quality and cost of transport services | 57.89 | 30.78 | 10.53 | 18.74 | 47.37 | 12.05 | 4.46 | 0.0000 |
| | Quality and cost of communications services | 21.05 | 6.50 | 26.32 | 46.27 | -5.26 | -39.77 | 3.04 | 0.0025 |
| | Labor resources (availability, qualification, remuneration) | 31.58 | 60.23 | 31.58 | 12.43 | 0.00 | 47.80 | -4.11 | 0.0000 |
| | Complicated procedures of access to financial resources | 26.32 | 28.68 | 31.58 | 24.09 | -5.26 | 4.59 | -2.01 | 0.0448 |
| | Cost of attraction of financial resources | 31.58 | 42.26 | 21.05 | 13.77 | 10.53 | 28.49 | -1.72 | 0.0868 |
| Administrative restrictions | Tax burden level | 73.68 | 66.73 | 5.26 | 4.97 | 68.42 | 61.76 | 0.59 | 0.5570 |
| | Supervision and audits by tax agencies | 26.32 | 28.11 | 21.05 | 17.59 | 5.26 | 10.52 | -0.74 | 0.4602 |
| | Activity of judicial agencies | 31.58 | 13.00 | 21.05 | 35.18 | 10.53 | 22.18 | 3.39 | 0.0007 |
| | Activity of law enforcement agencies | 21.05 | 9.94 | 21.05 | 44.93 | 0.00 | -34.99 | 3.17 | 0.0016 |
| | Activity of customs agencies | 10.53 | 13.00 | 36.84 | 40.92 | -26.32 | -27.92 | 0.15 | 0.8786 |
| | Labor legislation | 15.79 | 6.12 | 47.37 | 57.36 | -31.58 | -51.24 | 1.68 | 0.0927 |
| | Procedures of lease or acquisition of land plot | 47.37 | 20.65 | 36.84 | 42.64 | 10.53 | -21.99 | 3.38 | 0.0008 |
| | Licensing procedures | 31.58 | 23.71 | 15.79 | 30.98 | 15.79 | -7.27 | 3.73 | 0.0002 |
| | Procedures of registration and liquidation of enterprises | 10.53 | 7.07 | 42.11 | 46.27 | -31.58 | -39.20 | 0.67 | 0.5038 |
| | Procedures for obtaining construction permits | 15.79 | 22.94 | 21.05 | 30.78 | -5.26 | 7.84 | 1.1 | 0.4801 |
| | Actions undertaken by other enterprises in order to eliminate competition | 15.79 | 23.90 | 42.11 | 21.41 | -26.32 | 2.49 | -6.88 | 0.0000 |
| | Necessity for and size of informal deductions for benefit of officials | 10.53 | 10.71 | 10.53 | 26.77 | 0.00 | -16.06 | 1.90 | 0.0579 |
| | Macroeconomic restrictions | Competition with cheap imports | 21.05 | 46.27 | 31.58 | 21.03 | -10.53 | 25.24 | -3.55 |
| Ruble's exchange rate | | 21.05 | 19.50 | 21.05 | 27.53 | 0.00 | -8.03 | 1.29 | 0.1990 |
| Inflation (rapid growth of domestic prices) | | 63.16 | 74.19 | 0.00 | 2.29 | 63.16 | 71.89 | -0.83 | 0.4073 |
| Unpredictability of government economic policy | | 57.89 | 52.77 | 0.00 | 5.16 | 57.89 | 47.61 | 0.88 | 0.3784 |

³⁵ Answers were received from 19 enterprises in the extracting industry and 523 enterprises in the processing industry.

Table 6

Comparison of the results of polls conducted by the IET and BEEPS

| | | % of enterprises considering factor to be "significant obstacle" | | |
|------------------------------|---|--|------------|----------|
| | | BEEPS 2002 | BEEPS 2005 | IET 2008 |
| Resource-linked restrictions | Power supply and cost of energy resources | 10.22 | 11.51 | 55.05 |
| | Quality and cost of transport services | 12.00 | 12.46 | 31.56 |
| | Quality and cost of communications services | 12.45 | 8.13 | 7.16 |
| | Labor resources (availability, qualification, remuneration) | 32.24 | 37.37 | 59.08 |
| | Complicated procedures of access to financial resources | 44.83 | 35.94 | 28.62 |
| | Cost of attraction of financial resources | 43.39 | 45.42 | 41.83 |
| Economic environment | Tax burden level | 56.00 | 54.10 | 66.61 |
| | Supervision and audits by tax agencies | 61.57 | 59.59 | 28.07 |
| | Activity of judicial agencies | 26.62 | 30.41 | 13.58 |
| | Activity of law enforcement agencies | - | - | 10.28 |
| | Activity of customs agencies | 27.74 | 25.51 | 12.84 |
| | Labor legislation | 9.92 | 17.06 | 6.42 |
| | Procedures of lease or acquisition of land plot | 28.43 | 24.40 | 21.47 |
| | Licensing procedures | 31.85 | 34.04 | 24.04 |
| | Procedures of registration and liquidation of enterprises | - | - | 7.16 |
| | Procedures for obtaining construction permits | - | - | 22.57 |
| | Actions undertaken by other enterprises in order to eliminate competition | 36.83 | 39.02 | 23.49 |
| | Necessity for and size of informal deductions for benefit of officials | 29.12 | 39.34 | 10.83 |
| Macroeconomic factor | Competition with cheap imports | - | - | 45.32 |
| | Ruble's exchange rate | - | - | 19.45 |
| | Inflation (rapid growth of domestic prices) | - | - | 73.39 |
| | Unpredictability of government economic policy | 62.83 | 59.01 | 53.21 |

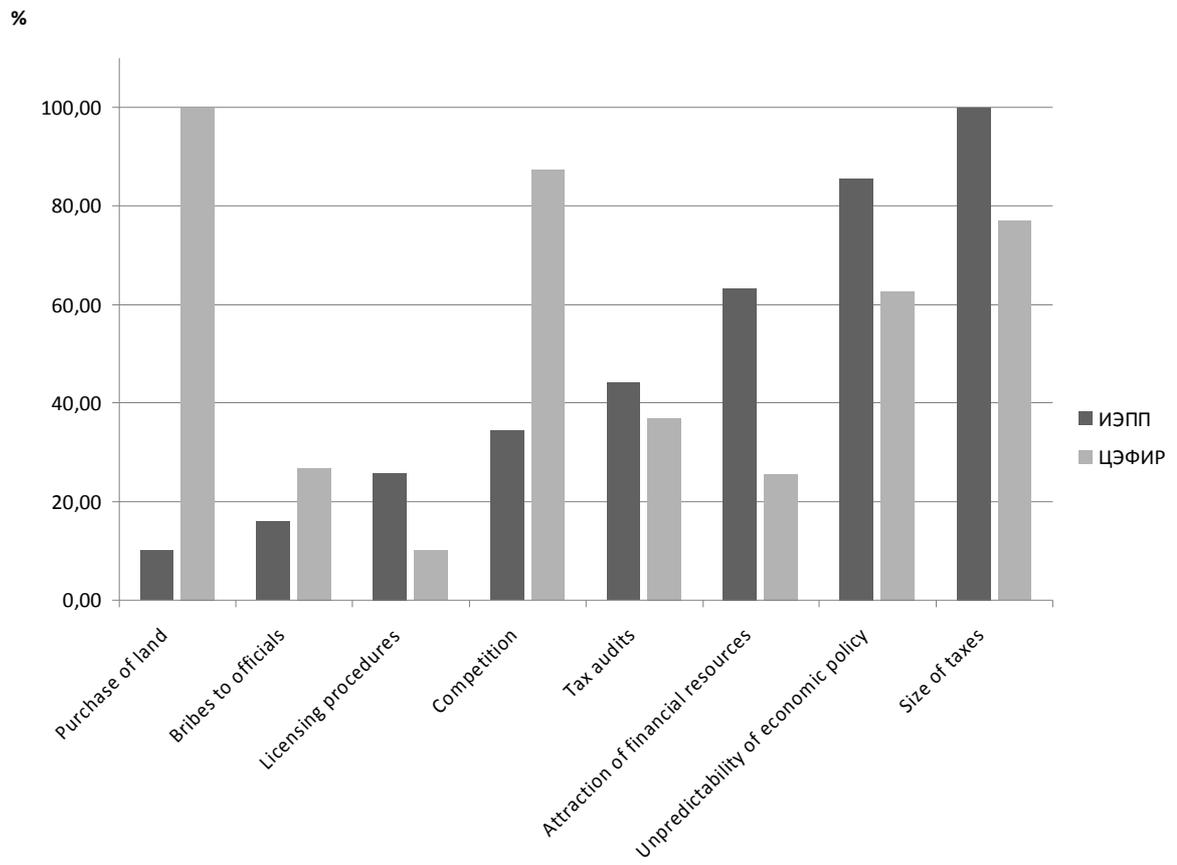


Fig. 3. Ranging of restrictions in the polls conducted by the IET and CEFIR³⁶

³⁶ 100 % represents the most unfavorable factor.