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RUSSIAN ECONOMIC DEVELOPMENTS

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RUSSIA'S ECONOMY IN JANUARY 2013: PRELIMINARY DATA AND MAJOR TRENDS

K.Rogov

Political Background: Political Conservatism Plus Economic Dirigisme?

The beginning of 2013 was marked by yet another outburst of opposition-led protest activity in Moscow, this time unexpectedly strong: according to different sources, between 20 and 50 thousand people took part in the March Against Scoundrels, which was aimed against the 'Anti-Magnitsky Law' adopted by the State Duma at the end of December 2012. Meanwhile, Parliament resumed business after the New Year recess, and once again began to churn out legally ambiguous, conservative and thoroughly repressive legislative acts.

Thus, the State Duma rushed the adoption, at first reading, of a draft law designed to make it possible for regional assemblies to abolish direct gubernatorial elections and to select the governor of a region from a list of candidates nominated by the RF President. The new procedure represents a revision of the political reform declared one year ago, which looks very dubious from the point of view of basic constitutional principles. It is clear that this legislative innovation exclusively serves some specific, pragmatic and tactical goals (such as, say, the possibility to keep in power an unpopular governor). At the same time, it is equally clear that the new law will further destabilize Russia's federal system. Another dubious draft law, 'On the Protection of the Population's Health...', designed to deal a heavy blow to small businesses (including small retail outlets), was somewhat mitigated at its second reading. And finally, the draft law on the imposition of a ban on 'homosexual propaganda', also passed by the State Duma in January, looks like a yet another declaration of the extreme conservatism typical of the Kremlin's domestic policies.

January saw a number of important discussions on the desirability of changes in Russia's economic policy. The sharp drop in the growth rate of the Russian economy registered at the end of 2012 caused concern among Russia's top officials: thus, President Putin once again declared his opinion that the refinancing rate should be reduced in order to increase the credit available to the economy. In response, the Chairman of the Bank of Russia said that the rate would indeed be reduced, but that first inflation should recede. It is evident that the President's statement reflected the growing demands that Russia's authorities should abandon their conservative monetary policy. And it was the necessity to stimulate Russia's economic growth that forced the RF Ministry of Economic Development to request that the authorities should mitigate the 'budgetary rule' adopted last year and begin to spend money from the State's reserve funds, even if the volume of those funds has not yet reached the prescribed level of 7% of GDP. The same is true of many other suggestions on economic development issues made in January – for example, the proposals that a Russian financial agency should be created, and that pension savings funds should be invested in the domestic market.

This combination of extreme conservatism in domestic politics and the strengthening of state dirigisme in Russia's economic policy is fraught with some strong political and macroeconomic risks in the medium-term perspective.

Macroeconomic Background: Inflation, Capital Flight and the Sprouts of Optimism

The macroeconomic background of January was largely determined by the situation in the global economy – which was characterized, on the one hand, by a rise in optimism over the future of the Eurozone, and on the other, by strong concerns over the major budget problems of the USA. This mixture of optimism and pessimism is reflected in the continuing strengthening of the Euro (1.32 USD per Euro as of 31 December 2012 and 1.36 USD per Euro as of 31 January 2013). The last ten days of January saw the beginning of a slow upward trend in oil prices (the price of Brent crude oil climbed from \$ 111.03 per barrel as of 17 January to \$ 115.05 per barrel as of 31 January). Against the background of this environment, the ruble was relatively strengthening against the U.S. dollar and weakening against the Euro. As a result, the value of the bi-currency displayed practically no changes at all over the course of January.

The MICEX Index climbed from 1,475 points (the last trading session of 2012) to 1,547 points as of 31 January 2013, which points to a relative rise in investor optimism. The rise in the MICEX Index was caused by the increased capitalization of consumer-sector and banking companies, notwithstanding a simultaneous drop in the capitalization of companies operating in the petrochemical and oil-and-gas sectors. It should be noted that the rise in prices was determined by the massive infusions of domestic investment carried out at a time when foreign investors were actively withdrawing funds from the Russian market. This situation clearly delimits the extent of the stock market's potential for growth that has just begun to manifest itself.

January also witnessed a continuation of December's accelerating inflation: while in December 2012 inflation amounted to 0.5% (vs. 0.4% in December 2011), the rise in prices from 1 January to 28 January 2013 amounted to 0.8% (vs. 0.4% in January 2012). It can be expected that January monthly results will show a price rise of around 0.9%, which would mean that in January Russia's annual inflation amounted to 7%. Meanwhile, the Core Consumer Price Index continued to decline throughout December. In December 2011, the Core CPI stood at 0.4% (same as in December 2011), while core inflation dropped to 5.7% (from +6.6% in 2011). The acceleration of general inflation taking place against the background of a deceleration of core inflation indicates that the price rise in 2012 was largely determined by some non-monetary factors. It is typical that the afore-mentioned acceleration in price growth was taking place against the backdrop of stagnation and decline (at the end of the year) in the disbursing prices of enterprises, registered by business surveys (see below).

Throughout most of 2012, the broad monetary base had remained practically unchanged, but at the end of the year it experienced a considerable growth – thus, in December alone it increased by 19%. So, over the course of 2012, the growth rate of the broad monetary base amounted to 14% (vs. 5.5% in 2011). December 2012 also saw a rise in the excess reserves of commercial banks: over the course of that month they grew almost twofold, to Rb 1,806.3bn. The amount of funds kept on correspondent accounts with the RF Central Bank rose to Rb 1,403bn, while the amount of funds kept on deposits therewith rose to Rb 403.3bn. The inflow of budget funds into the banking sector, observed during the end of the year, was of seasonal nature, and by the end of January, the excess liquidity kept by commercial banks on their correspondent accounts and deposits with the RF Central Bank began to dwindle because of the beginning of the tax payment period. As a result of the rise in the volume of liquidity available to commercial banks, the debt incurred by banks under REPO transactions declined to Rb 2 trillion. However, it is evident that any further fall in liquidity will cause a corresponding increase in the volume of refinancing.

In Q4 2012, capital outflows from Russia increased to \$ 9.4bn. After the Bank of Russia's re-estimation of the balance of payments for the first three quarters of 2012, preliminary estimates of net capital outflow from Russia over the course of 2012 put it at \$ 56.8bn (vs. \$ 80.5bn in 2011).

The Real Sector of the Economy: A Threat of Stagnation

Preliminary data on the dynamics of GDP in 2012 have confirmed the most pessimistic expectations: the 3.4% annual rise in GDP means that its growth rate dropped from 2.4% in Q3 to 1.8% in Q4.

This drop in the growth rate of GDP indicates that the possibilities of maintaining a high growth rate in the economy by stimulating consumer demand are largely exhausted. Over the course of 2012, the turnover in retail trade increased by 5.9% vs. by 7.0% in 2011. At the same time, there was a decline in the growth rate of consumer demand, taking place against the backdrop of high annual growth rates of the population's real disposable money incomes and wages (+4.2% and +7.8% respectively vs. +0.4% and +2.8% respectively in 2011) and a continuation of robust growth in credits granted to the population (the volume of credits granted to physical persons in November 2012 was 1.5 times higher than that in November 2011). It is noteworthy that the share of domestically produced goods in the structure of retail trade commodity resources declined by 2 pp. on 2011.

A decline in the growth rate of investment was the most important negative factor behind the slowdown of Russia's economy. Over the course of 2012, investment in fixed assets grew by 6.7% over the previous year (vs. by 8.3% in 2011); the construction work rose by 2.5% (vs. by 5.1% in 2011); and the commissioning volume increased by 4.7% (vs. by 6.6% in 2011). Investment activity was most robust from January through August, but much less so in the rest of the year, especially in Q4,

which saw a persistent downward trend in investment activity, a phenomenon absolutely untypical of the Russian building construction cycle. However, this drop in investment activity could have been expected because of the significant worsening in the financial performance of enterprises over the course of 2012 by comparison with their performance in 2011.

There was a considerable drop in growth rates across the board, including in mineral resources extraction – from 101.9% in 2011 to 101.1% in 2012, and in the processing industry – from 106.5% in 2011 to 104.1% in 2012. Especially noteworthy was the sharp drop in the growth rate of the processing industry: having stood at between 4.1 and 4.5% during the previous four quarters, the growth rate dwindled to 2.8% in the final quarter of 2012.

Business opinion surveys carried out by the Gaidar Institute demonstrated a continuing prevalence of extremely pessimistic opinions. The Industrial Optimism Index was on the decline throughout the last three months of 2012. In December, it hit its lowest level since the end of 2009. Demand for industrial products continued to display a downward trend: industrial enterprises' level of satisfaction with sales dropped 12 percentage points in November and December alone. While in the period from June through November the balance of opinion on output hovered around stagnation (-2 .. +2), in December the balance of opinion dropped with an intensity that had not been registered by surveys for 3.5 years (- 9 points). That drop in the balance should have been expected: at the beginning of Q4, the share of industrial enterprises whose output outpaced demand rose to 29-30%, although in the previous quarters this index had stood at 20-21%. In December the share of such enterprises fell back to its habitual 20% – but at a price of a significant decline in output.

For two months in a row business surveys demonstrated an absolute year-end drop in prices – the strongest ever recorded throughout the period of 2009–2012. It should be mentioned that October 2012 saw rise in prices at all, while August and September witnessed some very insignificant price growth. The aforesaid absolute drop in prices observed over the period of November and December affected almost every industry, except for the fuel industry (balance +14 points), the food industry (+10), and the timber industry (+2).

As far as employment in industry is concerned, it has been on a relatively steady decline since July 2012: the number of workers (the rate of change) has been changing within the range between -13 and -8 points. In Q4, the most intensive drop in the number of workers was registered in the timber industry, ferrous metallurgy, light industry and machine building. Recruitment was registered only in the electric power industry. Most of the industries are characterized by the predominance of expectations of personnel dismissals. These expectations are especially widespread in light industry (-25 points), ferrous metallurgy (-24 points), and machine building (-21 points).

In December 2012, the balance of investment plans collapsed by 10 points to its 3-year low. At year end, positive investment plans survived only in the timber industry (+7 points) and the construction industry (+3 points). In the rest of industries, investment plans reflected enterprises' intention to scale down their investment activity. This trend was especially apparent in the food sector and light industry.

In December, the aggregate ('above the norm' + 'in accordance with the norm') availability of credit in Russia's industry declined from 69% to 62%. That drop in credit availability was caused by access to credit having been constrained for very large enterprises (with more than 1,000 employees). For the rest of enterprises, credit terms remained unchanged, although it should be noted that they had been steadily worsening throughout several previous months. ●

THE POLITICAL AND ECONOMIC RESULTS OF JANUARY 2013

S.Zhavoronkov

January 2013 saw yet another surge in protests in Russia – now caused by Vladimir Putin’s approval, on New Year’s eve, of the draft law banning U.S. citizens to adopt Russian orphans (it should be noted that Russia’s authorities have so far failed to offer the orphans anything worth mentioning in return for the lost benefit). Russia’s authorities continued to busily erect some additional political barriers – this time by introducing the possibility for direct gubernatorial elections to be abolished by decision of regional legislatures. Private oil and gas companies were once again – and, in fact, for an indefinite length of time – denied the right to explore and exploit the resources of Russia’s continental shelf, thus dashing hopes that the Government might take a different decision on the matter. However, the Draft Law ‘On the Protection of the Population’s Health from the Effects of Tobacco Smoke...’ – which blatantly favored large retailers at the expense of small businesses – was somewhat mitigated; as a result, many types of small retail businesses will be able to continue trading in tobacco products.

In January, public attention in Russia was focused on the package of legislative acts informally known as the *Anti-Magnitsky Law*, which was finally signed by Vladimir Putin at the very end of 2012 after a period of initial hesitation. These laws adopted by the State Duma in the course of one week in December (although the essence of the *Magnitsky Bill* had been long known, and the inevitability of its passage through Congress had become apparent by the beginning of last autumn) contained a number of various measures. Some of them were mere declarations – for example, that the assets of U.S. citizens involved in some misdeeds or ‘human rights violations’ should be arrested, and that these persons should be banned from visiting Russia. Such declarations were inherently futile, because U.S. politicians do not own any assets in Russia, nor do they intend to visit this country. The other part of these laws continued to undermine the legal existence of Russia’s non-commercial organizations by introducing the possibility of their arbitrary closure and the imposition of heavy fines on such organizations for being simultaneously financed from abroad and getting involved in unspecified ‘political activities’¹. However, the State Duma had already made this situation extremely confused by passing, in summer 2012, the *Law on Foreign Agents*, which most of Russia’s human rights organizations had vowed to ignore, hoping that their standing in society would prevent the authorities from resorting to serious repressions. So far these hopes have proved to be well-founded.

However, the most noteworthy act passed in this respect by the State Duma was the cancellation of Russia’s adoption agreement with the USA, the prolongation of which had been agreed upon less than one month previously. The reason given for its cancellation was the deaths of adopted Russian children caused by the acts (or failure to act) of their U.S. foster parents, which U.S. courts judged to be accidental. The State Duma’s decision gave rise to a legal conundrum as well – the Agreement should be in force for one year since the moment of its denunciation by one of the parties, but it cannot be in force because U.S. citizens now have no right to adopt Russian children. Even some members of the Russian Government expressed opposition to this part of the *Anti-Magnitsky Law*, including the ministers directly concerned with the problem, such as the Minister of Foreign Affairs and the Minister of Education, who simply could not do otherwise bearing in mind that Russia was home to hundreds of thousands of orphans. However, the opponents of those ministers got the upper hand. The reasons behind their victory were as follows. Firstly, this action, unlike the rest of the State Duma’s decisions, had had an international resonance. Therefore, the Russian authorities were eager to show that they indeed intended to use Russia’s citizens, including orphans, as hostages, and would not hesitate to threaten harm to those foreign countries for which

¹ For example, in the USA the category of political activity comprises the activities for which no charitable tax deduction will be available, which limits the application of this term to the issuance of propaganda materials for or against an election aspirant, candidate or political party.

the protection of human rights is a priority. Secondly, the Russian authorities decided that the adoption of the Law would be in the interests of their domestic policies, and so would be warmly met by the general public as an anti-American measure – bearing in mind that the USA had long been depicted for domestic propaganda purposes as one of Russia's principal enemies. Moreover, the narrow, specialized and focused theme of orphans, which is not easily understood by many Russians (like the theme of the girls draconically punished one year ago for dancing in a church), perfectly served the purpose of focusing public attention on some small, intricate and dubious issues, and not on the issues of governance and election. It was a rather reasonable decision on the part of the authorities, although not without its flaws: having seemingly lost steam in December 2012, the opposition found a second wind in January 2013, when 20 to 25 thousand persons braved the frost and took part in a rally against the new law. Thirdly, the Law served as a litmus test for the loyalty of the ruling elite – the draft law was supported in the State Duma not only by *United Russia* MPs, but also by the leaderships of the CPRF, LDPR and *Fair Russia* factions (although some of their MPs voted against the draft law or abstained from voting). But to a much greater extent than the voting of the systemic opposition, the authorities were interested in the voting of certain individuals – big businessmen *cum* members of the RF Federation Council or the RF State Duma. The result of the latter voting can be characterized as a draw: more than two-thirds of this category of deputies voted for the Draft Law, in spite of the threat of the hypothetical sanctions that could be imposed against them by some foreign countries, which was a seemingly positive outcome for the authorities. However, almost one-third of MPs (that is, quite a lot of them!) refused to do so, and either demonstratively abstained from voting or voted against the Draft Law¹.

The response of foreign countries will become evident in the spring – by mid-April Barack Obama will have to personally compose the so-called *Magnitsky List*, and do this without offending U.S. public opinion. After the recent legislative innovations in Russia, it will be much more difficult for him to limit the blacklist to persons of minor importance, as it was in all likelihood initially planned.

The authorities continued their onslaught on human rights. In January, the State Duma rushed to pass the *Law on the Possibility of Abolishing Direct Gubernatorial Elections in a Region by Decision of That Region's Legislative Assembly* (practically all such assemblies are controlled by *United Russia*). The Law was adopted in its first reading, thus setting a legislative speed record of sorts, because the idea of partially scrapping direct gubernatorial elections had been first raised by Vladimir Putin as recently as last December. For the sake of comparison it should be noted that the *Draft Law on the Mandatory Direct Election of City Mayors* introduced by the RF Government into the State Duma as early as September 2012 has not yet been scheduled for consideration in Russia's parliament. It cannot be said, however, that the recently passed law is absolutely groundless. For example, many experts had expressed concern that direct popular elections in the multi-ethnic republics of the North Caucasus, especially in Dagestan, Karachaevo-Cherkessia and Kabardino-Balkaria, were fraught with the risk of civil war, because the ethnic groups defeated at the polls would have lost everything, bearing in mind the predominance of the State in that region's economy and the State's monopoly on land resources (in Dagestan and Kabardino-Balkaria). However, there was absolutely no reason for extending the Law onto the entire territory of Russia. In fact, the intention behind the Law is crystal clear: elections should take place only in those constituencies where, unlike the opposition, *United Russia* can put forth a popular candidate. Otherwise, the governor will not be elected, but selected by Putin. However, judging by the elections in the spring and autumn of 2012, and the highly memorable December 2011 elections, the political situation in Russia is prone to rapid changes. And when it becomes obvious that things are in flux, the opposition gets both the money and mass media attention, which it cannot hope to enjoy in a static situation. Therefore the issue of gubernatorial elections will remain one of the long-term destabilizing factors for Russia's authoritarian system.

1 For example, the billionaires Suleiman Kerimov and Boris Spiegel abstained from voting, while the billionaire Sergey Petrov voted against the Draft Law. The prominent businessmen Ahmed Palankoev, Ye. Malkin, Viacheslav Derev, Konstantin Dobrynin and businesswoman Larisa Ponomareva abstained from voting, while the businessman Viktor Ozerov cast a 'Nay' vote.

January 2013 has finally brought clarity to the long saga of the Draft Law *On the Protection of the Population's Health from the Effects of Tobacco Smoke...* and the accompanying draft laws introducing amendments to tax legislation and the consumer law. This draft law could well have been named *The Law on Combating Small Businesses*, because, contrary to common sense, it forbade small businesses to trade in high margin tobacco products, while permitting large retail networks to do so. Thus, small businesses were to be delivered a second heavy blow over a short period of time. The first blow was the planned ban on the sale of beer at kiosks and small shops. If the law had passed in its initial version, it would have meant a catastrophe for street-side kiosks and small shops – despite the fact that only one-half of Russia's population smoke and drink beer – the customer would have refrained from visiting the kiosks to purchase any other goods as well, but would have willy-nilly gone for that purpose to a large retail network trading in everything, including beer and tobacco products. The other victims of the Law would have been small-scale producers – the natural fellow travelers of small businesses. Such producers are denied access to large retail networks because of the small volumes of goods they can supply and their unwillingness to pay enormous penalties for even the slightest violation of delivery time or any other terms of delivery, etc. Had the Law been passed unamended, the number of unemployed and outraged in Russia's towns and cities would have considerably increased. Scared by this prospect, the authorities backed down a bit: in the decisive second reading of the Law, shops with trading space of up to 50 square meters were spared the axe. Kiosks, booths and stalls were stripped of the right to trade in beer and tobacco products – but not immediately. They were given a new lease on life – until June 2014.

In January 2013, the RF Government made an effort to resolve last year's torturous dispute over the terms of developing the hydrocarbon deposits of Russia's continental shelf. It should be reminded that, according to Russian legislation, the only companies vested with the right to explore and exploit the resources of Russia's continental shelf are *Gazprom* and *Rosneft*. Their 15-year-long monopoly in that field has been absolutely fruitless – unlike the activities of the private companies developing the hydrocarbon deposits of the Caspian Sea shelf. Last year, practically all Russian big companies, with the exception of *Gazprom* and *Rosneft*, began to demand that this monopoly should be abolished. From time to time, various government ministers also made similar demands. Vladimir Putin voiced his disappointment over the two companies' failures on Russia's continental shelf. However, the liberalization program mapped by the RF Ministry of Natural Resources and Ecology once again failed to be upheld, this time by the January 2013 meeting of high ranking officials at Novyi Urengoi, specifically devoted to developing Russia's continental shelf. Moreover, the RF Government announced its decision that the issue of liberalizing the terms of natural gas extraction from continental shelf deposits should be closed, and that *Gazprom* and *Rosneft* should be granted new licenses for the right of exploring and exploiting the resources of the undistributed subsoil fund. As regards the concept that private companies should be granted access to the continental shelf, the Government stated that another round of deliberations on that issue was eventually to be held. In return, the grateful state companies habitually promised to drill deeper and faster. In fact, it can be concluded that Russia's big private business have suffered yet another defeat, while the RF government officials concerned with this issue turned out to be unreliable allies, and clearly preferred not to engage in any serious discussion of the related matters. ●

INFLATION AND MONETARY POLICY

N.Luksha

In December the pre-Christmas growth in foodstuffs prices and in transport tariffs provoked acceleration of inflation, which made 0.5% within the month (against 0.4% in December 2011). As a result, by the end of 2012 the inflation rate made 6.6%, having matched the recent official forecast of the RF Central Bank. In January 2013 the increased excise duties and continued seasonal growth in prices for fruit and vegetables resulted in significantly accelerated growth rate of consumer prices: over the first three weeks of the month it amounted to 0.6%. In 2012 the monetary base in broad definition remained virtually unchanged, but by the end of the year it has significantly increased: only in the last month of the year it increased by 19%. Therefore, within the year its growth rate made 14% (against 5.5% in 2011). In the Q4 2012 capital outflow from the country has accelerated, having reached \$9.4bn. After the Bank of Russia has reviewed the balance of payments for the first three quarters of 2012, the tentative estimate of the net outflow of capital as of 2012 results amounted to \$56.8bn, as compared with \$80.5bn in 2011.

As per 2012 results, consumer price index made 6.6% (it should be noted, that within the entire contemporary history of Russia the minimum indicator of inflation was 6.1% in 2011).

In the last month of 2012 inflation has traditionally accelerated: as of the month results, the CPI has grown by 0.2 p.p. as compared with November and made 0.5% (+0.4% in December 2011). The main contribution to accelerated inflation in December 2012 was made by the pre-Christmas growth of prices for foodstuffs, as well as for commercial services.

Growth rate of food prices in December has nearly doubled as compared with November and made 0.9%. In December the utmost growth was noted in prices for eggs (+7.4%). They were followed by the highest growth rates in prices for fruit and vegetable products (+2.4%). Sugar price, which was declining within the preceding months, in December has also increased (+1%). There was no reduction in prices for any foodstuffs in December.

As of 2012 results, the only depreciating items in the group of foodstuffs under review were cereals and beans, which prices have decreased by 7%. At the same time, the highest growth over the year was observed in prices for alcoholic beverages (+12.1%), bread and bakery products (+12%), as well as fruit and vegetable products (+11%). The main reason for the increase in alcohol prices was the increase of excise taxes, while higher prices for bakery products, fruit and vegetables were due to the poor harvest of 2012.

In December, after the November pause, prices and tariffs for commercial services started to grow again, having increased within the month by 0.4% (against +0.3% in December 2011). The utmost growth was noted in prices for passenger transport (+3.3%). This was due to a substantial increase in the cost of long-distance trains. Herewith, prices were declining for healthcare and recreational services (-0.3%) and foreign tourism (-0.5%).

As of the year results, the leading position in the list of commercial services, which demonstrated the most significant price growth, were educational services (+10.6%), which have surpassed the traditional leader in price growth, i.e., housing and public utilities (+9.4%). They were followed by services of cultural organizations and healthcare services, the prices of which rose accordingly by 8.8% and 8.6%. There was no reduction in prices for any type of commercial services throughout 2012.

In December growth of prices for non-food goods continued to slow down (-0.4% in November 2012), amounting by the end of the month to 0.3%, similar to 2011. In the last month of the year the rate of growth continued to slow down in gasoline prices, which decreased by 0.1% (as compared with growth by 0.5% in November). Like a month earlier, audio-video goods became cheaper (-0.2%). Herewith, prices for tobacco products continued to grow (+0.7%).

According to the results of 2012, similar to 2011, the leader in price growth among all groups of consumer goods was tobacco, which has grown by 22.6% due to increased excise taxes. Herewith,

the growth rate of gasoline prices slowed down more than twice, from 14.9% to 6.8% due to the freezing of retail prices in Q1 of the current year, as well as due to the stabilized global oil prices. In 2012 there was a decline in prices for one group of non-food goods, namely for audio-video goods, which became cheaper by 1.1% within the year.

The core consumer price index¹ in December continued to decline and amounted to 0.4%, like in 2011. As of the year results, core inflation made 5.7%, which is lower in comparison with 2011 (+ 6.6%) (*Fig. 1*). The slowdown in core inflation against the background of accelerating cumulative inflation demonstrates that prices growth in 2012 was largely of nonmonetary nature.

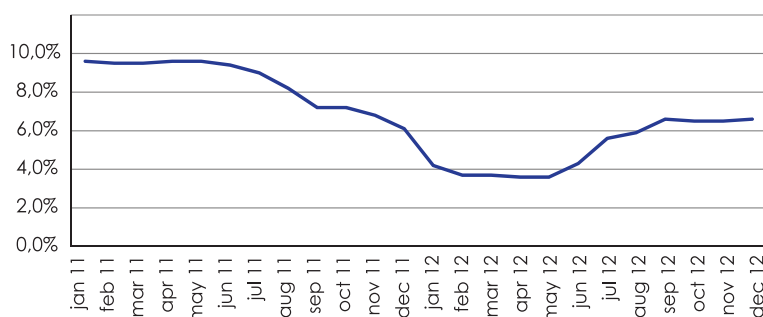
In January 2013 inflation has accelerated: as of the first three weeks of the month the CPI made 0.6% and exceeded the relevant indicator of January 2012 (+0.5%). The main impact on prices growth was provided by the increased excise taxes on alcohol products, the rising cost of transport services, as well as fruit and vegetable products: within the period under review, vodka has grown in price by 14.4%, tram and trolleybus tickets – by 6% and 5.6%, accordingly, fruit and vegetables – by 6–10%.

According to the official forecast of the Ministry of Economic Development of Russia, annual inflation in 2013, like in the last year, amounts to 5-6%. At the beginning of the year inflation will start to accelerate again due to increased rates of excisable goods and to seasonal growth in foodstuff prices. In Q2 one can expect some slowdown in consumer inflation as a result of decline in economic growth, slowdown in core inflation and moderate extension of monetary supply (the growth rate of monetary supply M_2 on December 1 made 14.4% vs. 20% in 2011). However, the decline of inflation rate term will be short, and in summer it will start to grow again along with the increased regulated tariffs of state monopolies. The factor of agricultural products harvest, hardly predictable, but having a significant impact on consumer prices, should be taken into regard as well. In the absence of external shocks, inflation in annual terms will largely depend on this factor.

As of 2012 results, the monetary base in broad definition increased by 14% to Rb 9,852.8bn. Herewith, the utmost extension of monetary base was noted in the last month of the year, when it increased at once by 19%, or by Rb 1,595.8bn. The main reason for the sharp increase in the monetary base in December was the traditional growth in budget expenditures at the end of the year. Within this month all components of the monetary base (except for the Bank of Russia bonds) were growing. Herewith, the utmost growth was demonstrated by deposits of banks, as well as correspondent accounts of credit institutions with the RF Central Bank, which have increased over the preceding month three-fold and 1.6-fold, accordingly. Due to a significant extension in December, the growth rate of monetary base in broad definition as per 2012 results increased by 2.5 times as compared with 2011 (+5.5%).

As per results of 2012, correspondent accounts of commercial banks with the Bank of Russia, which increased within the year by 38% to Rb 1,356.3bn, became the main item of growth of monetary base in broad definition. The amount of cash (aggregate M_0), as well as the amount of mandatory reserves were also significantly extended, by 11.2% to Rb 7,667.7bn and by 12.5% to Rb 425.6bn, accordingly. Growth of banks' deposits with the Bank of Russia within the year made 3.9%, and as a result, by the end of the year deposits reached Rb 403.3bn.

Note that the monetary base in narrow definition (cash plus mandatory reserves) in 2012 remained virtually unchanged as well. The utmost growth occurred in HQ 2012 and in the last month of the year, when it got increased at once by 11% to Rb 8,093.3bn (*Fig. 3*).



Source: RF Statistical Service.

Fig. 1. The Growth Rate of the CPI in 2011–2012 (% year to year)

1 The core consumer price index reflects the level of inflation in the consumer market after adjustment for the seasonal (prices of vegetable and fruit products) and administrative (regulated tariffs for certain types of services, etc.) factors, which is also calculated by the RF Statistical Service (Rosstat).

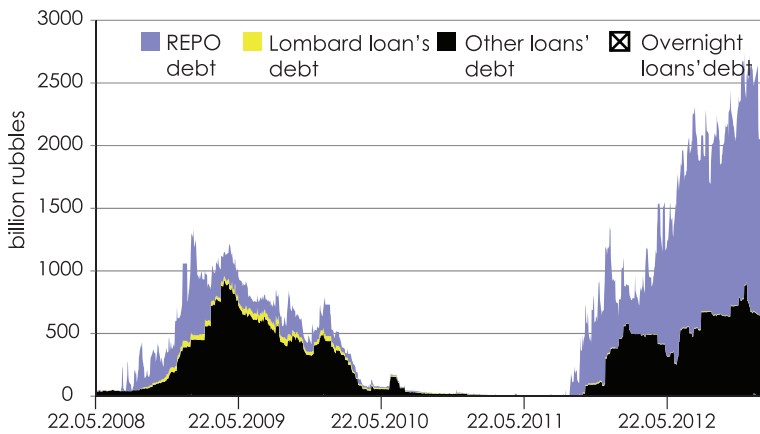


Fig.2. Arrears of commercial banks with the Bank of Russia in 2008–2012.

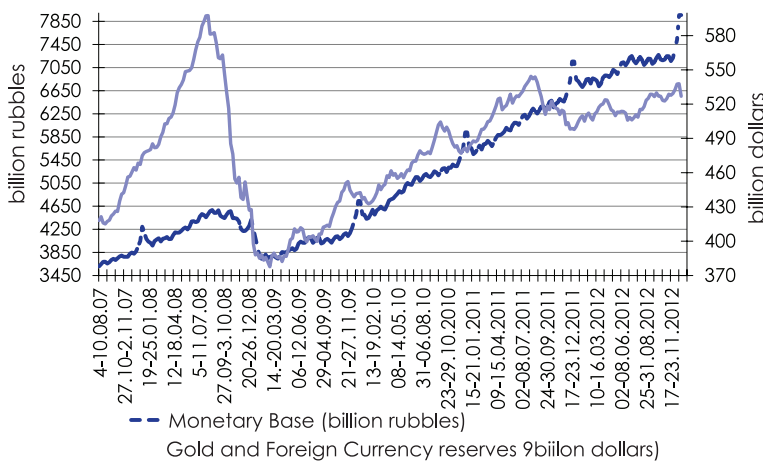
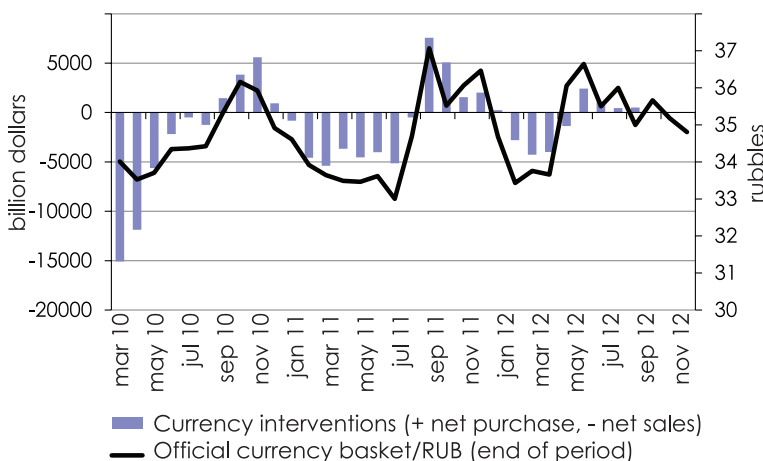


Fig. 3. Dynamics of the monetary base (in narrow definition) and foreign currency and gold (international) reserves in 2007–2012.



Source: RF Central Bank, author's estimates.

Fig. 4. The Bank of Russia FX interventions and ruble exchange rate against FX basket in March 2010 – December 2012

As a result, the monetary base in narrow definition (cash plus mandatory reserves)¹ in 2012 has grown by 11.3% (against 21.8% in 2011).

In December 2012, the excessive reserves of commercial banks² continued to grow: within the month they have almost doubled to Rb 1,806.3bn. The volume of correspondent accounts with the RF Central Bank increased to Rb 1,403bn and the volume of deposits – up to Rb 403.3bn. The inflow of budget funds to the banking sector at the end of the year was a seasonal factor. Anyway, by the end of January, the excessive liquidity on correspondent accounts and deposits of banks with the RF Central Bank will start to decrease in view of the onset of tax payments period. As a result of liquidity growth available to commercial banks by the end of the year, the banks indebtedness under REPO transactions has decreased to Rb 2 trillion (Fig. 2). Apparently, along with liquidity depletion, the volume of refinancing will continue to grow.

As of the end of 2012 the amount of net international reserves has increased by 6.4% from \$505.4bn to \$537.6bn. In the last month of the year, the reserves increased by 1.8%. The main reason for reserves growth was the change of US dollar against Euro.

Throughout 2012 the RF Central Bank was consistently reducing its presence in the foreign currency market. In December 2012, for the first time since 2008, the Bank of Russia did not carry out foreign currency interventions (Fig. 4³).

As of the end of 2012 the net outflow of capital from the country amounted to \$56.8bn, which was lower than the recent forecast of the RF Central Bank (\$ 67bn). This is also 1.5 times lower than the net capital outflow in 2011, when it amounted to \$80.5bn. Capi-

1 We would like to remind, that the monetary base in 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 supply), which is under total control of the RF Central Bank.

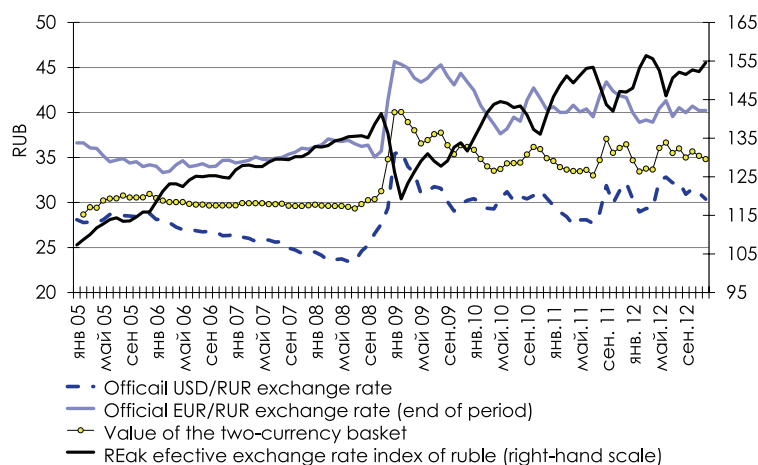
2 Under the excessive reserves of commercial banks with the RF Central Bank is understood the sum of correspondent accounts of commercial banks, their deposits with the RF CB and the RF CB bonds of commercial banks.

3 The level of January 2002 is accepted as 100%.

tal outflow has reached its maximum of \$33.3bn in Q1 2012. According to the tentative estimates of the RF Central Bank, in Q4 2012 capital outflow has increased again, having reached \$9.4bn. Herewith, in the last quarter of the year the capital outflow from the non-financial sector has virtually doubled (-\$23.6bn) along with the two-fold capital inflow to the banking sector (+\$14.2bn). Capital outflow growth from the non-financial sector in Q4 could be urged by the peak of payments of external debts of Russian companies, which happens at the end of the year.

In December the ruble real effective exchange rate resumed its growth again (+1.5%). As a result, index of the real effective exchange rate increased to 154.561¹ (see Fig. 4). As of the end of 2012, the ruble strengthening in real terms against FX basket made 2.4%, slightly exceeding estimates of the Ministry of Economic Development of Russia for this indicator (- 2%). In 2011, the ruble strengthening amounted to 4.7%.

From the second decade of December 2012 and in January 2013 the US currency rate against the ruble was declining. As a result of 26 days of January, dollar has been depreciated by 1% to Rb 30.05. There was a number of factors contributing to the ruble rate strengthening. Prevention measures against “fiscal downfall” in the USA have inspired the investor’s interest in risky assets, including Russian currency. Ruble was also supported to some extent by high global oil prices and by the onset of the domestic tax period. The Euro exchange rate against the ruble within 26 days of January remained virtually unchanged, staying at the level of Rb 40.24. The value of the two-currency basket within the period under review has decreased by 0.5% to Rb 34.6. ●



Source: RF Central Bank, author’s estimates.

Fig. 5. Indicators of ruble exchange rate dynamics in January 2005 – December 2012

1 The level of January 2002 is accepted as 100%.

FINANCIAL MARKET

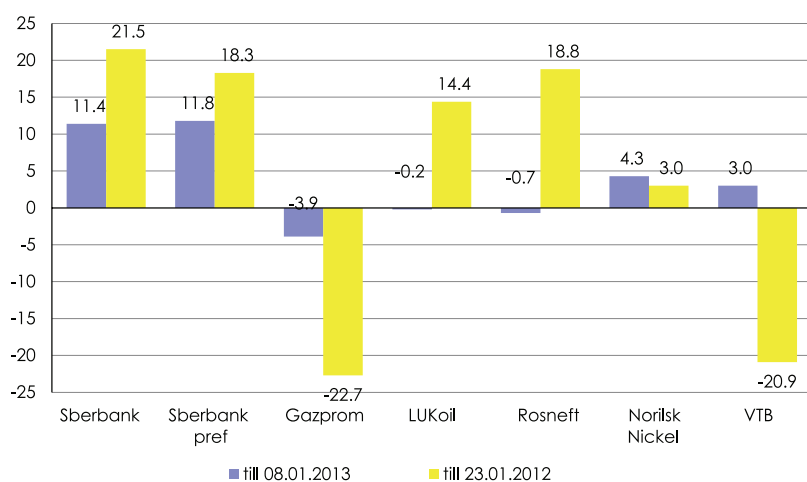
N.Andrievsky, E .Khudko

The new year's beginning was marked by a generally positive behavior of the stock market. The quotation changes displayed by major Blue Chips over January were multi-vectored. At the same time, it should be noted that the observed growth in prices was sustained by Russian investors, while foreign market participants continued to withdraw their resources from the Russian market. January also saw a rather favorable situation on Russia's domestic corporate bond market. The activity of the market's biggest bond emitters in registering their new issues hit its several-year high, while at the same time many big companies gave up their plans to place their previously registered bond loans, and so these issues were annulled.

The Movement of the Russian Stock Market's Main Structural Indices

In January (from 8th through 31st), the MICEX Index rose by 2.11% to 1,546.76 points, which is 2.16% above its value as of 31 January 2012. The movement of the main Blue Chip stocks over that month was multi-vectored. Thus, for example, *Sberbank's* shares climbed 11%, *Norilsk Nickel's* – 4%, and *VTB's* – 1.6%. The value of shares issued by oil and gas companies over January moved in the other direction and on the average dropped by 1.6%. Thus, *Sberbank's* shares in January demonstrated the highest yield per invested ruble – 11.4 kopecks; while the highest loss per invested ruble (3.9 kopecks) was on *LUKoil'* shares. In annual terms, however, their movement is somewhat different. Thus, the value of *VTB's* shares declined on its index as of 31 January 2012, and so the investors' loss amounted to 20.9 kopecks per invested ruble. The losses sustained by investors in *Gazprom* were somewhat greater – more than 22.7 kopecks per invested ruble as of 31 January 2012. The growth rate displayed by other companies' capitalization was from 3% to 21.5% per annum. This growth occurred in response to the positive stock movement on the world's major trading floors. In this connection it should be noted that the rising quotations were sustained by Russian investors, while foreign participants continued to steadily withdraw their resources from the Russian market.

December 2012 saw only one placement of Russian shares – the shares in Open-end Joint-stock Company *Multisistema*, a holding company specializing in the construction, assembly and maintenance of engineering systems, and also the equipment for the housing and utilities sector. The total face value of the placed shares is Rb 9.8m, which in no way influenced the stock market's structure



Source: Quote.rbc.ru; the author's calculations.

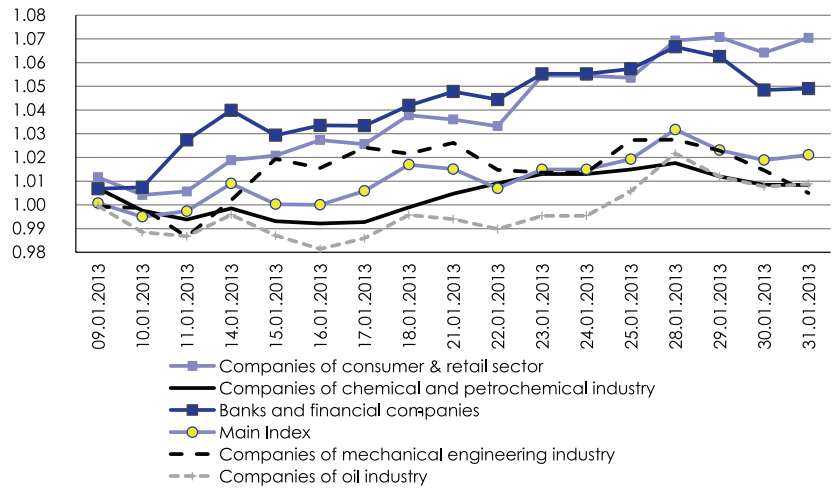
Fig. 1. Growth Rate of Blue Chip Stocks on the MICEX, %

over that month (the MICEX's total capitalization in Q4 2012 amounts to more than Rb 24 trillion). The total face value of shares placed on Russia's domestic stock market in 2012 is Rb 49.6bn (for reference: the total face value of shares placed on foreign markets is Rb 267bn).

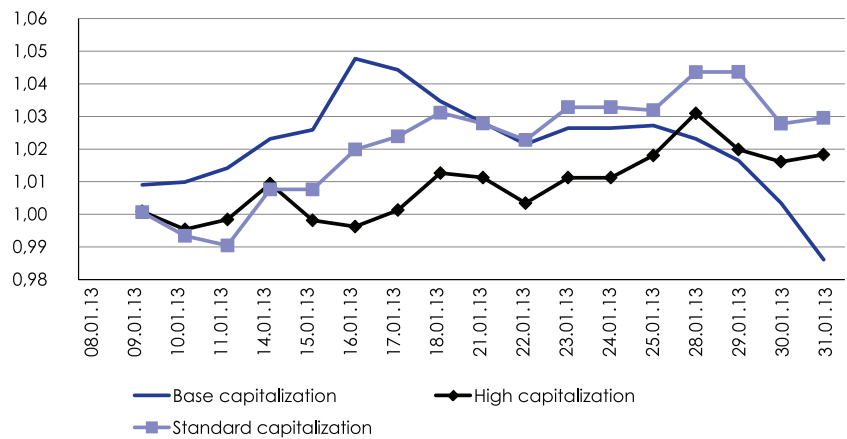
The beginning of the new year on the stock market was marked, on the whole, by a positive movement of stock indicators. The Main Index of the Moscow Exchange over the period from 8 through 31 January 2013 rose by 2.11%, while displaying noticeable variances in its behavior in different sectors (Fig. 2).

Thus, the New Year holidays and the expectations of incomes from 'holiday sales' pushed up the consumer & retail sector index by 15.4. The value of shares in mechanical engineering companies, as well as that of banking and finance sector shares, grew above the prescribed 10% threshold. It may be assumed that this result was achieved due to the high return on equity demonstrated by Russia's biggest banks and the underestimated value of the shares issued by the mechanical engineering industry's companies throughout the year 2012. The rate of growth displayed by the latter category of shares was, in fact, even higher than that of the shares in oil & gas companies. At the same time, the growth rates of the stock indices of chemical and petrochemical companies have been fluctuating around zero. Such values of these indices point to a low degree of investors' interest in the shares issued by companies belonging to that sector – mainly because they are part of vertically integrated holding companies, which do not permit the issuance of a more or less significant number of securities.

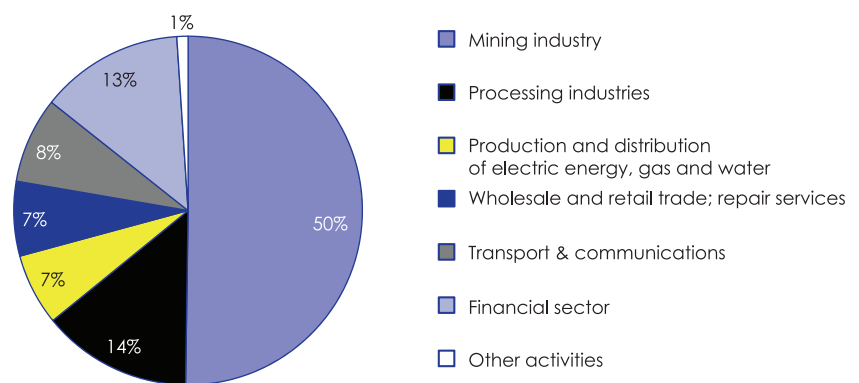
MICEX MC, the index of shares in Russian companies with standard capitalization (30 companies with an aggregate market capitalization of Rb 12.3 trillion and an average market capitalization of Rb 412bn), had caught up with MICEX LC, the index of shares in Russian companies with high capitalization, which grew at a rate of 7.9%. Thus, the rise in the capitalization of the companies included in MICEX MC amounted to 8.1%. Meanwhile, over the course of December 2012 and the first two weeks of January 2013, MICEX SC, the index of companies with base capitalization (50 companies with an aggregate market capitalization of Rb 16.6 trillion and an average market capitalization of Rb 333bn), increased by 12.7%.



Source: Quote.rbc.ru; the author's calculations.
Fig. 2. Movement of the MICEX Stock Indexes



Source: Quote.rbc.ru; the authors' calculations.
Fig. 3. Changes in the Capitalization Indices of the Stock Market



Source: the MICEX's official website; the authors' calculations.
Fig. 4. Structure of Capitalization of the MICEX Stock Market, by Type of Economic Activity

In 2012, the by-sector capitalization structure on the Russian exchange continued to be dominated by companies belonging to the extracting sector (50.2%), followed by the financial sector (13.3%) and the processing sector (13.9%), which indeed correlates with the by-sector structure of the real sector.

The Corporate Bond Market

At the beginning of 2013, the volume of Russia's domestic corporate bond market (by the nominal value of ruble-denominated securities in circulation) continued to grow, reaching the level of Rb 4,147.5bn, which represents a 2.7% rise on the end of December 2012 (in the previous several months, it had been growing at an average rate of 1.5% per month)¹. The increase in the volume of the market was once again caused by growth in the number of issued bond loans (894 ruble-denominated corporate bond issues vs. 881 issues as of the end of the previous month). At the same time, the number of emitters represented in the debt segment remained almost unchanged (337 vs. 338 in December). The ruble-denominated bond issues in circulation included several bond issues of foreign emitters (the International Finance Corporation, the European Bank for Reconstruction and Development, and *Uranium One Inc.*). Several U.S. dollar-denominated bond issues and one yen-denominated bond issue were still in circulation.

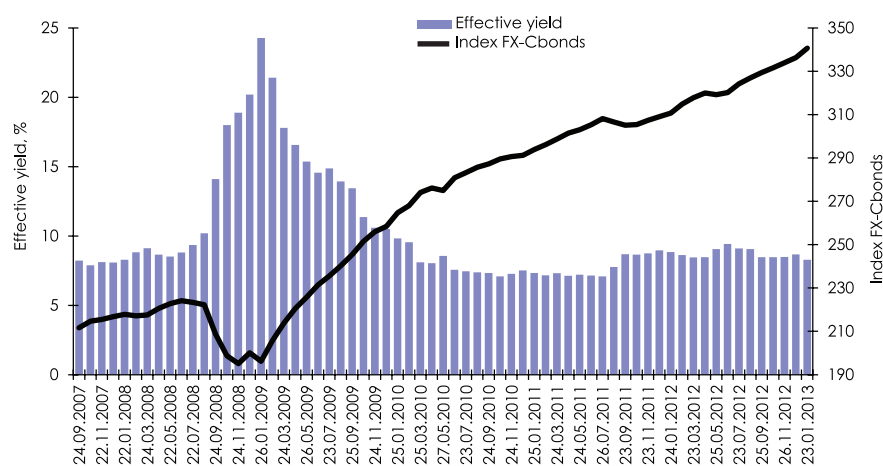
In late December 2012 and January 2013, the secondary corporate bond market saw a rise in investment activity, mainly accounted for by the final trading days of last year. Thus, from 24 December through 23 January, the combined volume of exchange transactions carried out on the Moscow Exchange amounted to Rb 146.5bn (for reference: from 26 November through 21 December, the trade turnover was Rb 129.1bn), while the number of transactions carried out over the period under consideration amounted to 26.5 thousand (vs. 27.5 thousand in the previous period)².

The IFX-Cbonds index of the Russian corporate bond market continued to rapidly rise. By late January 2013, it had climbed up by 4.4 points (or 1.3%) from the end of 2012. Having slightly increased in December, the weighted average effective yield on corporate bonds considerably dropped – from 8.67% as of the end of the previous month to 8.29% (*Fig. 5*). Both the rise in the yield at the end of a year and its drop at the beginning of a year are the seasonal phenomena that have been repeatedly observed in recent years³.

After a short period of growth at the end of 2012, the corporate bond portfolio duration index resumed its downward trend. As of the end of January, this index amounted to 571 days, which represented a 30-day drop on the end of December. That

drop in the corporate bond portfolio duration index reflected a reduction in bond loans' periods of circulation in the corporate segment.

The most liquid bond issues demonstrated fall of their yields (by 0.3–0.4 p.p., on average). The only exception was the Bank of Moscow's issue of Series 02 bonds. Like in December 2012, the biggest bond-yield losers (by more than 1 p.p.) were securities issued by manufacturing and energy



Source: According to data released by the Cbonds company.

Fig. 5. Behavior of the IFX-Cbonds Index of the Russian Corporate Bond Market and the Dynamics of its Weighted Average Effective Yield

- 1 According to data released by the Rusbonds information agency.
- 2 According to data released by the Finam company.
- 3 According to data released by the Cbonds company.

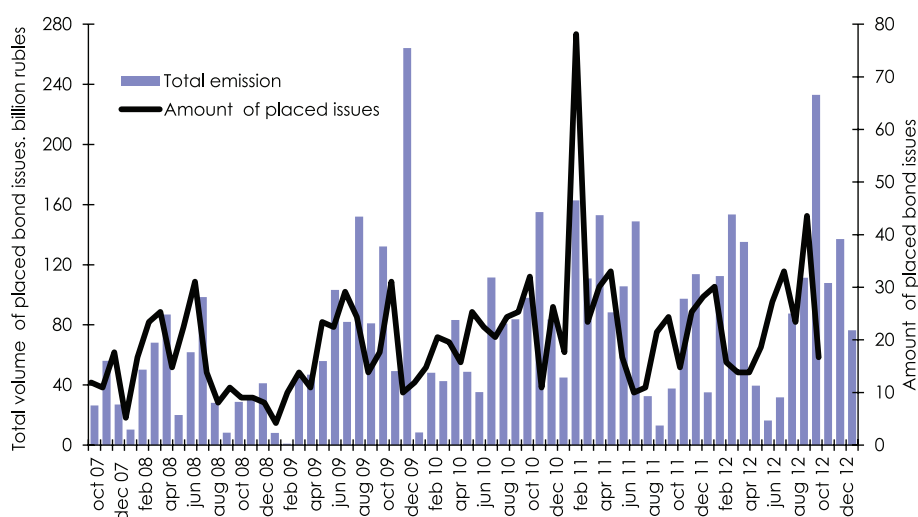
companies. By the end of January the yields on the bond issues of high-tech companies remained almost unchanged¹.

At the end of 2012 – start of 2013, bond issuance exceeded all forecasts, hitting a several year high. Thus, over the period from 22 December through 23 January, 14 emitters registered 99 bond issues with a total face amount of Rb 793bn (vs. 33 bond issues with a total face amount of Rb 148.4bn registered from 27 November through 21 December). However, it should be noted that in the main those record-high achievements resulted from the registration of the 51 commercial paper issues with a total face amount of Rb 500bn, released by JSC *Sberbank Rossii* [The Savings Bank of the Russian Federation]. Large issues of securities were also registered by JSC *AKB Bank Moskvyy* [the Joint-Stock Commercial Bank of Moscow] (8 series of commercial papers with a total face value of Rb 60bn), LRC *EvrasholdingFinans* [the Eurasian Financial Holding Company] (4 series of bonds with a total face value of Rb 50bn), JSC *Novolipetskii Metallurgicheskii Kombinat (NLMK)* [Novolipetsk Metallurgic Combine] (7 series of bonds with a total face value of Rb 50bn), JSC *RusGidro* [Federal Hydro-Generating Company] (4 series of bonds with a total face value of Rb 40bn)². More than two-thirds of the registered issues were commercial papers.

While the end of a year is always a time of hectic bond registration activity (although last year's end has broken all records in this respect), placement of securities in the immediate pre- and post-New Year's eve period is usually a much more subdued and humble affair, which can be explained by low investor activity in January. Over the period from 22 December 2012 through 23 January 2013 11 bond emitters placed 14 bond loans with a total nominal value of Rb 76.4bn (vs. 42 loans with a total nominal value of Rb 137.1bn placed from 27 November through 21 December) (Fig. 6). Commercial papers accounted for one-third of the placed issues. The largest bond loans were placed by Oil Transporting Joint-Stock Company *Transneft* (2 series of commercial papers with a total face value of Rb 34bn) and JSC 'Bank VTB' (1 series of commercial papers with a total face value of Rb 15bn)³. Two mortgage agents, *Aziatsko-Tikhookeanskii Bank* [Asian-Pacific Bank] and *Evropa 2012-1* [Europe 2012-1] managed to attract finance in the form of 32-year and 30-year loans respectively.

The low indices of primary placements can largely be explained by the fact that many big bond emitters changed their previous plans of attracting resources from the debt market. Thus, over the period under consideration, that is, from 22 December through 23 January, 16 bond issues were annulled by the Federal Financial Markets Service of Russia (FFMS) due to failure to place even a single security; their State registration was also annulled (for reference: over several previous months, no more than 6–8 issues had been annulled)⁴. Among the issues thus annulled there were, for examples, the bonds issued by *TGC-1*, *Mobile TeleSystems (MTS)*, the Novolipetsk Metallurgic Combine (*NLMK*), and *VimpelCom*.

Over the period from 22 December through 23 January, all the bond emitters redeemed their 6 bond issues with a total face value of Rb 8.6bn in due



Source: According to data released by the Rusbonds company.
Fig.6. Dynamics of the Primary Placements of Issues of Ruble-Denominated Corporate Bonds

1 According to data released by the Finmarket information agency.

2 According to data released by the Rusbonds company.

3 According to data released by the Rusbonds information agency.

4 According to data released by the Federal Financial Markets Service of Russia.

time, i.e., without declaring a technical default, which is exceptional in view of the history of the last four years. In February 2013, the redemption of 15 issues of corporate bonds with a total face value of Rb 60.9bn is expected¹.

The situation with regard to real defaults (when an emitter is unable to fulfill current obligations against a bond loan even in the next few days after the planned redemption date) has remained stable for several months. Thus, in the period from 22 December through 23 January only one bond issuer defaulted on the payment of the coupons to the securities holders. As in the previous months, all the bond issuers redeemed the face value of their bond loans before their maturity by means of a buyback offer to their current holders in due time or, at least, within the framework of a technical default².

In late 2012, some measures designed to further develop the investment instruments were implemented. Thus, among other things, the RF Government approved a decree whereby the formerly imposed ceiling (30%) for the share of infrastructure bonds of one bond issuer in the general pension saving investment portfolio of a government asset manager was abolished³. Alongside that measure, the government introduced more precise guidelines for *Vneshekonombank's* activities associated with investing pension savings in bonds secured by RF government guarantees, and also in bonds rated at or above the sovereign credit rating and issued with the purpose of providing funding for nationwide infrastructure projects. ●

1 According to data released by the Rusbonds company.

2 According to data released by the Cbonds company.

3 According to data released by the Cbonds company.

REAL ECONOMY: TRENDS AND FACTORS

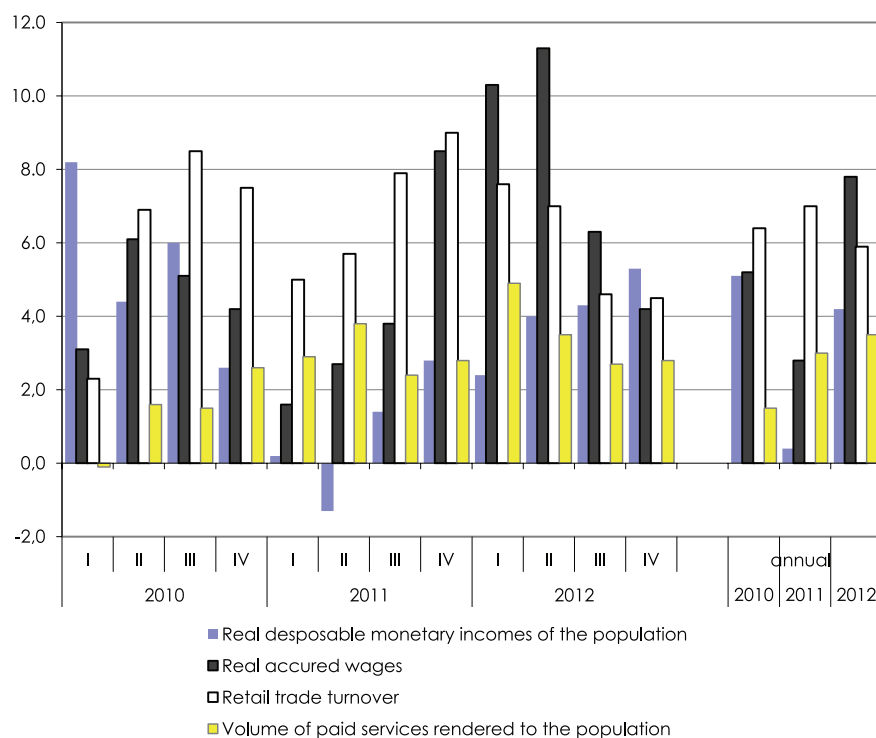
O.Izryadnova

Throughout 2012 the macroeconomic situation has been characterized by the gradual decrease of the economic activity. It was the simultaneous slowdown of both the internal and external demand growth rates that was one of the factors contributing to the low dynamics of 2012. According to the preliminary data of the RF Ministry of Economic Development, in 2012 GDP growth rates made 103.4% versus the previous year, investments in fixed assets – 106.7%, retail trade turnover – 105.9%. In 2012 the growth rates of the industry slowed down to 102.6% versus 104.7% in 2011. The plunge in the agriculture production of 4.7% versus 2011 had a negative effect on the output.

In 2012 the slowdown of the annual and quarter-by-quarter dynamics of the GDP was determined by the slowdown of the investment and consumer demand growth rates. At the same time, throughout 2012 the consumer demand remained one of the factors supporting the economic growth. On the whole, as a result of 2012 the increase of the retail trade turnover made 5.9% versus 7.0% a year ago. The slowdown of the consumer demand growth rates in 2012 occurred against the background of high annual growth rates of the real disposable incomes of 4.2%, of real wages – of 7.8% versus 0.4% and 2.8% correspondingly in 2011.

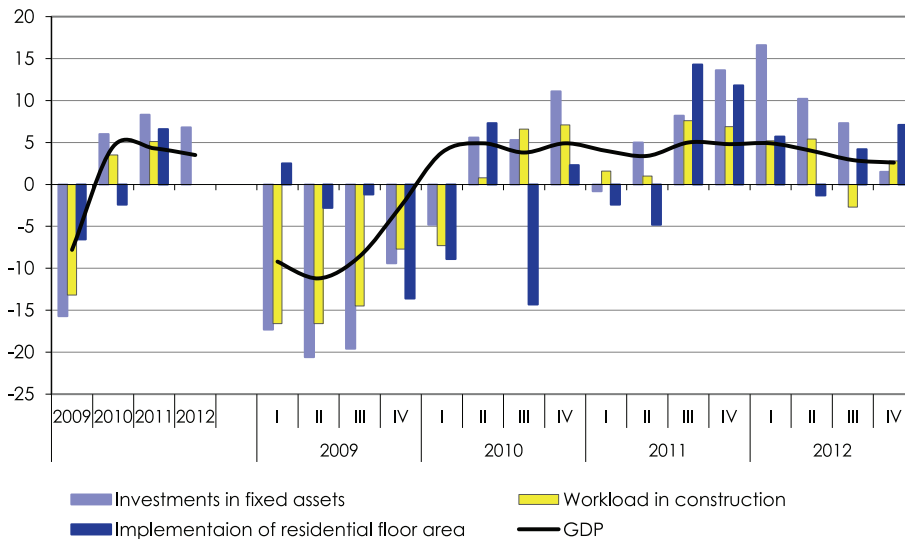
In 2012 quarter-by-quarter dynamics of the retail trade turnover demonstrates that the drop in the demand growth rates was accompanied by the gradual slowdown of the growth rates of the real incomes of the population and the real wages. In H1 2012 the increase in the retail trade turnover made 7.3%, the wages increasing by 10.7%, while in H2 2012, the figures were 4.5% and 4.2%, respectively, versus the corresponding period of the previous year. The inflation acceleration observed starting with H2 2012 has also had a negative impact on the consumer demand. The same as in 2011 the increase in the retail trade turnover occurred simultaneously with the expansion of the consumer crediting. In November 2012 the credits issued to the natural persons reached Rb 7887.5bn, having increased by 1.5 times versus the corresponding month of 2011. In January–November 2012 the proportion of savings in the incomes of the population remained approximately at the level of the previous year being equal to 9.1%. It should be noted that in January–November 2012 the proportion of expenses for foreign currency purchase in the incomes of the population was observed to expand to 5.1% versus 4.3% in the corresponding period of the previous year.

In 2010–2012 the growth rates in the investment sector anticipated the GDP dynam-



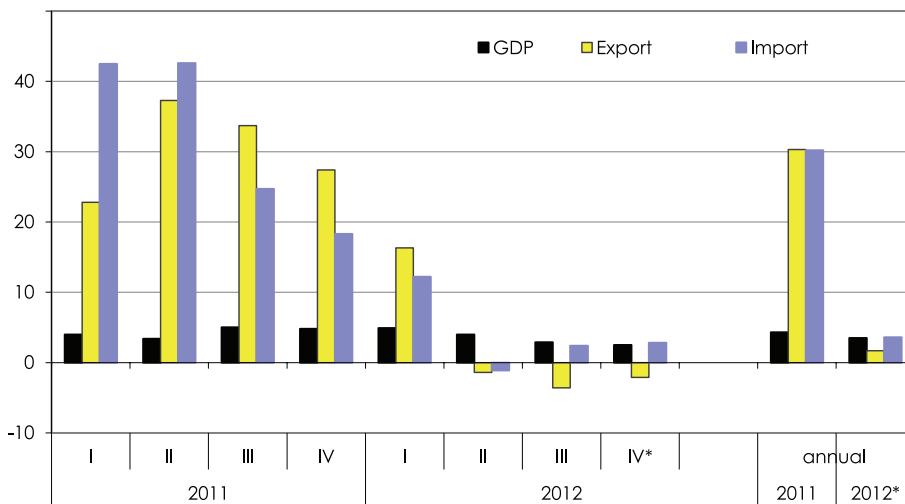
Source: Federal State Statistics Service.

Fig. 1. Dynamics of Retail Trade Turnover, Paid Services Rendered to the Population and Real Incomes on the Corresponding Period of the Previous Year, as Percentage



Source: Federal State Statistics Service.

Fig. 2. Dynamics of Investments in Fixed Assets and GDP, as Percentage to the Corresponding Period of the Previous Year



Source: RF Ministry of Economic Development, RF Central Bank, Federal State Statistics Service.

Fig. 3. Dynamics of Export and Import Value Volume and GDP Real Volume, as Percentage to the Corresponding Period of the Previous Year *) preliminary estimation

growth rates in Q1 2012. Value volume of the foreign trade expanded by 2.3% in 2012, export increasing by 1.7% and import – by 3.6%. Under the existing dynamics and structure of the foreign trade turnover, the foreign trade balance contracted by 1.4% as compared with the previous year.

The sector of commodities production was characterized by the intensified differentiation by types of economic activities. In 2012 the index of industrial production made 102.6% versus 2011 (104.7% in 2011 versus 2010), in minerals extraction – 101.1% (101.9%), in manufacturing industries – 104.1% (106.5%). It was the contraction of the agriculture production by 4.7% versus 2011 that had a negative effect on the economic dynamics in 2012.

In 2012 the manufacturing industry remained at the leading positions in the sector of commodities production as judged by the growth rates. However, it should be noted that the dynamics changed considerably in Q4 2012, when the growth rates hit the minimum of the post-crisis period of 2010–2012, making 2.8% versus Q4 2011. It should be noted that in December 2012 the production was observed to drop in the most types of the economic activities as compared both with the previous

ics. By 2012 the aftermath of the deep investment crisis of 2008–2009 was overcome. Thus, in 2012 the investments in fixed assets by 3.2%, and the implementation of the residential floor area – by 1.9% – exceeded the pre-crisis level of 2008.

As a result of 2012 the investments in fixed assets grew by 6.7% versus the level of 2011 (8.3% a year ago), the workload in construction – by 2.4% (5.1% in 2011), implementation of the residential floor area – by 4.7% (6.6%). The upsurge of the investment activity occurred in January–August 2012 died away in the following months, and in Q4 2012 the trend for the slowdown of the investment activity was observed, which is uncharacteristic for the Russian construction cycle, resulting in quite reserved growth figure on the whole over the year.

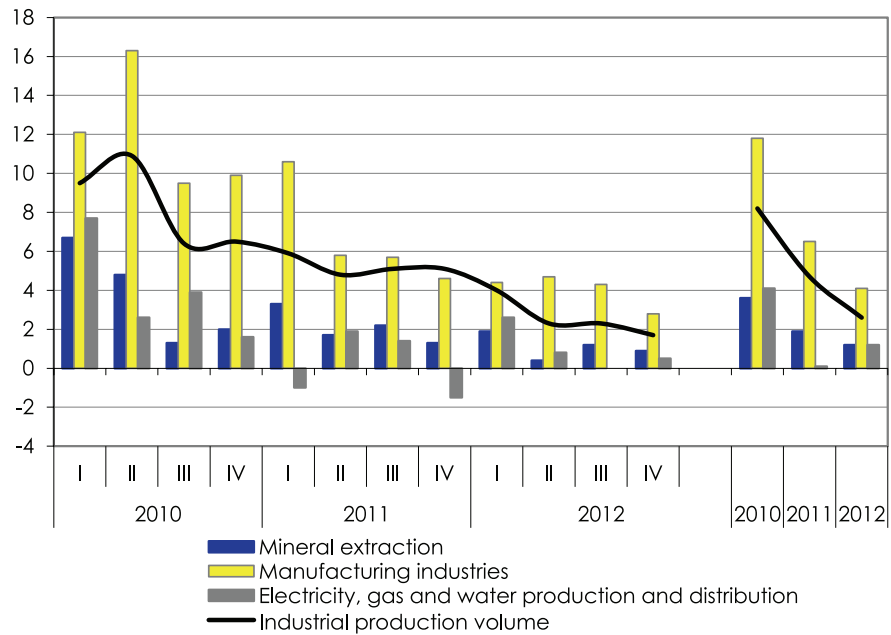
In 2012 the macroeconomic situation was considerably influenced by the drop of foreign trade growth rates in Q2–Q4, which intensified the trend towards the slowdown of the GDP growth rates. In 2012 the positive dynamics of the foreign trade indices was maintained due to the high

month and December 2011. The contraction of the production and demand, especially in machine-building and consumer complexes, at the end of 2012 will determine the conditions for the production development in the first months of 2013.

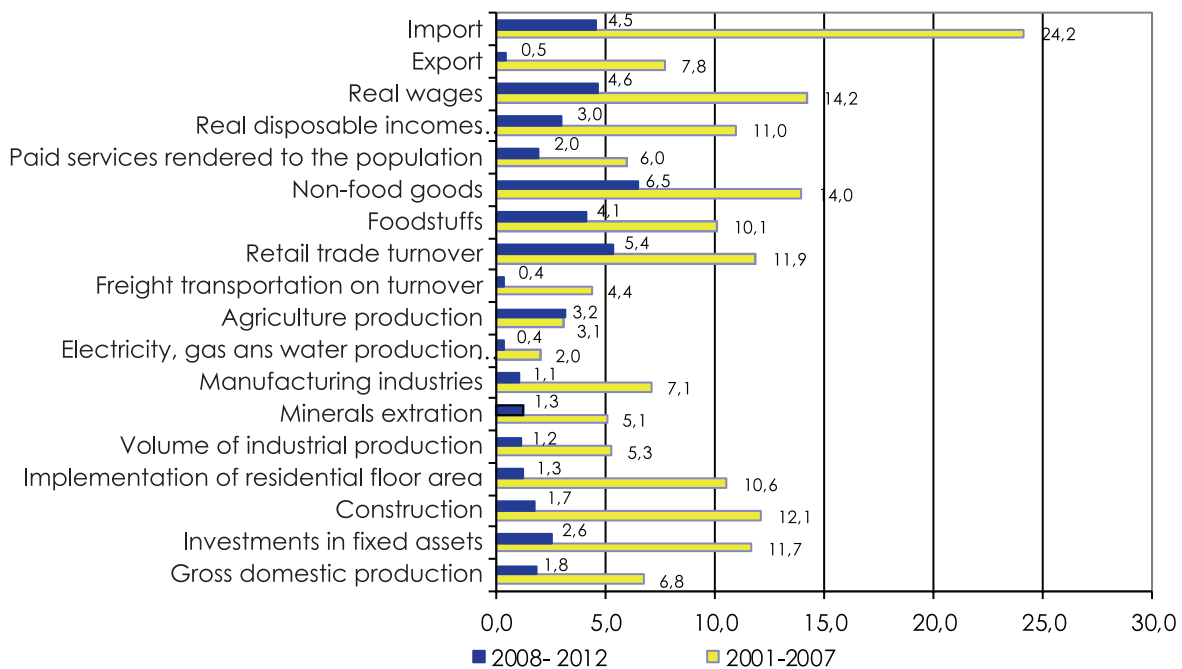
As compared with the previous year the production of the foodstuffs, rubber and plastic goods and construction materials grew at anticipating rates in the manufacturing industries.

Since in the post-crisis period the dynamic recovery of the machine-building had a considerable effect on the aggregated indices of the manufacturing industries development it should be noted that in 2012 the growth rates of machine-building complex made 107.5% versus 114.5% in 2011. However in 2012 it was only the production of the transport vehicles and equipment has recovered to the pre-crisis level of 2007. In 2012 the production of machinery and equipment, as well as production of electric, electronic and optic equipment remained at approximately 15% below the level of 2007.

Among the consumer goods productions, it is only the foodstuffs industry that is characterized by the steady positive dynamics. Textile and sewing production, leather, leather goods and foot-



Source: Federal State Statistics Service.
 Fig.4. Production Growth Rates, as Broken by Types of Economic Activities in Industry in 2008-2011, as Percentage to the Corresponding Period of the Previous Year



Source: Federal State Statistics Service.
 Fig. 5. Average Annual Growth Rates of the Main Socio-Economic Indices in 2011-2007 and 2008-2012, as Percentage

wear production have contracted versus the previous year. Under the existing dynamics of the consumer commodities production development the proportion of the domestically produced goods in the structure of retail trade resources decreased by 2% as compared with 2011.

The analysis of the main macroeconomic trends allows making conclusion that although in 2012 the Russian economy on the whole overcame the aftermath of the crisis the unsteady dynamics of the main macroindices and slow recovery rates of the investment sector will limit the development in the short run.

It should be noted that at present the economy is still dominated by the factors determining its dependence on the world prices for the exported raw materials: low internal demand and slow development of promising markets for consumer, investment and intermediate goods by the domestic producers, as well as the weak financial system.

Noting the significance of the internal market expansion as the factor dominating the post-crisis development of the economy in 2010–2012 the following factors should be taken into account. The current situation is complicated by the anticipating growth of import versus the export by the physical volume, and, consequently, the contraction of the net export. Besides, the Russian economy is characterized by the long-term trend for the anticipating growth of import supplies as compared with the dynamics of the domestic production.

The formation of the prerequisite economic conditions for the start of the steady development implies the fulfillment of a number of measures aimed at the modernization of the production potential, spurring of the investment activity and increase in the human capital assets quality. ●

RUSSIAN INDUSTRY IN DECEMBER 2012

S.Tsukhlo

An in-depth analysis of the December data from the surveys of the Gaidar Institute¹ showed that the end of 2012 was unfavorable to the industry. With continued weakening of demand in industrial products enterprises had to review evaluations of it, switch over to explicit reduction of output and prices, but keep under control the stocks of finished products. Workers keep quitting industry due to low wages and salaries, and investment plans are getting worse.

The Industrial Optimism Index

The December value of the Industrial Optimism Index (Fig. 1) shows that negative trends in Russian industry still prevail.

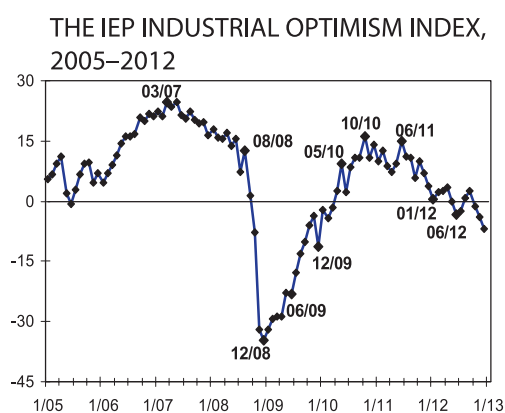


Fig. 1

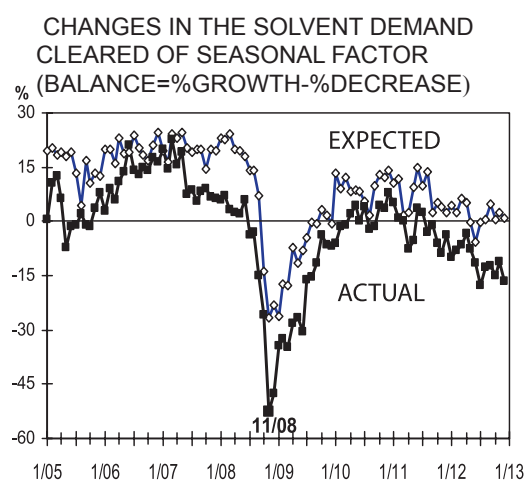


Fig. 2

The Demand on Industrial Produce

Late in 2012, the dynamics of demand on industrial produce was still negative. The initial data showed that the December rate of a drop in sales reached the four-year maximum, that is, such a strong drop in demand was never registered by surveys from 2009. With clearing of the seasonal factor (Fig.2), the value of the balance amounted again (as in July 2012) to the 42-month maximum (the worst value in this particular case). According to all the data available, the situation with sales in Russian industry is getting worse.

Also, the above conclusion is confirmed by enterprises' evaluations of current volumes of demand. In December, the share of normal evaluations fell to 40% and amounted to the 33-month minimum. Only in November–December, loss of satisfaction with sales in Russian industry amounted to 12 p.p. In November–December, in iron-and-steel industry satisfaction with demand amounted to the mere 23%. In other industries, that index is higher and remains mainly within a range of from 40% in engineering to 52% in light industry. In power industry and fuel industry, the rates of satisfaction with demand amount to 75% and 82%, respectively.

The Output

In December, the industry reported a strong drop in rates of change in the output. The initial balance lost straight 15 points, fell to -18 points and became the month's worst value in the 2009–2012

1 Surveys of managers of industrial enterprises are carried out by the Gaidar Institute in accordance with the European harmonized methods on a monthly basis from September 1992 and cover the entire territory of the Russian Federation. The size of the panel includes about 1,100 enterprises with workforce exceeding 15% of workers employed in industry. The panel is shifted towards large enterprises by each sub-industry. The return of queries amounts to 65–70%.

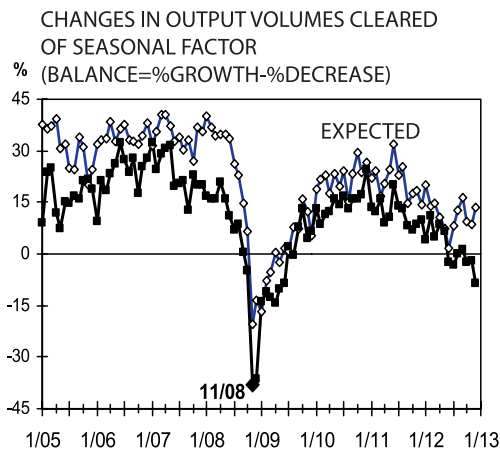


Fig. 3

to pay for such a return by considerably slowing down production.

However, in December initial output plans did not undergo negative changes (which are typical of that month) as compared to November. Probably, all such negative changes were “absorbed” by industry’s November plans and the actual dynamics in December. At present, the industry is looking to revival of production.

Stocks of Finished Products

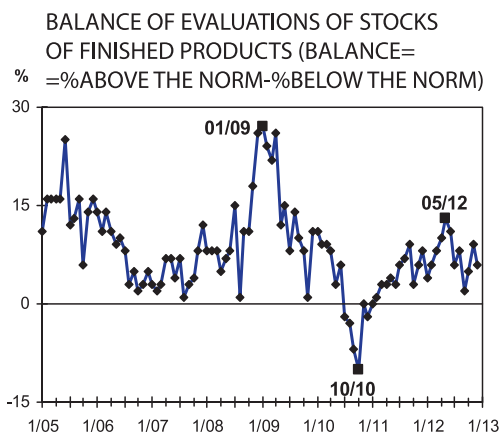


Fig. 4

period. Clearing of the seasonal factor showed a decrease in the balance from the symbolic -2 points to explicit -9 points (Fig. 3). After remaining at the level of stagnation in June–November (-2 .. +2), in December the rates of change in the output showed a tangible drop of such an intensity that was not registered by surveys in the past 3.5 years.

Such negative dynamics of output can be explained by enterprises’ willingness to bring changes in production in line with those in demand. In December, that relationship amounted to 70% though in October–November it was in the range of 60% to 61%, which situation was the result of industry’s effort to keep the output from explicit reduction. In the beginning of the 3rd quarter, the share of industry where the output outran the sales rose to 29–30%, though earlier that index was at the level of 20–21%. In December, it returned to the normal 20%. However, the industry had

Slowdown of the output dynamics permitted the industry to keep under control the stocks of finished products (Fig. 4) and improve by 4 points the balance of evaluations of them thanks to a decrease in the share of the *above the norm* answers. In the second-half year of 2012, the main portion of enterprises (65–70%) regarded their stocks as normal. Such evaluations in non-ferrous industry and chemical industry amounted to 93% and 81%, respectively. In iron-and-steel industry and food industry, they amounted to 75% each. In the second half-year, the share of normal evaluations increased along with growth in the size of enterprises. At small and mid-sized enterprises it amounted to 54%, while at large enterprise and very big plants, to 60% and 70%, respectively.

Prices of Enterprises

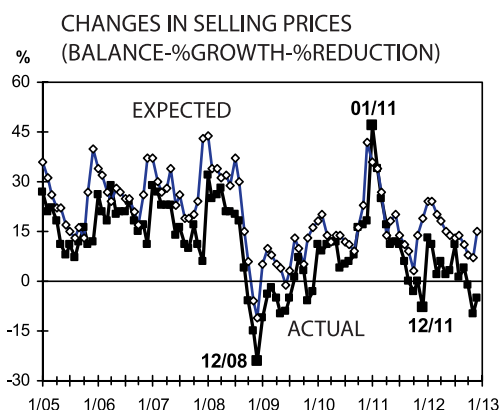


Fig. 5

In a situation of weak demand, industry has both to slow down the output and switch over to a reduction of prices (Fig. 5). For two months running, the strongest price reduction at the year-end in the 2009–2012 period was registered by surveys. It is to be noted that in October 2012 there was no growth in prices, while in August–September it was the minimum one.

In November–December, a price reduction in absolute terms was demonstrated by all the sectors of industry, except for fuel industry (balance +14 points), food industry (+10 points) and wood industry (+2). The strongest drop in prices took place in iron-and-steel industry (balance (-34) points), building industry (-7) and chemical industry (-6).

In December, enterprises' pricing plans rose straight by 8 points for the first time in 2012. In previous months of 2012, plans used to decrease, but at a very slow rate and, as a result, they lost only 17 points by November.

Actual Dynamics and Lay-Off Plans

In industry, reduction of employment has steadily continued since July 2012 (Fig. 6). Throughout the entire second half-year, the balance of change in the number of workers (rates of change) was in the range of from -13 points to -8 points. In the 4th quarter, the strongest reduction of workforce took place in wood industry (balance (-17) points), iron-and-steel industry (-15), light industry (-13) and engineering (-11). Hiring of workers was registered only in power industry.

Forecasts of changes in the number of the employed remain highly pessimistic for the second month running. Hiring of workers is likely only in non-ferrous industry. In other sectors, expectations of lay-offs prevail, particularly, in wood industry (-25 points), iron-and-steel industry (-24 points) and engineering (-21points).

Enterprises' Investment Plans

In December 2012, the balance of investment plans dropped straight by 10 points to the 3-year minimum (Fig. 7). A similar December drop in investment plans was registered late in 2011, but recovery took place already in January 2012. However, in May they fell to +5 points and remained that weak for four months running. After that, they kept gradually declining and in December they dropped to -15 points. Recovery from the last December drop is unlikely to be that quick as a year ago.

At the end of the year, positive investment plans prevailed only in wood industry (+7 points) and building industry (+3 points). In other sectors, they point to enterprises' intentions to reduce investment activities: in food industry to -48 points, light industry (-37 points) and iron-and-steel industry (-12 points).

Lending to Industry

In December, the aggregate ("above the norm" + "norm") availability of loans in Russian industry decreased from 69% to 62%. The latter value became the 32-month minimum. Such a drop took place due to tightening of access of large enterprises (with over 1,000 workers) to loans. In other groups, lending conditions did not change (Fig. 8).

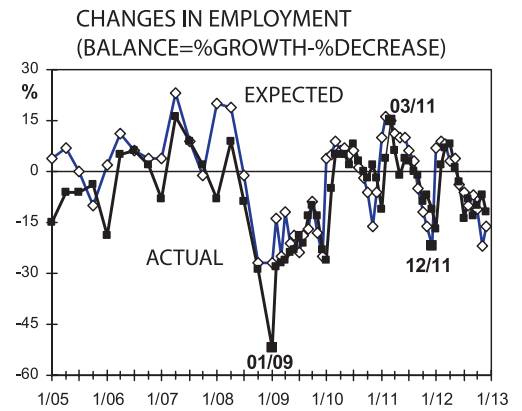


Fig. 6

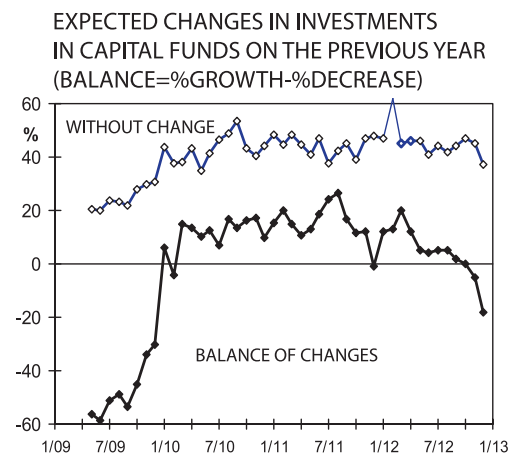


Fig. 7

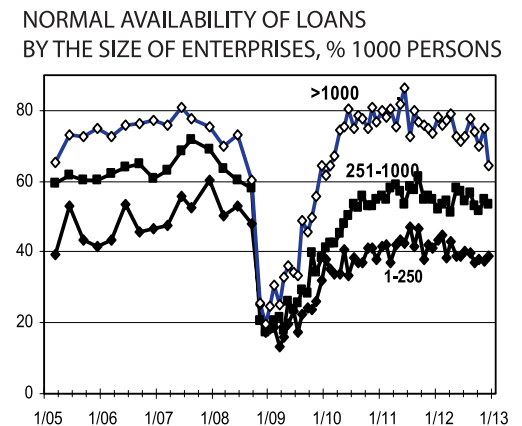


Fig. 8

FOREIGN TRADE

N.Volovik, K.Kharina

In November 2012, the negative dynamics of Russia's main foreign trade indices was observed, which situation reflects a drop both in domestic and external demand. Having become a full member of the World Trade Organization, Russia has started to utilize instruments developed by the WTO for protection of domestic producers.

According to the World Bank's Report on Global Economic Prospects¹ published in January 2013, the world economy is still unstable four years after the beginning of the global financial crisis. Economic growth in high-income countries remains insignificant. The main drivers of global growth are developing countries, but their growth rates are slowing down: the lowest economic growth rates in the past decade were registered virtually in all the developing countries last year. However, it is stated in the Report that despite the fact that the risks still prevail the possibility that they will materialize has decreased together with their potential negative effect, while the prospect of recovery of high-income economies faster than it was earlier expected has increased.

According to the estimates of the World Bank, in 2012 growth in global GDP amounted to 2.3%, though in June 2012 it was expected to amount to 2.5%. It is expected that in 2013 the growth rates will remain virtually unchanged and amount to 2.4%, while later they gradually increase to 3.1% and 3.3% in 2014 and 2015, respectively. In 2012, the developing countries' GDP rose by 5.1%. According to the forecast of the World Bank, in 2013 and 2014 it will increase by 5.5% and 5.7%, respectively, while in 2015, by 5.8%. Growth evaluations in countries with a high level of income were revised downward as compared to the earlier forecasts and amount to 1.3% both in 2012 and 2013 with subsequent growth to 2.0% and 2.3% in 2014 and 2015, respectively. In 2013, in countries of the euro area GDP is expected to decrease by 0.1%. Return of growth to positive values is expected only in 2014 when growth of 0.9% is forecasted. In 2015, growth of 1.4% is expected to take place.

The authors of the Report left the previous forecast of GDP of the Russian Federation in 2013 unchanged at the level of 3.6%, having admitted that in 2014 that index may rise to 3.9%, while in 2015 it falls again to 3.8%. On the basis of the 2012 results, growth in the Russian GDP amounted to 3.5%.

In 2012, the volume of the global trade increased by the mere 3.5%. According to the forecast of the World Bank, in 2013 the growth rates of the global trade in goods and services are to amount to 6.0%, while in 2014 and 2015, to 6.7% and 7.0%, respectively.

Slowdown of growth rates of the world economy has resulted in a situation where the global market's demand in the main fuel and energy commodities supplied by Russia decreased. As a result, early in 2012 growth rates of Russian export slowed down to be followed by a drop in Russian export in absolute terms. Due to slowdown of Russian economic growth rates, solvent demand on the domestic market went down and, as a result, import deliveries decreased.

In November 2012, Russia's foreign trade turnover calculated on the basis of the methods of the balance of payment amounted to \$75.5bn which is 2.8% lower than the 2011 index. It is to be noted that a drop both in import and export was registered. In November 2012, the volume of Russian export was estimated at \$45.4bn which is 4% and 1.3% lower than the November 2011 index and the previous month index, respectively. In November 2012, import fell by 1% and 4.6% as compared to November 2011 and October 2012, respectively, and amounted to \$30.1bn.

In November 2012, as compared to November 2011 the surplus of the foreign trade balance of the Russian Federation decreased by 9.2% from \$16.9bn to \$15.4bn.

¹ http://siteresources.worldbank.org/INTPROSPECTS/Resources/334934-1322593305595/8287139-1358278153255/GEP13AFinalFullReport_.pdf

According to the evaluation by the Bank of Russia of the 2012 balance of payment, in December 2012 export decreased by 2.6% to \$50.0bn as compared to December 2011, while import grew by 2.3% to \$31.4bn. The trade balance surplus fell by 9.8% to \$18.6bn.

As a result of development of shale gas and oil production technologies in the United States, the global energy resources market has split into the following two independent parts: the Eurasian market with high prices on oil and gas and the US market where a decrease in prices on those commodities is observed. The

US market depends completely on the state of the US economy and the continued tensions in the Middle East do not affect prices on energy resources in the US, unlike Europe and Asia. In January 2013, Iran suspended sale of oil and gas to all the 27 states of the European Union. Last year, Teheran suspended export of energy resources to Britain and France, while at present that decision is applied to all the countries of the European Union.

In November 2012, the European Brent oil cost \$23 more than the US WTI oil, while before the mid-2009 the price on the US WTI oil used to be \$2 to \$3 higher than that on Brent oil.

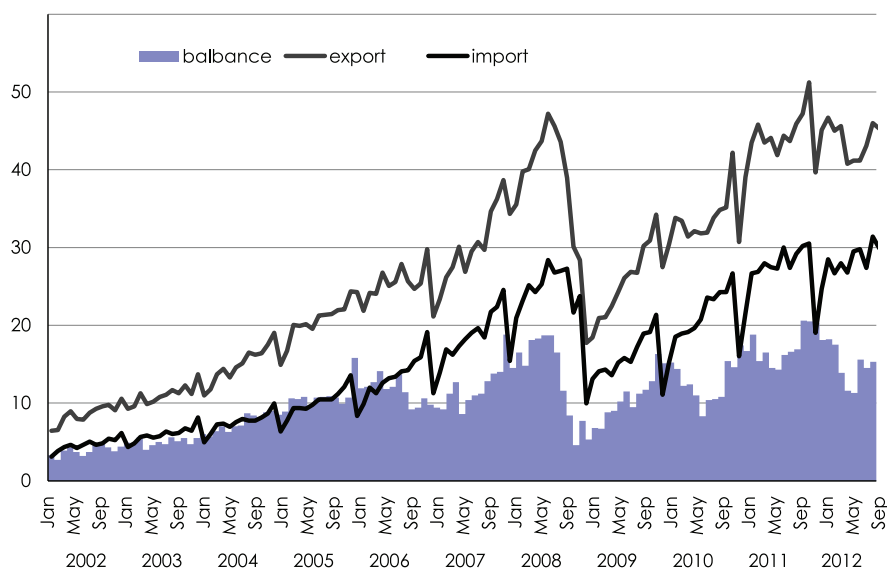
In November 2012, the average Brent oil price was formed at the level of \$109.71 a barrel which is 0.7% lower than the level of November 2011. The maximum price within the month was registered on November 19 (\$111.9 a barrel), while the minimum one, on November 3 (\$105.5 a barrel). In November 2012, the average price on Urals oil amounted to \$108.3 a barrel which is 2.1% lower than that in November 2011 (\$110.65 a barrel).

During eleven months of 2012, the average price on Urals oil was registered at the level of \$110.6 a barrel; in January–November 2010 it cost \$109.5 a barrel.

According to the data of the Ministry of Finance of the Russian Federation, in the period from December 15, 2012 till January 14, 2013 the average oil price under the oil price monitoring amounted to \$110.4 a barrel. So, in accordance with Resolution No. 27 of January 23, 2013 from February 1, 2013 the export duty on Russian oil will amount to \$403.3 per ton. From February 1, 2013, the single rate of export duty on light and dark oil products, except for petroleum, calculated on the basis of the “60/66/90” method will amount \$266.2 per ton against \$261.1 per ton in January. It is to be noted that the duty on petroleum – preserved at the level of 90% of the duty on oil – will grow in February to \$363 per ton from \$356 per ton in January.

On the global market of non-ferrous metals, the situation is still unfavorable for producers of non-ferrous metals. In 2012, the worst pricing situation emerged on the nickel market where in the period of eleven months nickel prices depreciated by 32.5% as compared to the same period of 2011. In the same period, tin depreciated by 28.7%, lead – 23.9%, aluminum – 25.2%, zinc – 14.8% and copper – 19.1%. The above situation can be explained by a drop in demand on the part of large consumers, that is, Europe which is experiencing debt problems and China where GDP growth rates have slowed down.

In November 2012, the FAO food price index amounted to 210.9 points which is 3.2 points lower than in October 2012. A slump took place mainly due to a drop in international prices on meat, grain and vegetable and animal fats. Sugar prices depreciated a great deal.



Source: The Central Bank of the Russian Federation.

Fig. 1. The main indices of the Russian foreign trade (billion \$)

Table 1

MONTHLY AVERAGE GLOBAL PRICES IN NOVEMBER OF THE RESPECTIVE YEAR

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Oil (Brent), USD/a barrel	24.18	28.77	43.05	55.54	58.48	92.53	53.24	77.42	85.67	110.50	109.71
WTI oil, USD/a barrel	26.28	31.09	48.45	58.28	59.13	94.76	57.29	78.0	84.24	97.12	86.68
Natural gas*, USD/1m BTU	3.34	3.90	4.96	7.46	8.99	9.47	15.81	7.81	8.59	11.32	11.83
Petroleum, USD/a gallon	0.801	0.841	1.43	2,056	1,484	2.13	4,195	2.01	2.16	2.58	2.66
Copper, USD/per ton	1519.0	1916.4	3012.0	4060	7500	8008	4925.7	6675.6	8756.8	7551.8	7711.2
Aluminum, USD/per ton	1313.2	1474.8	1822.8	1929	2659	2442	2121.4	1949.3	2596.3	2073.6	1948.8
Nickel, USD/per ton	6840.9	11030	14483	12403	32348	30999	12140	16991	22600	17882	16335

* Market of Europe, average contract price, Franco-border.

Source: calculated on the basis of the data of the London Metal Exchange and the Inter-Continental Oil Exchange (London).

In January–November 2012, according to the data of the Central Bank of the Russian Federation Russia's foreign trade turnover amounted to \$784.7bn which is 2.7% higher than the last year index. The export grew to \$480.7bn (growth of 2.1%), while import, to \$304.0bn (a 3.7% growth). Though the trade balance was positive and amounted to \$176.7bn, it decreased by 0.5% as compared to January–November 2011.

Growth in export supplies was observed only in respect of the following three commodity groups: food products and agricultural primary products, machines, equipment and means of transportation and fuel and energy commodities. Export of food products and agricultural primary products was growing at a higher rate (growth of 31.1% to \$15.4bn). The main factors behind that growth were a 17.9% increase in the export of grain and meslin in physical terms with growth of 15.9% in export prices.

In January–November 2012, the export of machines and equipment increased by 6.5% as compared to the same period of 2011. The volume of export of cars in value terms rose a great deal by 55.3%. 103,700 cars were sold abroad which figure is 39% higher than during 11 months of 2011. It is to be noted that export prices were 11.7% higher. Almost all the cars (96%) were sold to CIS states.

Growth in export of fuel and energy commodities in value terms took place due to an increase in export prices on oil, gas and oil products, by 1.7%, 3.8% and 3.4%, respectively. It is to be noted that the physical volumes of oil and gas exported from Russia decreased by 1.4% and 5.7%, respectively. The export of oil products in physical terms rose by 4.1% mainly due to growth of 14.8% in export diesel fuel supplies.

Despite growth in physical volumes of export of non-ferrous metals, the volume of export of the *metals and products made of metals* commodity group in value terms decreased by 4% as a result of a drop in export prices. In January–November 2012, the export of aluminum rose by 2.8% to 3.2m ton, nickel – by 30.9% to 201,600 tons, copper – by 63.5% to 230,700 tons as compared to the same period of 2011. Over 11 months of 2012, the export of aluminum and nickel in value terms fell by 8.2% to \$6.1bn and 7.9% to \$3.4bn, respectively, while that of copper rose by 33.6% to \$1.74bn.

Growth in import supplies was observed in respect of the following three commodity groups: chemical industry produce (growth of 4.2%), textile, textile products and footwear (growth of 5%) and machines, equipment and means of transportation (growth of 6.7%). As regards other commodity groups, import decreased.

Having become a full member of the World Trade Organization, Russia has started to utilize WTO instruments of protection of domestic producers. By decision of the Eurasian Economic Com-

mission, a preliminary special protective duty of 27.5% on import of combine harvesters to the Customs Union (CU) was introduced. The above duty will be in effect till July 5, 2013, included until the current investigation has been completed and a decision on imposition of the final protection measure taken.

After Russia's accession to the WTO, export duties on combine harvesters were reduced from 15% to 5%.

A protective investigation into the effect of imported combine harvesters on production of harvesters in the territory of the Customs Union was started as early as in July 2012. It was initiated by Rostov-based Rostselmash plant and Krasnoyarsk-based harvester-manufacturing plant. Their initiative was supported by Belorussian Gomselmash and Lidagroprommash plants. The above plants account for 95.9% of combine harvesters manufactured in the Customs Union.

To introduce special protective measures in accordance with the WTO rules, the Eurasian Economic Commission had not only to establish the fact of growth in import, but also justify that that growth was a sharp and sudden one and changed unexpectedly the situation on the market. In the course of investigation, the Commission succeeded in identifying such facts, that is, soaring growth in import and the damage caused by it to that industry of the Customs Union.

In the 2009–2011 period, the import of combine harvesters to countries of the Customs Union rose by 19.9%, while in the first six months of 2012, by 92.3% (on the same period of 2011). As a result, the domestic production and sales fell by 14.4% and 43.4%, respectively, while inventory stocks rose by 67.4%. The share of manufacturers on the CU market decreased by 14.6 p.p., while their profit, by 72.2%. The main suppliers of agricultural equipment to the Russian Federation are the US and the EU.

Manufacturers of agricultural equipment expect other measures of state support, as well, for instance, subsidizing of interest rates on investment loans, reduction of borrowing costs and support of the export.

In accordance with the decision of the Board of the Eurasian Economic Commission, from January 26, 2013 customs duties on import of personal computers which cost is below \$3,000 were raised from 0% to 10% of the customs value of the customs duty on import of personal computers which cost is below \$3000. The proposal to raise the import duty to that level was made in mid-summer 2012 by *K-Systems*, a Russian-based PC assembling company which is the owner of the IRBIS brand.

Within the frameworks of obligations assumed by Russia when it joined the WTO, the rate will gradually go down: a 10% duty will be in effect till August 2013 and then it will be replaced by a 6% duty until August 2014, while a zero rate is returned from August 2015.

The above decision is meant both to motivate foreign manufacturers to assemble personal computers in Russia and support domestic companies. In Russia, the share of Russian-manufactured PC does not exceed 20%, while the situation is quite the opposite in the markets of Belarus and Kazakhstan – according to experts' estimates the share of PC assembled in the territory of Russia amounts to 75%.

Belarus suggests that duties should be raised on most types of household appliances (microwave ovens and vacuum cleaners) within the limits of obligations of the Russian Federation to the WTO. ●

STATE BUDGET

T.Tishchenko

In 2012, federal budget revenues increased by 0.6 p.p. of GDP against the previous year. As per results of 11 months of 2012, revenues to the consolidated budget of the Subjects of the Russian Federation have decreased by 1.4 p.p. of GDP as compared with the same period of the last year. In general, the situation with the execution of the federal and consolidated budgets can be estimated today as balanced. However, the slowdown in economic growth and investment rates at the background of sustained uncertainty in the prospects of the world economy development can provide a negative impact on the budget system.

Tentative estimates of federal budget execution over January–December 2012

According to the Russian Ministry of Finance, federal budget revenues in January–December 2012 amounted to Rb 12,858.3bn (21.0% of GDP), which exceeds the indicator of the same period in 2011 by 0.6 p.p. of GDP (Table 1). The federal budget execution in cash terms made 99.6% within 12 months of 2012 and totaled Rb 12,871.1bn (21.0% of GDP), which is by 1.4 p.p. of GDP higher than the value of late 2011. Oil and gas revenues increased by 0.4 p.p. of GDP to Rb 6,452.9bn (10.5% of GDP); as of 2012 results, execution of the budget revenue in cash terms made 100.7% against the estimated value.

Table 1

KEY INDICATORS OF THE RF FEDERAL BUDGET WITHIN JANUARY–NOVEMBER 2011–2012

	January–December 2012		January–December 2011		Execution vs. estimated annual budget 2012, %	Change	
	Rb bn	GDP%	Rb bn	GDP%		Rb bn	p.p. of GDP
Revenue, including:	12858.3	21.0	11367.6	20.4	99.6	1490.7	0.6
Oil and gas revenue	6452.9	10.5	5641.7	10.1	100.7	811.2	0.4
Expenditures, including:	12871.1	21.0	10935.6	19.6	99.3	1935.5	1.4
Percentage expenditures	320.0	0.5	262.7	0.5	96.4	57.3	0.0
Non-percentage expenditures	12551.1	20.5	10672.9	19.1	99.4	1878.2	1.4
Federal budget surplus (deficit)	-17.2	0.0	432.0	0.8		-449.2	-0.82
Non-oil and gas deficit	-6470.1	-10.5	-5209.7	-9.3		-1260.4	-1.2
GDP estimates	61149.3		55798.6				

Source: Ministry of Finance of Russia (estimated values), RF Federal Treasury, Gaidar Institute assessments.

The expenditures growth as broken down by federal budget items (see Table 2.) in terms of GDP share within January–December 2012, as compared with the same period of the last year was noted in “National Security and Law Enforcement” – by 0.8 p.p. of GDP, “Social Policy” – by 0.7 p.p. of GDP, “National defense” – by 0.3 p.p. of GDP, “Healthcare” – by 0.1 p.p. of GDP. As per 2012 results, federal budget expenditures were reduced in three items, namely: “Intergovernmental Transfers” – by 0.2 p.p., “Housing and public utilities” – by 0.1 p.p. of GDP, “Physical Training and Sports” – by 0.01 p.p. of GDP, as compared with January–December 2011. In the other federal budget items expenditures in the twelve months of 2012 in terms of GDP shares remained at the level of January–December 2011.

The list of organizations of strategic importance, which includes those two producers, was approved by the Government Commission on Sustainable Development of the Russian Economy at the end of December 2008 in the framework of anti-crisis measures of the Russian Government. However, the feasibility of some organizations’ inclusion in this list and the need for government

guarantees on loans granted in the post-crisis period is questionable. For example, Lipetsk metallurgical works “Svobodny Sokol” is not (with regard to production scope of Novolipetsk steel mill located in the same region) a strategic enterprise or manufacturer of innovative products (according to quarterly reporting, its intangible assets are assessed at Rb 45,000). Moreover, the key shareholders of the company are legal entities registered outside the Russian Federation.

Table 2

FEDERAL BUDGET EXECUTION IN TERMS OF EXPENDITURES IN JANUARY–NOVEMBER 2011–2012

	January–December 2012		January–December 2011		Change, p.p. of GDP
	Rb bn	GDP%	Rb bn	GDP%	
Expenditures, total, including:	12871.1	21.0	10935.6	19.6	1.4
Federal issues	796.3	1.3	777.7	1.3	0.0
National defense	1812.8	3.0	1515.9	2.7	0.3
National defense and law enforcement	1833.0	3.0	1259.8	2.2	0.8
National Economy	1968.2	3.2	1790.1	3.2	0.0
Housing and public utilities	228.8	0.4	279.8	0.5	-0.1
Environmental protection	22.5	0.03	17.6	0.03	0.0
Education	603.8	1.0	533.4	1.0	0.0
Culture and cinematography	89.8	0.1	83.8	0.1	0.0
Healthcare	613.9	1.0	499.5	0.9	0.1
Social policy	3859.5	6.3	3128.5	5.6	0.7
Physical training and sports	45.7	0.07	44.2	0.08	-0.01
Mass media	77.5	0.1	61.1	0.1	0.0
Public and municipal debt servicing	320.0	0.5	262.7	0.5	0.0
Intergovernmental transfers	598.9	1.0	651.2	1.2	-0.2

Source: Federal Treasury, Gaidar Institute assessments.

In December 2012 the Ministry of Finance of Russia has carried out two payments to OAO “Sberbank of Russia” to perform liabilities under the state guarantee of the Russian Federation in the amount of:

- Rb 1.6bn under the liabilities of OAO “LMZ Svobodny Sokol” provided in 2009;
- Rb 1.5bn under the liabilities of “Volgograd concrete products plant No. 1”, provided in 2010

Despite the significant growth of budget expenditures by 1.4 p.p. of GDP in 2012 against the preceding year and the slowdown of the federal budget revenue growth, the budget deficit in 2012 increased only by 0.8 p.p. of GDP as compared with 2011 and amounted to Rb 17.2bn, or by 0.02% of GDP. Non-oil deficit in 2012 increased by 1.2 p.p. of GDP, while oil and gas budget revenue increased by 0.4 p.p. of GDP and accounted for 50.1% of the total federal budget revenue in 2012 against 49.7% of revenues in 2011.

As of 01.01.2013, the Reserve Fund amounted to Rb 1,885.7bn, and the National Welfare Fund – Rb 2,6906bn.

Key indicators of the RF Subjects consolidated budget in January–November 2012.

Consolidated budget of the RF Subjects was executed with a surplus of Rb 236.4bn (0.4% of GDP), with the execution of budget expenditures in cash terms at the level of 76.2% (Table 3). Consolidated budget revenues for January–November 2012 amounted to Rb 7,150.7bn (12.9% of GDP), expenditures – Rb 6,914.3bn (12.5% of GDP). Compared with the relevant period of the last year, there was a reduction of the budget revenue by 1.4 p.p. of GDP, expenditures decreased by 0.2 p.p. of GDP. Nevertheless, even with this reduction in expenditures, within 11 months of 2012 against the previous year, according to tentative data of the Russian Ministry of Finance, revenues of RF the Subjects in 2012 have exceeded by Rb 250bn the initial forecast¹ of Rb 7,900bn.

A comparison of taxes and levies revenue of the consolidated budget of the RF Subjects over 11 months of 2012 against the preceding year demonstrates:

1 <http://www.minfin.ru>

- reduction of corporate income tax revenue in terms of GDP share by 0.4 p.p.; in absolute terms revenue from this tax in 2012 made Rb 1,844.2bn against Rb 1,806.5bn in 2011;
- there were no changes in estimated in GDP share revenues from personal income tax (3.5% of GDP), excise tax on the goods produced in the RF territory (0.7% of GDP), property tax (1.4% of GDP), aggregate income tax (0.4% of GDP).

Table 3

KEY INDICATORS OF THE RF SUBJECTS CONSOLIDATED BUDGET IN JANUARY–NOVEMBER 2011–2012

	January–November 2012		January–November 2011		Change, p.p. of GDP
	Rb bn	GDP%	Rb bn	GDP%	
Revenues, including:	7150.7	12.9	6928.4	14.3	-1.4
Corporate profit tax	1844.2	3.3	1806.5	3.7	-0.4
Individual income tax	1940.3	3.5	1699.2	3.5	0.0
Excise duties in the RF territory	403.4	0.7	339.7	0.7	0.0
Property tax	759.2	1.4	660.0	1.4	0.0
Aggregate income tax	264.2	0.4	208.3	0.4	0.0
Expenditures, including:	6914.3	12.5	6156.7	12.7	-0.2
Surplus/Deficit of the RF Subjects consolidated budget	236.4	0.4	771.7	1.6	-1.2
GDP estimates	55460		48541		

Source: Federal Treasury, Gaidar Institute assessments.

Table 4

DYNAMICS OF THE RF SUBJECTS CONSOLIDATED BUDGET EXPENDITURES IN JANUARY–NOVEMBER 2011–2012

	January–November 2012		January–November 2011		Change, p.p. of GDP
	Rb bn	GDP%	Rb bn	GDP%	
Expenditures, including:	6914.3	12.5	6156.7	12.7	-0.2
Federal issues	423.5	0.7	390.8	0.8	-0.1
National defense	3.2	0.0	2.8	0.0	0.0
National defense and law enforcement	73.9	0.1	221.8	0.5	-0.4
National Economy	1233.3	2.2	1004.5	2.1	0.1
Housing and public utilities	691.9	1.2	731.7	1.5	-0.3
Environmental protection	16.7	0.03	13.5	0.03	0.0
Education	1767.2	3.2	1425.9	2.9	0.3
Culture and cinematography	219.7	0.4	188.6	0.4	0.0
Healthcare	1142.5	2.0	958.1	2.0	0.0
Social policy	1107.3	2.0	1010.9	2.1	-0.1
Physical training and sports	124.8	0.2	108.6	0.2	0.0
Mass media	32.2	0.05	27.9	0.05	0.0
Intergovernmental transfers	18.1	0.0	14.1	0.0	0.0
Public and municipal debt servicing	59.7	0.1	56.9	0.1	0.0

Source: Federal Treasury, Gaidar Institute assessments.

Within the first 11 months of 2012 the surplus was preserved in most regions and only in seven Subjects of the RF consolidated budget teas executed with a deficit, while the situation with the performance of the consolidated budgets, as compared with January–November 2012 has changed for the worse: then the budget surplus was observed only in seven RF Subjects.

Expenditures of the RF Subjects consolidated budget in the first 11 months of 2012 have decreased by 0.2 p.p. of GDP against the same period of 2011 (*Table 4*) with cash execution at 76.2% (73.5% in January–November 2011) due to expenses for items “National Security and Law Enforcement” by 0.4 p.p. of GDP, “Housing and public utilities” by 0.3 p.p. of GDP, “Federal Issues” and “Social Policy” by 0.1 p.p. of GDP each. Growth of consolidated RF Subjects regional budget expenditures over January–November 2012 as compared with the same period of the last year was noted only under the line “Education” by 0.3 p.p. of GDP.

Debt of the RF Subjects consolidated budgets on 01.12.2012 amounted to Rb 1,164.8bn, or 16.8% of revenues for eleven months of 2012. In 2013, due to financing of social liabilities for performance of the President’s Decree dated May 7, 2012 from the RF Subjects consolidated budgets, and public debt, according to tentative estimates of the Ministry of Finance of Russia may be increased by 11%.

Therefore, if the trends of reduction the growth rate of the regional budgets revenues are sustained in 2013, a number of Russian regions might need more subsidies from the federal budget. Thus, the state of regional budgets can become one of the negative internal factors, which affect the stability of the national financial system throughout this year. ●

RUSSIAN BANKING SECTOR

M.Khromov

Annual growth of budget expenditures, observed in December, has resulted in the funds extension of households and corporate clients with the bank accounts. This has urged a traditional growth of bank liquidity, which, however, has only slightly exceeded the refinancing rate of the Bank of Russia and the Ministry of Finance of Russia. The downward trend in the growth rate of bank assets and lending was maintained in H2 2012.

In December 2012 the growth rate of bank assets traditionally accelerated¹. In a month total assets increased by 4.2%. Nevertheless, the annual growth rate remained stable at about 20%. However, in 2012, for the first time after the crisis of 2008–2009, the growth rate of bank assets was recorded at a lower level than in the preceding year. In 2011 they were increased by 21.4%.

The Bank of Russia refinancing contribution in the growth of banking assets has been increased. In 2012, the regulator's support ensured 3.6 p.p. of the growth (about Rb 1.5 trillion), while in 2011, Rb 0.9 trillion, received by the banks, covered only 2.6 p.p. of the total banks' assets growth.

At the end of 2012 the banks' equity growth rate has increased. If in 2011 it has grown by 11%, in 2012 this indicator reached 14%. The rate of return on the banking authorized capital and the capital surplus more than doubled from 4.6% in 2011 to 10.7% in 2012, but the main source of banks' own funds growth is profit. As a result, in 2012 capitalization of earnings has ensured two thirds of the banks' own funds growth.

The volume of the banks' profit in 2012 has reached a record value in nominal terms – more than Rb 1 trillion. Herewith, in December financial performance of the banking sector (Rb 82bn) was close to the average monthly profit in 2012 (Rb 84bn). However, in the last month of the year a significant contribution to the final financial performance was made at the expense of provisions for possible loan losses. Regardless transactions with the provisions, the December profit could be far less – Rb 35bn.

Profitability of the banking sector for the year reached 2.3% in return on assets (ROA) and 19.8% in return on equity (ROE). These figures remain stable for nearly eighteen months. Therefore, it means that the record return on assets in nominal terms reflects only the expansion of banking business transactions.

Raised funds

In December the inflow of funds growth rate to the *deposits of individuals* with the banking sector made 6% or Rb 829bn. In general, as of the year end, the growth rate of the individual funds has not changed, having made 19.4% vs. 19.5% a year earlier.

In the choice between the deposits in national and foreign currencies, in December bank clients preferred accounts in rubles. Ruble funds of individuals with the banks have grown over the month by 7.1%, while foreign currency accounts in US dollar equivalent increased only by 1.8%. In this regard December is different from preceding months, when individuals were more actively accumulating deposits in foreign currencies. This situation is clearly based on seasonal factor and is associated with an increase in household incomes in December. As a result, if in the first 11 months of the year the growth rate on the funds with the banks in national and foreign currencies accounted for 11.1% and 19.5% with an obvious preference for FX deposits, by the year result, the dynamics of the two components of organized individual savings was more balanced: 19.0% and 19.5%, respectively.

The rate of household savings in cash and bank deposits in 2012, according to tentative estimates, amounted to 7.0%, that is, somewhat less than in 2011 (7.4%). At the same time, the bank-

¹ Hereinafter growth rates of balance sheet are adjusted for exchange rate revaluation of foreign currency component, unless otherwise indicated.

ing sector has got some more of the individuals' income than in the preceding year: 5.6% instead of 5.3%. It means that in 2012 the sustained inflow of funds to the banks at the level comparable to 2011 was largely due to a decline in demand for cash.

The volume of *corporate clients' assets* with the banks in December increased by 8.9% or Rb 970 bn. The December upsurge has not changed the trend of this type of bank liabilities growth rate in annual terms. As per the year result, the growth rate of the bank accounts of enterprises and organizations made only 10.7%, having decreased more than twice within the year (vs. 23.4 in 2011).

Herewith, in contrast to household savings, there was noted a clear shift in favor of the national currency in the dynamics of corporate clients' funds. Over the year ruble funds have grown by 13.0%, while foreign currency assets – only by 4.3%.

In December three fourths of the corporate return on assets were allocated on fixed-term deposits, rather than on settlement and current accounts. As of the year end, corporate sector has accumulated in the fixed-term bank deposits 54% of the total amount of funds allocated with banks by enterprises and organizations. This is the maximum value of this ratio for the entire period of comparable bank reporting.

Based on the banking reporting, their FX liabilities in December have grown by \$7bn, and all in all by \$31bn over the year. Due to the differences in accounting methods, this information is different from the balance of payments (39.5bn in 2012), but both of them evidence a significant gross inflow of non-residents funds to the Russian banking sector.

Table 1

STRUCTURE OF THE RUSSIAN BANKING SYSTEM LIABILITIES (END OF MONTH), AS % OF TOTAL

	12.07	12.08	12.09	12.10	12.11	03.12	06.12	09.12	10.12	11.12	12.12
Liabilities, Rb bn	20125	28022	29430	33805	41628	41533	44266	45861	47096	47669	49510
Own assets	15.3	14.1	19.3	18.7	16.9	17.5	16.8	16.9	16.7	16.7	16.2
Loans of the Bank of Russia	0.2	12.0	4.8	1.0	2.9	3.5	5.1	5.1	5.4	6.0	5.4
Interbank operations	4.1	4.4	4.8	5.5	5.7	5.1	4.8	5.1	5.1	5.1	5.6
Foreign liabilities	18.1	16.4	12.1	11.8	11.1	10.2	11.3	11.0	11.1	10.9	10.8
Private deposits	26.2	21.5	25.9	29.6	29.1	29.4	29.4	28.7	28.2	28.4	28.9
Corporate deposits	25.8	23.6	25.9	25.7	26.0	25.7	24.0	23.3	23.2	22.9	24
Accounts and deposits of state agencies and local authorities	1.5	1.0	1.0	1.5	2.3	1.4	1.5	2.5	2.7	2.4	1.6
Securities issued	5.8	4.1	4.1	4.0	3.7	4.8	4.5	4.8	5.0	5.0	4.9

Source: Central Bank of Russia, IEP estimates.

Investments

In December 2012 the bank's *retail lending* growth rate amounted to 2.4%. In total for the year the volume of outstanding liabilities on loans of individuals to the banks increased by 39.1%. This is certainly more than in 2011, when the growth rate of loans to individuals made 35.7%, but lower than the mid-2012 maximum peak. In H2 2012 lending growth rate was slowing down. As of 2012 end, bank lending has provided about 25% of retail turnover and household spending on commercial services.

The quality of retail loan portfolio indicators of the banking sector in the credit market in December has improved. The value of overdue debt has declined within the month by 5%, and its share in the loans to individuals made 4.1% against 5.3% a year earlier. The volume of provisions for possible losses over the last month remained virtually unchanged, but against the background of the total loan debt the ratio of provisions/loans decreased in December by 0.2 p.p.

A marked improvement in the quality of the loan portfolio is apparently caused by write-off of bad debts or its selling to collection agencies. This also may be the reason of low growth rate of total debt of individuals to the banks in December. This strategy of the banks was urged by more stringent re-

quirements of the Bank of Russia to the quality of loan portfolio, which makes it more profitable for the banks to transfer bad debts to collection agencies in the earlier periods of overdue arrears.

Corporate lending in December 2012 also demonstrated low rates of growth. The amount of overdue loans increased by 0.6% over the month and in total by 15.5% in annual terms. It is noteworthy that the increase of arrears in corporate clients segment has virtually matched the growth of retail loans. Outstanding liabilities of enterprises and organizations to domestic banks have grown over the year by Rb 2.50 trillion, while those of individuals – by Rb 2.34 trillion.

The quality of corporate credit debt in December continued to improve. Overdue loans decreased from 4.8 to 4.6%, and the ratio of provisions for loans – from 7.6 to 7.5%

Liquidity and government support

In December the federal budget is traditionally executed with a significant deficit, which results in replenishment of financial sector with surplus liquidity. Thus, the account balances of budgets of all levels with the Bank of Russia have been decreased by Rb 1.6 trillion in December. This indicator virtually matches the total growth of funds in the individual and corporate accounts with the banks (Rb 1.8 trillion).

The growth of funds in clients' accounts allowed the banks partially, and apparently temporarily, to reduce the volume of their arrears to the monetary authorities, but this reduction was much less than the increase in liquidity growth from budget resources. Thus, the amount of deposits of the Ministry of Finance of Russia with commercial banks has declined over the month by Rb 153bn, arrears of the banks to the Bank of Russia – by Rb 162bn, which makes in total about 20% of the budget funds, addressed to the economy in December.

Liquidity of the banking sector, i.e., the share of liquid assets in the aggregate banking assets made 6.7% as of January 1, 2013. This is by 0.4 p.p. higher than a year earlier (6.3% as of January 1, 2012). But on the basis of 2012, nearly total amount of the banks' liquidity was formed at the expense of the funds of monetary authorities. The banking sector own liquidity, excluding loans from the Bank of Russia and the deposits of the Ministry of Finance of Russia at the end of December has barely exceeded the zero indicator (0.2%), vs. 2.0% a year earlier. Therefore, as a natural result, in the first months of 2013 the banks' arrears to monetary market regulators will again exceed the value of liquid assets.

Table 1

STRUCTURE OF THE RUSSIAN BANKING SYSTEM ASSETS (END OF MONTH), AS% OF TOTAL

	12.07	12.08	12.09	12.10	12.11	03.12	06.12	09.12	10.12	11.12	12.12
Assets, Rb bn	20125	28022	29430	33805	41628	41533	44266	45861	47096	47669	49510
Cash and precious metals	2.5	3.0	2.7	2.7	2.9	2.4	2.5	2.6	2.6	2.6	3.1
Deposits with the Bank of Russia	6.9	7.5	6.9	7.1	4.2	3.2	3.0	2.8	2.7	2.9	4.4
Interbank operations	5.4	5.2	5.4	6.5	6.4	6.2	5.8	5.8	6.1	6.1	6.8
Foreign assets	9.8	13.8	14.1	13.4	14.3	14.2	14.2	13.9	14.3	14.2	13.0
Individuals	16.1	15.5	13.1	13.0	14.4	15.3	16.0	16.8	16.8	17.0	16.8
Corporate sector	47.2	44.5	44.5	43.6	44.0	44.4	43.6	43.4	42.9	42.5	41.3
Government	4.1	2.0	4.2	5.1	5.0	4.9	3.8	3.3	3.2	3.0	3.2
Property	2.2	1.9	2.7	2.6	2.3	2.4	2.3	2.3	2.3	2.2	2.2

Source: Central Bank of Russia, IEP estimates.

MORTGAGE IN THE RUSSIAN FEDERATION

G.Zadonsky

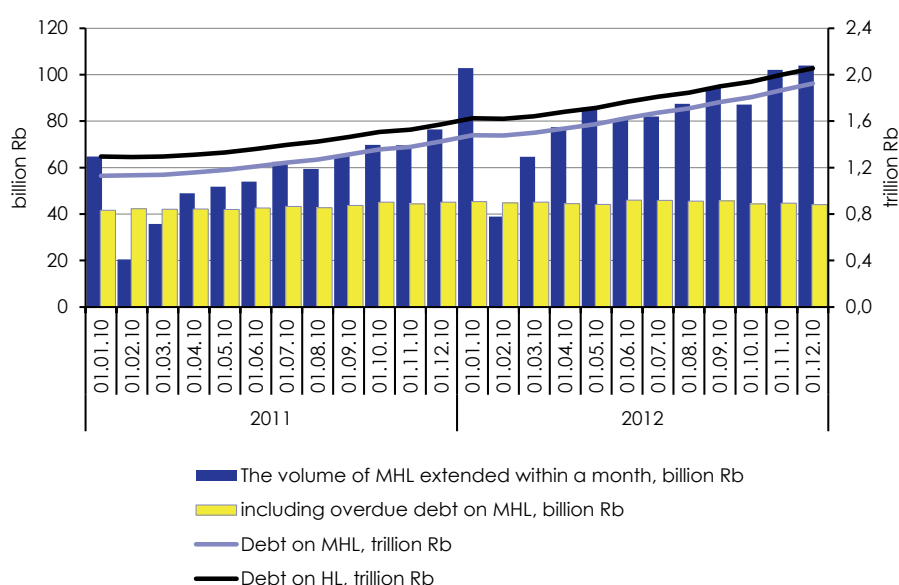
In 12 months of 2012, the volume of mortgage housing loans (MHL) exceeded by 47.3% that in the same period of 2011 and amounted to Rb 904.6bn, despite the continued growth in the weighted average rate on MHL in rubles extended within a month. In November 2012, the weighted average rate amounted to 12.5%. In November 2012, the overdue debt as percentage of the outstanding debt on MHL in rubles decreased to 1.38%, while that on MHL in foreign currency increased to 15.35%.

According to the data of the Central Bank of the Russian Federation, as of December 1, 2012, from the beginning of the year 611,487 mortgage housing loans (MHL) for the total amount of Rb 904.6bn were extended with the debt amounting to Rb 1,923.5bn. From the beginning of 2012, the number of loans and the volume of loans in monetary terms were 36.1% and 47.3% higher, respectively, than those as of December 1, 2011. As of December 1, 2012, the volume of housing loans (HL) amounted to Rb 943.5bn or 657,994 loans with the debt of Rb 2,055.1bn. In November 2012 (Fig. 1), Rb 103.9bn worth of MHL was extended, which figure is 1.82% higher than in October. As of December 1, 2012, the overdue debt on MHL decreased by 2.36% as compared to November 1 and amounted to Rb 44.1bn. It is to be noted that in November 2012 the share of the overdue debt in the outstanding debt on MHL decreased by 0.06 p.p. as regards loans in rubles to amount to 1.38% and increased by 0.19 p.p. as regards loans in foreign currency to amount to 15.35%. In November 2012, the total overdue debt as percentage of the total outstanding debt decreased by 0.1 p.p. and amounted to 2.29% as of December 1.

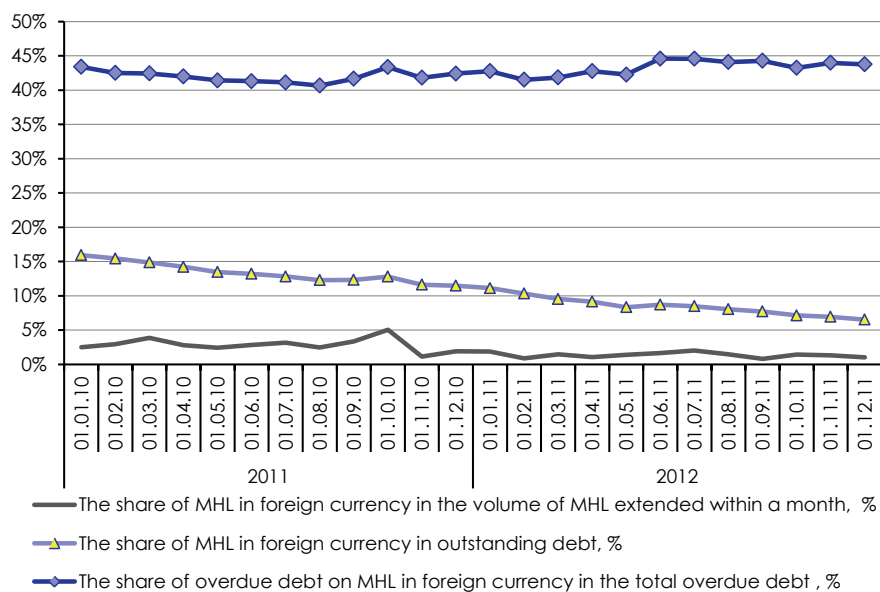
According to the data of the Central Bank of the Russian Federation, in November 2012 the share of the debt on MHL without overdue payments as percentage of the total debt on MHL increased by 0.09 p.p. and amounted to 94.87%. The share of the debt on defaulted loans (with payments overdue for over 180 days) in the total debt on MHL fell by 0.19 p.p. and amounted to 2.46%.

The share of MHL in foreign currency in the volume of loans extended in November 2012 amounted to 1.03% which is 0.3 p.p. lower than in October 2012. As of December 1, 2012, the share of such loans in the outstanding loan decreased by 0.4 p.p. as compared to November 1 and amounted to 6.54%, while the share of the overdue debt on MHL in foreign currency in the total overdue debt amounted to 43.76% as of December 1, 2012 (Fig. 2).

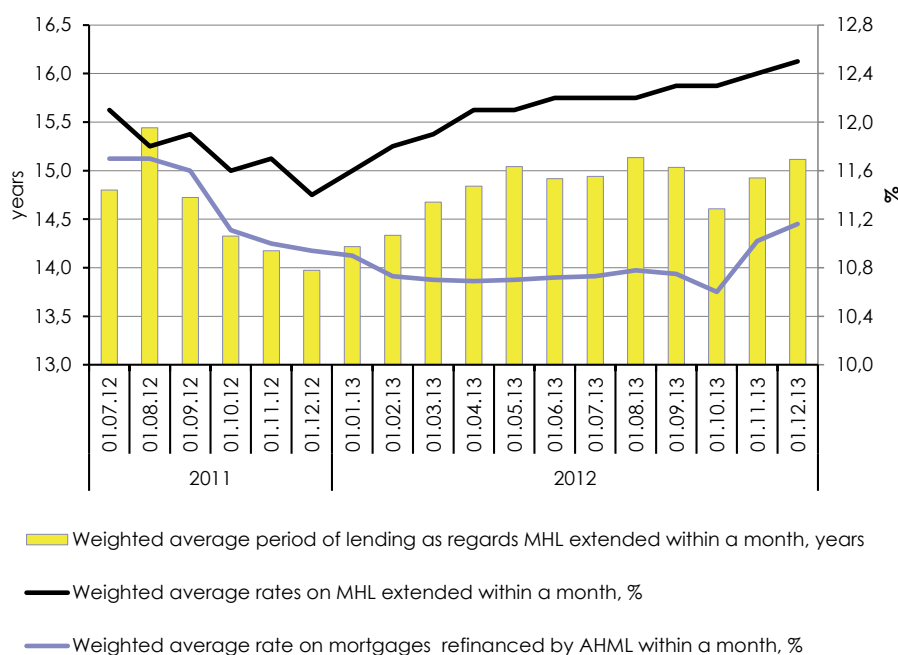
In November 2012, the weighted average rate on MHL in rubles extended within a month amounted to 12.5%, which is 0.1 p.p. and 1.1 p.p. higher than in October 2012 and November 2011, respectively. In November 2012, the weighted average rate on loans refinanced by OAO Agency for Housing Mortgage Lending (AHML) amounted to 11.16%, which is 0.56 p.p. higher than the minimum



Source: The data of the Central Bank of the Russian Federation.
Fig. 1. Dynamics of provision of housing loans



Source: On the basis of the data of the Central Bank of the Russian Federation.
 Fig. 2. Dynamics of correlation of rubles/foreign currency in the main MHL indices



Source: The Central Bank of the Russian Federation and OAO AHML.
 Fig. 3. The weighted average periods as regards MHL in rubles extended within a month and interest rates on such loans

risks related to provision of such loans are higher than those of MHL, the average value of such loans is lower than that of MHL and as of December 1, 2012 the average MFHL in rubles amounts to 62% of the average MHL in rubles (Fig. 4).

In January–December 2012, AMHL1 refinanced 45,489 MHK for the total amount of Rb 61.39bn. In January–November 2012, the share of loans refinanced by AHML in the total volume of MHL

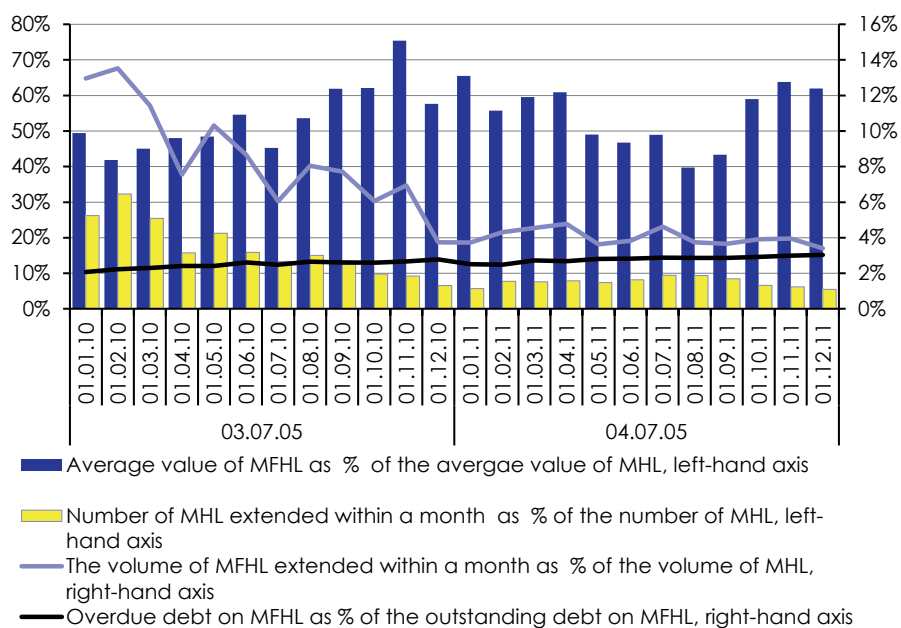
rate in September 2012 (Fig. 3). In the same period, the weighted average rate on HL in rubles extended within a month amounted to 12.6%, having gained 0.1 p.p. and 1.0 p.p. within a month and a year, respectively. As of December 1, 2013, the weighted average rate on MHL in rubles extended from the beginning of the year amounted as in the previous two months to 12.2%, while that on MHL in foreign currency to 9.7% as in the previous two months. In November 2012, the weighted average period of lending as regards MHL in rubles extended within a month amounted to 15.12 years (Fig. 3), while that as regards HL in rubles, to 15.0 years. As of December 1, 2012, the weighted average period of lending as regards MHL in foreign currency extended from the beginning of the year amounted to 11.6 years.

Housing loans (HL) include apart from MHL (that is, mortgage loans) mortgage-free housing loans (MFHL), as well. If the overdue debt on MHL in rubles as percentage of the outstanding debt kept decreasing and amounted to 1.38% as of December 1, 2012, the respective index as regards MFHL in rubles kept growing and amounted to 3.03% as of December 1 (Fig. 4). As

1 OAO Agency for Housing Mortgage Lending (AHML) was established by the Government of the Russian Federation in 1997 to ensure liquidity of Russian commercial banks which provide long-term housing loans to households by means of purchasing of rights of claim under such loans with use of funds attracted through placement of the Agency's bonds on the stock market.

in rubles amounted to 6.1%, which is 1.3 p.p. lower than in the same period of 2011. According to the estimates of AHML, in the total volume of loans refinanced by the Agency, social products amount to about 30%. In 2013, AHML expects to refinance over Rb 24bn worth of loans within the frameworks of all the social programs. The Agency plans to spend Rb 15bn and Rb 6bn on the Military Mortgage Program and the Maternity Capital Program, respectively. Also, about Rb 1bn and Rb 3bn are expected to be spent on the Young Scientists Program and the Young Teachers Program, respectively.

ZAO Ipotechny Agent NOMOS¹ has completed placement of Rb 5bn worth of A- and B- class mortgage-backed bonds with the maturity date of November 7, 2045. The Federal Financial Market Service of the Russian Federation registered the issue and prospectus of the above mortgage-backed bonds on November 29, 2012. ●



Source: On the basis of the data of the Central Bank of the Russian Federation.
Fig. 4. Dynamics of provision of non-mortgage housing loans (MFHL)

¹ Ipotechny Agent NOMOS, a closed joint-stock company was established on November 15, 2011 as a mortgage agent in accordance with Federal Law No. 152-FZ of November 11, 2003 on Mortgage-Backed Securities for carrying out securitization of mortgage loans of NOMOS-BANK, an open-end joint stock company.

INTEGRATION PROCESSES WITH IN THE CES SPACE: HAZARDS FOR RUSSIAN MILK PRODUCERS

N.Shagaida

The principal differences between economic systems in Russia and Belarus condition price advantages of Belarusian products over those produced in Russia. Belarusian producers operate under government restrictions on prices paid by them for agricultural inputs and received by them from marketing of their produce on the domestic market. In this situation penetration into the Russian market enables them to get larger profits owing to higher market prices for food in Russia. As a result Russian buyers are actually rendering support to exporters of Belarusian commodities and – to some extent – to Belarusian farm producers.

The increase of production and exports of farm products is one of the priority objectives declared by the Republic of Belarus (RB). At present the per capita production of milk in RB is 2.8 fold higher than in the EU countries, that of meat – 1.1 fold higher, of grain – 1.6 fold higher¹. The orientation towards larger exports of farm products is established in the republican state programs. According to Guidelines of the program for social and economic development of the Republic of Belarus in 2011-2015, by 2015 the country plans to increase exports of agricultural and food products up to \$7-7.2 bn.

Dairy and meat products dominate in the structure of Belarusian farm production conditioning the prevalence of these items in the country's export structure. In 2011 the share of farm livestock, meat and meat products² in the value of food exports to Russia amounted to 35.6%, the share of dairy products – to 47.9%, of sugar and sugar products – to 5.2%, of vegetables – to 2.1%. All other groups of food products accounted for less than 2% thereof³. Skipping the group of sugar and sugar products the supply of which to Russia is not attractive for Belarusian operators⁴, the export of meat and milk items is potentially most sensitive for the Russian market.

The expansion to the Russian market can be adjusted depending on the growth of domestic production in Russia: the Belarusian side is already building chains for the export of meat products to the non-CIS countries so as to re-channel supplies there in case of shorter demand in Russia.

Potatoes are also considered by Belarus as one of the priority items for export. So far their supply to Russia has been insignificant.

The country's strategic goal is the development of flax production and processing. Russia is not considered here as the main partner. The priority target for inviting foreign investments is the integration into production and marketing chains of transnational corporations which provides access to foreign technologies. Besides, the following priority directions for developing the country's agricultural production are named:

- highly efficient seed breeding;
- pedigree livestock breeding.

Elite seeds and pedigree animals are considered to be potential export items but so far they pose no threat to the Russian market.

The comparison of RB's potential exports of basic export items to all countries by 2015 with the current sales volumes of these products in Russia shows that the most vulnerable (i.e. the share of imported goods may reach 20% of the overall sales) segment of the market is that of milk and dairy products (*Table 1*).

The main flow of Belarusian products is forwarded not to the border areas but to Moscow and thus the fears of Russian producers – first of all the ones forming the market of dairy products in

1 <http://law.sb.by/1002/>

2 According to the Commodity classifier for foreign economic activities the group also includes products made of fish, shellfish and crawfish but their share is small.

3 Federal Customs Service, <http://stat.customs.ru/apex/f?p=201:4:985447166262331:proverka:NO::>

4 In 2012 Belarus will cut the purchase of raw sugar almost 2 fold. <http://news.tut.by/economics/271049.html>

Moscow – have grounds. The growing exports of Belarusian potatoes can also become sensitive for the national market as the structure of this crop production in Russia changes. At present the bulk of potato output is both produced and consumed by households. Only a small share of the overall volume produced is retailed. Therefore if one compares imports from Belarus with retail sales, the share of the former seems to be great. In case the production shifts from households to commodity farms supplying products to retail networks the competition with Belarusian potatoes is possible.

Table 1

ESTIMATED POTENTIAL EXPORTS OF BASIC FOOD PRODUCTS FROM BELARUS AS COMPARED WITH THEIR TOTAL RETAIL SALES IN RUSSIA

Item	Projected exports by 2015 as compared with 2010 (to all countries)	Total retail sales of this item in RF (2010 ¹)	Ratio of Belarusian exports (2015) to the total retail sales (less trade margin) in Russia (2010)
Milk and dairy products	2-fold growth (up to \$3 bn by 2015)	639.8 bn RF rubles or \$22.3 bn ²	Over 16% ³ (at present – 8.4%)
Meat and meat products	2.9-fold growth (up to \$1.8 bn)	1,326.1 bn RF rubles ⁴ or \$44.2 bn	5.7% (at present – 2.5%)
Potatoes	Small imports (500,000 tons or \$200 m)	80.5 bn RF rubles or \$2.7 bn	11% (at present – 3.8%)

Source: Rosstat, State Customs Service, RF Ministry of Agriculture, RB Ministry of Agriculture.

The plans of two governments specified in the national agricultural policies allow to identify hazards for farm producers.

Adoption of state programs for supporting milk production. Such programs were enacted in both countries at about the same time – in 2009. The Russia’s Ministry of Agriculture adopted the departmental target program “Milk”. The State program for milk industry development was adopted in the Republic of Belarus.

Term of the programs. In the Russian Federation the program was adopted for 3 years. From 2013 to 2020 the State program for agricultural development and regulation of agricultural and food markets in 2013–2020 (henceforth – the State program) will be in force.

In Belarus the program is effective from 2010 to 2015.

Financing. The RF program “Milk” envisaged financing to the amount of 12 bn RF rubles, i.e. 4 bn RF rubles per annum on the average. It’s impossible to estimate precisely the amount of milk industry financing under the State program.

The program of the Republic of Belarus stipulates allocation of 37.1 trillion RB rubles (in 2009 prices) to the industry’s development. Given that the official exchange rate is 90 RB rubles per 1 RF ruble, within 6 years the country plans to allocate 412 bn RF rubles to its milk program, or 68.7 bn RF rubles per annum. This means that the scopes of support are incommensurable: the Republic of Belarus plans to spend on it almost 17 fold more funds than Russia⁵.

The projected growth of output as the result of program implementation. The RF State program for agricultural development in 2013-2020 sets the task to increase the production of milk by 2015 by only 0.3 m tons as compared with 2009. The Republic of Belarus projects to bring its milk output to 10 m tons by 2015, i.e. to enlarge it by 4.4 m tons as compared with 2009.

The plans of Belarus government concerning milk production constitute an additional factor of risk that the expansion of this product to the Russian market will enhance.

1 The latest available data.

2 The exchange rate being \$1 = 30 RF rubles.

3 Retail price was “cleared” of trade margin. The level of this margin was determined as the ratio between retail and factory (or another supplier) prices. According to the data of price monitoring carried out by the RF Ministry of Agriculture as of July 1, 2011 the trade margin for meat was 1.4, for milk – 1.2, for potatoes – 1.5. mcx.ru

4 http://www.gks.ru/bgd/regl/b11_58/IssWWW.exe/Stg/d1/2-15.htm

5 At present the exchange rate of RB ruble fell almost 3 fold.

Russian producers of agricultural – and first of all dairy – products repeatedly draw attention of the RF government to the fact that it's hard for them to compete with farm producers from Belarus¹. Three hazards are formulated below:

- volumes of Belarusian supplies to the Russian market;
- low prices;

Belarusian subsidies per litre of milk exceed those in Russia 5 fold.

One of the hazards – volumes of supplied milk – was examined above. Further we'll attempt to estimate two other hazards.

Level of prices for Belarusian milk. From all the available sources the author derived information on prices for farm products in Belarus and Russia on the way of these products from producers to final consumers (*Table 2*).

Table 2

PRICES FOR MILK AT DIFFERENT STAGES OF PRODUCT CHAIN

Republic of Belarus	Russian Federation
Average farm producer price – 1545,0005 RB rubles per ton or 9.8 ² RF rubles per litre	Farm producer price (as of July 1, 2011) – 16.31 RF rubles per litre
Minimal limit prices for farm products purchased for state needs ³ : Extra – 1210,000 RB rubles per ton or 7.7 RF rubles per litre Superior grade – 1045,000 RB rubles per ton or 6.6 RF rubles per litre First grade – 965,000 RB rubles per ton or 6.1 RF rubles per litre	Products for state needs are purchased on the free market
Data not available	Factory price: Dry milk with 20–25% fat content – 165 RF rubles per kg; 1 litre of packed milk with 3.2% fat content – 28.1 RF rubles per litre; Butter – 212.6 RF rubles per kg
Price indicated in declaration submitted to the State Customs Service	Retail price
Imports from the Republic of Belarus to Russia 040120 – milk and cream, non-condensed, without adding of sugar or other sweeteners, fat content over 1% but not more than 6%–21 RF rubles per kg ⁴ 040210 – milk and cream, condensed or with adding of sugar or other sweeteners, powdered, granulated or in other solid forms, fat content not more than 1.5%–84.4 RF rubles per kg 040221 – milk and cream condensed, fat content over 1.5%, powdered, granulated or in other solid forms, without adding of sugar or other sweeteners – 64.5 RF rubles per kg 040229 – other milk and cream with fat content over 1.5%, powdered, granulated or in other solid forms – 102.7 RF rubles per kg 040510 – butter – 141.2 RF rubles per kg	Packed milk with 2.5–3.5% fat content – 31.99 RF rubles per litre ^{5*} Butter – 239.55 RF rubles per kg*

*average price on consumer market in 2010; data for 2011 are not available.

The prices for Belarusian dairy products are well below those for Russian produce. It's clear that in this situation Russian market is attractive for Belarusian producers. But why are prices in Belarus so much lower than those in Russia?

Price regulation. In the Republic of Belarus prices for agricultural and food products as well prices for farm inputs are regulated. The legal basis for this regulation are Decrees of the President

1 <http://pomidorus.ru/news/444/>

2 Agriculture of the Republic of Belarus, 2012. Converted into RF rubles at the average annual rate of RB Central Bank as of July 1, 2011: 1 RF ruble = 157.43 RB rubles. <http://nrb.by/statistics/Rates/AvgRate/?yr=2011>

3 Beginning from March 30, 2011 – Resolution of RB Government No.23 of 30.03.2011.

4 The average annual exchange rate is 29.35 RF rubles per 1 USD. <http://www.fedstat.ru/indicator/data.do>

5 http://www.gks.ru/bgd/regl/b11_58/IssWWW.exe/Stg/d1/2-31.htm

and Resolutions of the Government. Flour, bread, milk and dairy products, meat and (with some exceptions) vegetables are subject to regulation.

Besides, one sets prices for agricultural products purchased for state needs.

Until April 3, 2012 the RB Ministry of Agriculture took decisions on establishing minimal limit prices for agricultural products purchased for state needs. Among crop products concerned are grains, legumes (including those used for production of formula feeds), rapes, sugar beets, feed lupine, spring vetch. Among livestock products concerned are milk, pork, beef, live pigs and young cattle, cows, etc. Beginning from April 3, 2012 fixed prices are used instead of minimal limit prices. They are lower than the prices at which Russian producers sell their output. Although these prices are set for products purchased for state needs, they serve as a guide for other buyers.

Prices for farm inputs are regulated as well¹. The most important of them are gas, electric and thermal power. The RB Ministry of agriculture periodically informs by its circulars about recommended prices for formula feeds, feed grains for their production, veterinary drugs. For instance, in 2012 the department informed formula feed factories, livestock and poultry farms about recommended prices for purchasing new crop grain from farm producers. *Table 3* demonstrates that if converted into RF rubles at the rate effective on July 1, 2012 (the date of issuing the directive), prices recommended by the RB Ministry of Agriculture were well below those observed in Russia in the period of the most intensive harvesting works (as of September 1, 2012) when they were the lowest.

Table 3

RECOMMENDED PURCHASE PRICES FOR FEED GRAINS (THE RB MINISTRY OF AGRICULTURE, 2012)

	Price in Belarus, per ton		For reference: per ton price in RF
	1,000 RB rubles	RF rubles	
wheat	1200	4320	6080
rye	750	2700	4870
barley	1100	3960	5950
oats	600	2160	5210

The RB Ministry of Agriculture also periodically sends advisory circulars to the attention of buyers of formula feeds and regional bodies administering agriculture in which it indicates recommended ex-factory prices for formula feeds. Thus not only prices for inputs needed for manufacturing of formula feeds but also prices for formula feeds being an input for livestock production are restricted. At present a circular dating back to June 9, 2010 is posted on the Ministry's website but unfortunately no later publications are available. Prices are presented in *Table 4*. It can be seen that formula feeds from Belarus could be bought much cheaper as ex-factory prices for them were lower.

Table 4

LIMIT EX-FACTORY PRICES FOR FORMULA FEEDS SOLD TO FARM PRODUCERS

Type of formula feed	Recommended limit ex-factory price in Belarus, per ton		Price for formula feed in Russia as of 22.10.12, 1,000 RF rubles
	In 1,000 RB rubles	In 1,000 RF rubles	
For dairy cows KK-60 in bags	500	2.8	12.5 ² – 13.5 ³ (delivery from Moscow oblast) 6.5 (wholesale, 21 tons and up, delivery from Belarus) ⁴
For broilers aged 31 days and more	1070	6.0	13 ⁵ (Khabarovsk region) 5.5 ⁶ (Altay region) 25.7 ⁷ (Perm) 18.0 ⁸ (Penza)

1 The same practice exists in the Russian Federation but in Belarus prices for inputs are lower than in Russia.

2 <http://www.agroserver.ru/b/kombikorm-dlya-molochnykh-korov-i-koz-157660.htm>

3 <http://www.agroserver.ru/b/kombikorm-dlya-molochnykh-korov-164113.htm>

4 <http://www.agroserver.ru/b/kombikorma-dlya-krs-kk-60-kk-61-kdk-60-161777.htm>

5 <http://uspkorm.ru/p8110151-kombikorm-dlya-brojlerov.html>

6 http://borona.net/trade/poultry/Forage-fodder-feed-concentrates/Forage-fodder-feed-concentrates_314.html

7 <http://perm.tiu.ru/p5211937-kombikorm-dlya-brollerov.html>

8 <http://www.agroserver.ru/b/polnoratsionnyy-kombikorm-dlya-tsyplyat-broylerov-pk-6-rost-fini-187501.htm>

There are also recommendations concerning limit factory prices on oilseed meal (cake) and on products produced and marketed through OJSC “Belzooovetsnabprom”.

Despite the fact that the circulars are recommendatory, their effect should not be underestimated: in the Republic of Belarus there are a lot of enterprises that remain state-owned. For instance, by January 1, 2012 23.6% of corporate farms were fully owned by state and 24% had a state share in their capital¹. In this situation government recommendations look like insistent demands of the owner to follow his directives.

In addition to these prices and tariffs, the discount rate and bank interest rates on credits are regulated. The *discount* rate being the basis for shaping bank interest rates on credits was established directly till November 2012².

The terms of crediting were examined taking the case of Belagroprombank through which the most part of credits to the agrifood sector is channeled³. In addition to the fact that interest rates on credits are set pursuant to the President’s Decrees, it was revealed that:

- credits on purposes that the state identifies as priority ones (including the development of agriculture) are granted at much lower interest rates as compared with those in Russia;
- by means of credit terms benefitting entities engaged in export supplies to the Russian Federation, Belarus applies support measures that are prohibited on the territory of the Common Economic Space. In case a commodity is exported outside the Republic of Belarus, the producer can take a credit in RF rubles at the interest rate equal to the discount rate established by the RF Central Bank. This is far below market interest rates in Belarus.

Additional interest rate benefits in credit terms can be provided through support programs established under Decrees of the President. For instance, under the program for developing dairy industry the state partially compensates interest rates on credits – to the amount of discount rate. A Belarusian farm producer has to pay to the bank only 1.5% interest irrespective of the market interest rate. In Russia a farm producer pays the difference between the market interest rate and the discount rate that is compensated by the state.

The restriction of retail prices for farm products in Belarus leads to the restriction of prices for inputs. Lower costs result in competitive advantages of Belarusian commodities over the Russian ones. The restraining of prices on the domestic market coupled with the possibility to sell produce on the territory of Russia causes the reduction of output of products subject to price regulation in Belarus or to their outflow to the foreign market.

It’s hard to estimate the surplus export revenues of Belarusian market operators from administratively lowered production expenditures since there are mechanisms of regulating exporters’ incomes. Among them is the forced sale of 30% of foreign currency revenue. Given that administrative methods of establishing exchange rates are applied, such sales can infringe economic interests of exporters. In recent time due the deficit of currency, the foreign currency revenues of exporters-state entities are redistributed between enterprises of the industry at undervalued exchange rates (there are so called “intra-departmental exchanges”)⁴. Taking into account that not the part of the currency revenue that constitutes the exporter’s profit is to be sold but a part of the overall currency revenue, the exporter’s profit gets smaller. So, the current state of affairs with price advantages of Belarusian commodities is not stable but in the short and medium run it is hazardous for the Russian farm producers.

Given the principal difference between economic systems in Russia and Belarus it’s impossible to secure similar approaches to the support of farm production and to compare the extent of such support. The fact that dairy products in Belarus are produced under the administrative restriction of prices but are sold in Russia by market rules implies that the support to Belarusian producers is partially rendered at the expense of Russian consumers. ●

1 Agriculture of the Republic of Belarus. Minsk, Belstat. http://belstat.gov.by/homep/ru/publications/2012_16.php

2 http://www.ng.by/ru/issues?art_id=70038

3 According to Decree of RB President No. 480 of September 14, 2010 “On some issues of dairy industry development” two banks are charged with crediting the industry under the state program – Belagroprombank and the Savings bank “Belarusbank”.

4 <http://news.rufox.ru/texts/2011/08/25/209490.htm>

FORMATION OF LEADING UNIVERSITIES: THE RUSSIAN APPROACH

I.Dezhina

At the government level, an objective was set to secure a place for a few Russian universities in the world's best top list by 2020 by means of increasing considerably their budget financing. International experience points to importance of a combination of a few key factors for a university to be a leading one with the factor of funding being only one of them. The Russian approach should be adjusted towards expansion of the number of measures and go beyond the limits of quantitative and financial parameters alone in measuring achievement of that goal.

In May 2012, at the expanded meeting of the State Council President Dmitry Medvedev expressed an opinion that at least five Russian institutions of higher education (IHE) should secure a place in the top hundred of the main world ratings. By the end of the year, the reformed Ministry of Education and Science of the Russian Federation announced its plans to support 10 to 15 IHE which would be granted substantial budget subsidies for that purpose. As of 2013, Rb 9bn was reserved for development of that elite group of universities, while in 2014 and 2015 – \$21bn and \$24bn¹, respectively.

So, the main principles on which cultivation of leading research (they may be also called innovation and entrepreneurial as plenty of such fashionable terms have been coined recently) universities is based are the following: selection on a tender basis of 10 to 15 IHE, rendering of substantial budget support to such IHE and, by all appearances, concentration of efforts on meeting of a number of parameters which are included in the assessment criteria in preparation of international ratings. At present, the worst results of domestic IHE are related to their research activities, that is, the number and specific characteristics of publications, the quoting rate of such publications and the share of highly quoted papers which are indexed in global data bases. The above indices are expected to be raised by means of financial incentives.

Publication activities indices are, indeed, attached great importance to – they account for one-third of the total number of the main indices of achievement of the goals of the *Development of Science and Technology State Program*² approved late in December 2012. The above program provides for growth in the unit weight of “institutions of higher vocational training in domestic expenditures on research and development to 15% by 2020”.

The campaign to build up quantitative indices has already started: the number of IHE where lecturers are now paid extra funds for publications in journals and publications indexed in Web of science and Scopus global data bases, as well as in journals from the BAK list has increased. Will higher funding and better quantitative indices of publication activities permit Russian universities to become the world's leading ones?

If the international experience – as the established and thoroughly analyzed one – and recent debates are referred to, it becomes apparent that financial incentives are only one factor which is important for becoming the leader. A university becomes a leading one if a combination of the minimum three parameters is achieved³:

- Concentration of high-skilled personnel and gifted students;
- Sufficient funds which create favorable conditions for training and research;
- Effective management incorporating a strategic vision and flexibility.

So, financial indices alone are an important factor, but insufficient one. It is to be noted that though the quality of personnel can be ensured, including by means of a high pay, however, that

1 P.Panov. IHE will be granted Rb 55bn for securing a place in the world elite. 06.12.2012. <http://izvestia.ru/news/540974>

2 Resolution No. 2433-r of December 20, 2012 of the Government of the Russian Federation.

3 J.Salmi. Challenges of Establishing World Class Universities / Jamil Salmi, translated from English – M.: Ves Mir Publishing House, 2009, p.7.

factor is not a determining one. Research points to the fact that the high level of training and research strongly correlates with such index as mobility. So, on the basis of the data on European universities it was shown that there is a direct correlation between the policy of hiring, selection of lecturers and R&D outputs¹.

In particular, low domestic mobility creates an enclosed academic space and a university that enrolls mainly its own students in a master course and hires lecturers from among those who graduated from it will never become the world's leading one. Universities with a high degree of endogamy (that is, there is a large number of graduates of that university among lecturers) have the lowest R&D ratings. It is to be noted that high endogamy is the specifics of Russian IHE, including elite and status universities.

In its turn, effective management means that universities should have an autonomy which permits them to reduce red-tape barriers in decision-making and leadership, including successful experience of university managers in research work and engagement of managers of private companies in the work of universities' boards of trustees and boards. The private sector's contribution may consist in development of relevant training programs and plans, as well as applied research lines and projects. Finally, management will never be effective without academic freedom. It is for that reason Chinese universities fail to be among the leaders. At those universities, "lecturers and students can only to a limited extent call in question the state policy or participate in discussions of important issues. But such limitations hinder creative thinking"².

If the most up-to-date processes which both take place in the world's leading universities and have an effect on the state of such universities are referred to, it can be concluded that the HR policy and management are becoming ever more flexible. So, in 2012 the US National Research Council drew the government's attention to the fact that the leading positions of US universities needed to be strengthened as problems related to effective management were getting bigger and bigger. The above problems included the following: limited opportunities for young researchers to make an academic career, such complex regulatory norms introduced by the state as create an additional burden on universities and reduce efficiency of their work, as well as growing competition to win over the best foreign students and researchers³. The proposed solutions include the following: provision of higher autonomy to state research universities, easing of the formalities for inviting foreign researchers and enrolling the best students from abroad by means of optimization of visa-issuing procedures and strengthening of the role of business. Specifically, business is no longer regarded only as the buyer of intellectual property and graduates. The focus is shifted more and more towards development of post-graduate programs in the interests of science-intensive sectors and promotion of utility of science and its contribution to development of the community in general.

Similar processes take place at UK higher education institutions: the assessment criteria now include the index of "a contribution" and the index of "an impact" of the research in terms of the social utility⁴. So far, it is a widely debated topic as it is rather difficult to assess the contribution of research to economic, social and political development.

Finally, motivation of mobility and the proposed forms of hiring is getting more flexible. The practice of "life-long" tenures is becoming more and more controversial, new options of employment are being developed and various conditions of and ratios between training work and research work are offered and change in place of work for the period of from six months to a couple of years is encouraged as it is believed to be important for a lecturer or researcher to obtain new knowledge and skills and establish new professional contacts. Motivation of professors is changing, as well. The perception that a high pay can attract leading researchers does not work. Such factors as freedom of traveling, opportunities to maintain and develop scientific contacts, the minimum of bureaucratic formalities which accompany the research and availability of the state-of-the art

1 J.Salmi. Challenges of Establishing World Class Universities / Jamil Salmi, translated from English – M.: Ves Mir Publishing House, 2009, p.21.

2 J.Salmi. Challenges of Establishing World Class Universities / Jamil Salmi, translated from English – M.: Ves Mir Publishing House, 2009, p.63.

3 Research Universities and the Future of America. Ten Breakthrough Actions Vital to our Nation's Prosperity and Security. National Research Council, the National Academies Press, 2012.

4 <http://www.ref.ac.uk/>

technologies and chemical agents are getting more and more important. If not the last in that list, the factor of a pay is, certainly, not on the top.

In this context, the very first and, in a sense, simple steps are being made in the Russian policy aimed at promotion of Russian IHE to the range of leading research universities. However, at the initial stages it would be important to care about utilization of more subtle motivation instruments and introduce those which suit better the existing conditions. In particular, it concerns motivation of mobility, including that between IHE, reduction of the number of bureaucratic procedures at least at the IHE level and creation of the new basis of networking with industry. If promotion of such measures succeeds, they may be followed one day by development of academic freedoms, but that process is related to a greater extent to a change in mentality. ●

THE GLOBAL FDI MARKET IN 2012

A.Pakhomov

As demonstrated by preliminary data released by the United Nations Conference on Trade and Development (UNCTAD), in 2012, global foreign direct investment (FDI) inflows declined by 18.3% – to as low as \$ 1.3 trillion, which is practically the same as the level recorded over the crisis period. This situation has arisen as a result of turbulences across the world economy and the uncertainty of prospects for strategic investors¹.

A sharp drop in the inflows of foreign direct investment turned out to be an unexpected phenomenon for the UNCTAD's experts, who only a year ago had predicted a moderate growth of cross-border FDI flows (FDI Inflows) – approximately to \$ 1.6 trillion. However, as early as the first half-year of 2012, due both to the low rate of the world economy's development and the persisting financial troubles in the Eurozone countries, the volumes of FDI in the world shrank by 8.4%, and the rate of decline further accelerated towards the year's end. Such a situation contrasts noticeably with the rates of growth displayed by the behavior of the other macroindices of the world economy's development (*Table 1*).

Thus, the volumes of global gross product, world trade and employment had returned to their pre-crisis levels as early as 2010, while that of gross investment in fixed assets – in 2011. At the same time, the inflows of FDI in 2012 remained at a level of approximately 11% below their pre-crisis per annum average – \$ 1,472bn in 2005–2007, and nearly 41% below their record high (\$ 2,217bn) registered in 2007².

As a result, among all the sectors of the world economy, it is the investment activity that was hit hardest by the crisis, and it is the developed countries (where, last year, the level of FDI inflows dropped to their ten-year low) that experienced the most visible downfall. This is a clear indication of the sensitivity and vulnerability of the processes of global capital movement to the effects of a crisis – they need more time for recovery and reestablishment of the initial *status quo* than does any other sphere of the global economy.

Table 1

THE GROWTH RATES OF SOME OF THE WORLD ECONOMY INDICES IN 2008–2014 (%)

Index	2008	2009	2010	2011	2012*	2013**	2014**
Global gross product	1.4	-2.1	4.0	2.7	2.3	2.4	3.1
International trade	3.0	-10.4	12.6	5.8	3.2	4.5	5.8
Gross investment in fixed assets	2.3	-5.6	5.3	4.8	4.6	5.3	6.0
Employment	1.1	0.4	1.4	1.5	1.3	1.3	1.3
FDI	-9.5	-33.0	14.1	16.2	-18.3	7.7	17.1
Total FDI inflow (trillion USD)	1.81	1.21	1.38	1.60	1.31	1.4	1.6

* Estimate. ** Forecast.

Source: UNCTAD Global Investment Trends Monitor, Geneva, No 11, 23 January 2013, p. 2.

At the same time, the short-term forecasts published by the UNCTAD's experts are rather optimistic – they expect that the overall situation in the world economy is going to improve (*Table 1*)³. Thus, it is expected that, in 2013 and 2014, the global FDI flows will increase to \$ 1.4bn and 1.6bn respectively – provided, however, that no new macroeconomic upheavals occur over that period⁴.

1 See UNCTAD Global Investment Trends Monitor, Geneva, No 11, 23 January 2013, 8 p. The final data as to the cross-border flows of FDI will be published in the UNCTAD's next World Investment Report in July 2013.

2 World Investment Report 2011. Chapter IV *Non-equity Modes of International Production and Development*. UNCTAD, 2011, New York and Geneva, p. 2.

3 UNCTAD Global Investment Trends Monitor, Geneva, No 11, 23 January 2013, p. 5.

4 World Investment Report 2012. *Towards a New Generation of Investment Policies*, UNCTAD, NY & Geneva, 2012, Overview, p. 4.

However, a negative scenario is also possible. According to the pessimistic forecast of the World Bank (an unresolved debt crisis spreading into several EU member countries), the decline in the Eurozone in 2013–2014 may be observed at the level of 7.9% and 5.2%, and the slowdown in the world economy – at 1.7% and 0.5% respectively, while oil prices will drop by 25%¹. If such a scenario becomes a reality, global capital flows (being the most sensitive segment of the world economy) will be shrinking.

An analysis of the situation with regard to the worldwide investment process that emerged after the crisis has made it possible to identify the new trends and phenomena that became visible during the pre-crisis period of 2005–2007².

In 2010, for the first time in the nearly half-century history of UNCTAD statistics, in response to the redistribution of the declining FDI flows, the share of the developed countries in the group of FDI recipients decreased to less than one-half, which represents a certain psychological threshold. In 2012, the decline of FDI in the developed economies amounted to 32.1%, that in the developing economies – to only 3.2%, and in the transitional economies³ – to 13.1%. As a result, in 2012 the share in the global FDI inflow of the developing economies (first of all, in Asia) exceeded 52%, and that of the transitional economies amounted to about 6%⁴.

Besides, it is necessary to point out a number of other factors shaping the current phase of the global processes taking place in the investment sphere, as well as the mechanisms of their functioning. The annual dynamics of cross-border mergers and acquisitions (M&A) and international greenfield projects, the principal methods of capital investment, is highly volatile and displays multi-vectored trends of growth in different groups of countries across the globe.

In 2012, the total value of cross-border M&A dropped by 41% to its record low since 2009, largely due to the declining activity of businesses in the developed countries. The volume of cross-border transactions carried out by the developing economies, on the contrary, hit their record high of \$ 115bn, or 37% of all the purchases in that sphere. The value of greenfield projects has been on the decline for four years in a row, and in 2012 it fell by 34%. At the same time, greenfields take up 2/3 of global investment.

The biggest mega-deals are: the acquisition, by the Malaysian corporation *Petronas*, of *Progress Energy Resources Corp* (Canada) for \$ 5.4bn; the purchase, by Chinese *Sinopec Group*, of Brazilian company *Petrogal Brasil Ltd* for \$ 4.8bn; and the purchase, by *China Three Gorges Corp*, of the Portuguese company *Energias de Portugal SA* for \$ 3.5bn. In spite of the rising activity of Latin American cross-border corporations, Asiatic investors still account for approximately 75% of all the acquisitions made by businesses from developing economies.

The mechanisms of global capital movement have become more complex: primary FDI sources underwent a transformation (being now dominated by reinvested incomes instead of capital stock), the role of non-traditional forms of capital investment is increasing, and so on. Besides, some new investment policy methods have emerged that no longer have a direct financial component – for example, ‘Non-Equity Modes of International Production and Development’⁵.

The geographical origins of FDI have also changed: the traditional capital flows from the developed economies (North) into developing (South) and transitional ones (East) gave way to some new sustainable FDI flows along South-North, or even South-East routes.

1 *Kommersant*, 15 August 2012; *Vedomosti*, 24 January 2013.

2 For more details on the post-crisis trends in the world capital movement, see: Pakhomov A. A. *Eksport priamykh investitsii iz Rossii: ocherki teorii i praktiki*. [Export of Direct Investment from Russia: Essays on Theory and Practice]. Ye. T. Gaidar Institute for Economic Policy, *Delo*, 368 p.

3 According to the UNCTAD’s classification, the group of countries with transitional economy in 2012 consisted of 18 countries: all the member states of the CIS and former Yugoslavia (with the exception of Slovenia – a member of the EU), and also Albania. This classification is applied for statistical and analytical purposes, but by no means always reflects the specific phase of economic development of each given country. World Investment Report 2012. *Towards a New Generation of Investment Policies*, UNCTAD, NY & Geneva, 2012, p. ii.

4 In this connection, the aggregate amount of foreign direct investment in the economies of the new participants in the global movement of capital (the BRICs) was \$ 262.8bn, or 20.1% of the world’s total FDI inflow (in 2011 – \$ 281.0bn, or 17.5% respectively).

5 See World Investment Report 2011. Non-Equity Modes of International Production and Development, UNCTAD, NY & Geneva, 2011, 253 p.

The current phase is also characterized by an increasing role of governments in shaping the national and international investment policies – which can be regarded as a form of response to the imperfections of the market and competition mechanisms, which indirectly contributes to the increasing prominence of the political factor in the regulation of global investment flows.

In the UNCTAD's World Investment Report 2012 *Towards a New Generation of Investment Policies* (published in July 2012) it is noted that a broader development policy agenda is emerging in the world that has inclusive and sustainable development goals, implying attraction of FDI and ensuring that it yields tangible benefits. Such an approach will require that government should set and accomplish complex tasks at national and international levels¹.

All these trends have altered the nature and direction of global investment flows, including the market for loan and entrepreneurial capital. The financial and economic effects of the recent crisis acted as a catalyst of these changes. Such trends are further enhanced by the increasing multipolarity of the world economy and its major actors.

Probably, the crisis followed by recession caused some irreversible changes in the relative positions held by the existing groups of countries on world financial markets, including the loan capital market (issuance of loans, credits etc.) and the entrepreneurial capital market (investment in the material sector and services), which had previously been dominated by a limited number of developed economies. Thus, new centers (or poles) of power are emerging not only in the international financial system, but also in the world economy as a whole.

Table 2

LEADING COUNTRIES – FDI RECIPIENTS ACROSS THE WORLD IN 2012 (BN USD)

No	Country	Volume	2012 against 2011 (%)
1.	USA	146.7	-35.3
2.	China	119.7	-3.4
3.	Brazil	65.3	-2.0
4.	UK	62.5	22.2
5.	France	58.9	43.8
6.	Singapore	54.4	-15.1
7.	Australia	48.5	-26.3
8.	Canada	47.2	14.0
9.	Russia	44.1	-16.6
10.	Ireland	39.1	245.1

Source: UNCTAD Global Investment Trends Monitor, Geneva, No 11, 23 January 2013, p. 2.

In the list of leading FDI recipients (*Table 2*), Russia rose from 8th place in 2011 to 9th place in 2012, with her relative share in the world FDI inflow volume increasing from 3.3% to 3.4%. However, in this connection it should be remembered that, traditionally, approximately a half of that FDI inflow consists of Russian 'repatriated' capital – including the flows from offshore jurisdictions².

At the same time, as estimated by the RF Ministry of Economic Development, the minimum volume of foreign direct investment required for Russia's national economy's modernization should amount to \$ 75bn per annum, or twice as much as that of the current FDI inflow into this country³. This circumstance points to the existence of some systemic problems that are preventing Russia from being an attractive target for foreign investment, which have to do with the structural disproportions in the national economy, and Russia's unfavorable business climate and inadequate institutional environment. ●

1 La CNUCED propose un cadre pour les politiques d'investissement au service du développement durable, Rapport sur l'investissement dans le monde 2012 de la CNUCED, Communiqué de presse, Genève, 5 July 2012, p.2.

2 According to the RF Central Bank's preliminary estimates, the volume of FDI inflow in Russia's non-banking sector amounts to \$ 38.9bn. See *Otsenka platěžnogo balansa Rossijskoi Federatsii za 2012 god (analitichaskoe predstavlenie – po metodologii RPB 6)* [An Estimation of the Balance of Payments of the Russian Federation for 2012 (An Analytical Presentation – Based on the Balance of Payments Methodology 6)].

3 Beliaikov S. *Seichas sistema motiviruet biznes neformal'no reshat'svoi voprosy.* [At Present, the System Creates Incentives for Businesses to Settle Their Problems Informally]. *Kommersant-Dengi* [Kommersant Money], No 44, 5 November 2012, P.16.

2012: A YEAR OF THE STATE'S INCREASING PRESENCE IN THE STOCK MARKET

A.Abramov

During the recent financial crisis, governments in many countries around the world took on the role of an agency responsible for calming down market upheavals. This global trend has found expression in the adoption of measures designed to save systemically important financial institutions, in various quantitative easing policies, in turning private debt into public debt, and in a switchover to new internal control and risk management standards.

All those developments did not bypass Russia. In 2012, the Russian financial market saw further strengthening of the government's role, which manifested itself in its decision that a mega-regulator should be created; in the increased volume of credit resources issued by the Bank of Russia to the banking system, and primarily to state-owned banks; in the increased share of the government structures participating in the exchange trade in shares and bonds; in the putting forth, by the government, of various legislative initiatives in the sphere of financial markets; and in the increasingly prominent role of the Bank of Russia in the management of the Moscow Exchange. In late 2011, the unified exchange was turned into an organization whose controlling block of shares is held by government structures. In 2012, the Bank of Russia, state-owned banks and the Russian Direct Investment Fund (RDIF) owned 57.5% of the Exchange's charter capital.

Oftentimes, an increasing presence of the government on a financial market helps to eliminate certain problems that financial organizations are unable to tackle on their own in conditions of a well-developed market. Thus, for example, in 2012 the Bank of Russia dramatically increased the volume of loans issued to banks through REPO operations on the Moscow Exchange. As a result, over that year the banks managed to keep the growth rate of their credit portfolios at a high level without resorting to their formerly applied risky methods of capital attraction, including through the carry trading strategy¹. As shown in *Table 1*, this enabled Russia's stock exchanges to smooth over, on the stock market, the adverse consequences of the global-scale downward trend displayed by the exchange stock trade in response to investors' avoidance of risky investments. For reference: in 2012 the volume of trade in shares on US stock exchanges amounted to only 54.5% of its 2007 level; the value of that index for the London Stock Exchange, *Euronext* (Europe), and *Deutsche Börse* was 21.3%, 27.9%, and 37.9% respectively.

Table 1

BEHAVIOR OF MARKET TRANSACTIONS WITH SHARES ON MAJOR GLOBAL STOCK EXCHANGES
IN 2007–2012, IN TERMS OF VALUE (2007 = 100%)

	2007	2008	2009	2010	2011	2012
USA (NYSE и NASDAQ)	100	150.2	109.7	71.5	72.2	54.5
China (two exchanges)	100	70.2	114.9	103.1	98.5	63.8
Japan (Tokyo and Osaka exchanges)	100	90.5	64.5	65.9	64.0	55.5
UK	100	62.8	33.0	29.1	28.8	21.3
Euronext	100	78.2	35.1	35.8	37.8	27.9
Germany	100	92.3	38.3	41.8	52.3	37.9
Hong Kong	100	177.4	162.5	174.2	169.2	120.6
Canada	100	107.6	75.3	83.0	92.4	82.5
Australia	100	76.9	57.6	92.4	94.2	70.8
Russia (MICEX – market transactions)	100	74.5	90.5	106.0	151.9	44.7
Russia (MICEX – all trade modes)	100	117.2	71.4	84.1	134.6	125.7
NASDAQ OMX Nordic Exchange	100	73.6	40.3	41.3	45.6	32.3

Source: calculations based on data published by the World Federation of Exchanges (WFE).

¹ Cheap short-term currency borrowed abroad and then invested in ruble-denominated financial assets.

The current situation on the Moscow Exchange (MICEX-RTS) is very controversial. The volume of market exchange transactions with shares in 2012 dropped to only 44.7% of its 2007 level, while those of the transactions in shares carried on in all trade modes rose by 25.7%. We believe that the reason why, in contrast to many foreign exchanges, the overall volume of trade in shares on the Moscow Exchange in 2012 managed to remain above its 2007 level, was the indirect support of the stock market's liquidity by the Bank of Russia¹.

Nevertheless, the fact that, throughout 2012, the role of the government agencies on the stock market continued to gain in prominence have given rise to some thoughts as to where the limits for such an expansion should be set, and how high might be the risk that the attempts to prevent market downfalls may lead to government downfalls. The essence of one of the current problems is that the concentration of financial flows at the government agencies' level coupled with the Bank of Russia's liberal policy in refinancing the banking system significantly undermine any impetus for state departments and state-owned banks to create a system of domestic private savings. In 2012, some measures were implemented in order to reduce the amount of deductions to the funded component of the pension system in favor of its distributive component. As far as private pension saving is concerned, Russia has been following Argentina's example, with frequently changing rules of game on the pension saving market, complicated functioning of private pension institutions and shrinking deductions to the funded pension component². At the same time, so far the government has failed to offer the Russian public any new and attractive voluntary pension saving schemes. The year 2012, similarly to a number of previous years, saw no significant tax exemptions introduced for the purpose of encouraging people to invest in long-term saving, although such measures are indeed envisaged in the *Strategy for the Development of the Financial Market*, approved by the RF Government as of 29 December 2008, No 2043-r.

Although the period of 2011–2012 saw a number of major positive changes in the Russian stock market's infrastructure, including the merger of RTS and MICEX with the creation of a single Moscow Stock Exchange (MICEX-RTS), the adoption of legislation on a central depository, the implementation of an exchange strategy, the extension CCP stock market clearing with T+n (n>3) settlements, no solution to the problem of attracting to the exchange a broad range of private investors has been found so far. Moreover, a reverse trend has manifested itself after the merger, when the number of private investors operating on the Moscow Exchange continues to decline, the scale of participation of state-owned banks and the Bank of Russia in the exchange trade in shares and bonds is on the rise, and their influence in the structure of property on the new exchange is becoming stronger. So far, no qualitative changes have been seen with regard to attracting global foreign investors to its trading activity, either.

As a result, for a third year in a row, the MICEX – and now the Moscow Exchange – have been witnessing a shrinking number of active private clients of brokers, which are defined as individual investors completing at least one transaction with shares on an exchange (*Fig. 1*). A record high number of active clients of brokers – 114.1 thousand – was seen in 2009. According to our estimations, as of 1 January 2013 it was as low as 70.3 thousand. There has been a noticeable slowdown in the growth rate of the number of registered clients of brokers. In 2012 it increased by 24.7 thousand against 42.8 thousand in 2010 and 66.5 thousand in 2011.

In the structure of exchange transactions with shares, the percentage of market transactions declined from 62.4% in September 2009 to 13.0% in December 2012 (*Fig. 2*). The percentage of REPO operations whereby market participants attract necessary resources for margin credits to their clients rose in 2012 to 85.6%. This means that the bulk of the turnover of shares on the MICEX-RTS stock exchange is constituted by speculative leverage transactions, while the role of classical private investors on that market is limited. *Fig.3* shows the results of transactions with shares on the MICEX-RTS Main Market carried out by state-owned banks and related structures³.

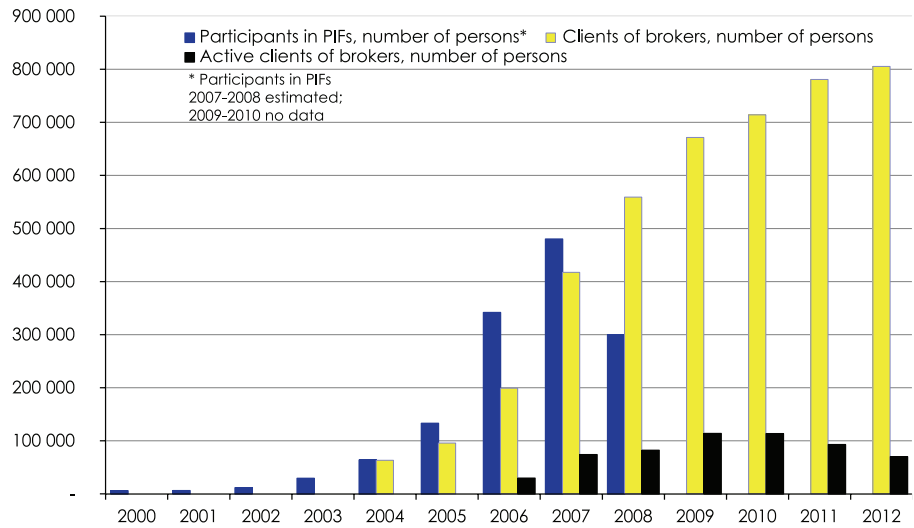
1 As a rule, the Bank of Russia carries out a very limited number of REPO operations on the exchange stock market. However, the high liquidity volume channeled by it to biggest banks through the market for REPO bonds enables the latter to use part of their excessive liquidity thus obtained to provide brokers and their clients with credits on the market for REPO shares.

2 A similar pension system development scenario in Argentina ended up in an enforced nationalization of private pension funds. As a result, as far as effective solutions to the pension provision problem are concerned, Argentina – a country with nearly a century-old history of pension system reforming – now lags decades behind Brazil and Chile.

3 VEB, VTB, VTB Capital, VTB24, Gazprombank, Sberbank, KIT Finance, Sviaz Bank, Bank of Moscow, TransCreditBank, and since 2011 – the *Troika Dialog* investment company.

During the period of market recovery after the 2008 crisis the participation of state-owned banks and their affiliated structures in exchange trades in shares had declined, but from February 2011 it was again on the rise, hitting the mark of 32.1% in December 2012. This can be explained by *Sberbank's* acquisition of the *Troika Dialog* investment company coupled with its increasing trade activity. Besides, in 2012 the Bank of Russia began to be actively involved in exchange trades in shares – since April, its operations have been varying between 2 and 8% of the total trade volume. These operations are associated with loans issued by the Bank of Russia to banks and secured by shares on the REPO market. Consequently, the volume of participation of private structures in exchange trading in shares so far has been displaying a downward trend.

On the bond market, which is used by private companies as a source of funding for their medium- and long-term investment, the situation in recent years has also been shifting in favor of the public sector. The secondary market has also been sustained mostly by state-owned banks acting in unison with the Bank of Russia. Moreover, it is state-owned banks that also act as underwriters and investment consultants in connection with the placement of corporate bonds. This fact is confirmed by the data presented in *Table 2*. In 2007–2012, state-owned banks were the un-



Source: The author's calculations based on data released by the National League of Management Companies and the Moscow Exchange.

Fig. 1. Number of Management Companies' Private Clients and Brokers

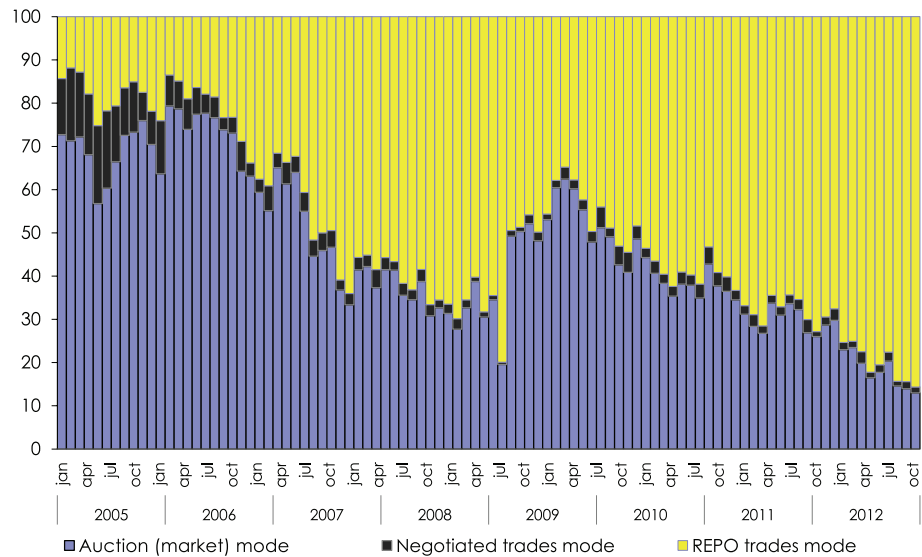
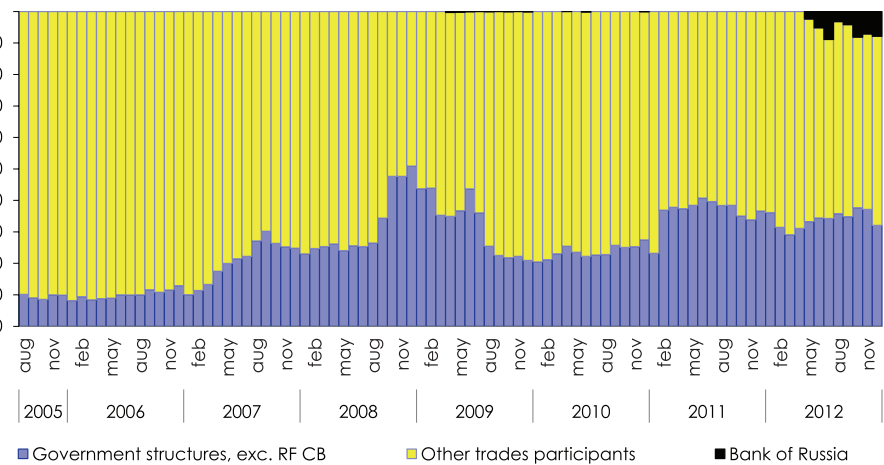


Fig. 2. Structure of Transactions with Shares in the Moscow Exchange's Main Market, %



Source: The author's calculations based on data released by the Moscow Exchange.
Fig. 3. Participation of Private and Public Brokers in the Trade in Shares on the Moscow Exchange, %

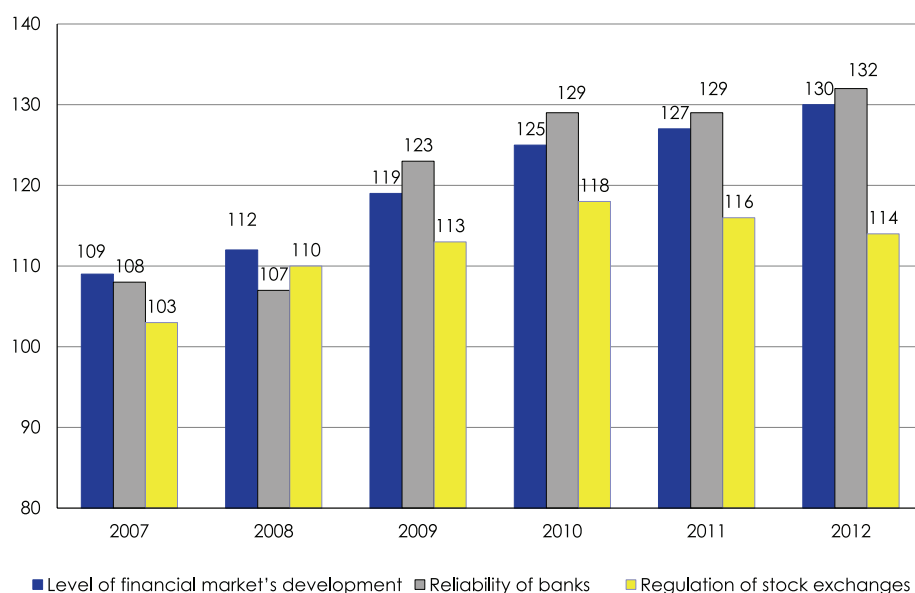


Fig. 4. Russia's Ranking in the World Economic Forum's Global Competitiveness Report

remains relatively weak. For example, Russia ranks 130th (out of 144) on the 'financial market development' indicator, 132nd on the 'soundness of banks' indicator and 114th on the 'regulation of securities exchanges' indicator. Besides, Russia's 'financial market development' indicator and the 'soundness of banks' indicator have deteriorated by comparison with the previous year.

Thus, the model based on the State's increasing role in the regulation and development of Russia's financial market have so far found no appreciation among global or domestic investors.

derwriters in approximately 40 to 60% issues of corporate and regional bonds (in terms of value).

The fact that the increasing interference of the State with the functioning of Russia's stock market has been giving rise to more problems is also confirmed by the competitiveness data released by the World Economic Forum (WEF). The WEF's Global Competitiveness Report 2012–2013, published in the autumn of 2012, shows that as far as a number of key indicators are concerned Russia's competitiveness position

Table 2

PARTICIPATION OF PUBLIC AND PRIVATE FINANCIAL ORGANIZATIONS IN THE MARKET OF SERVICES PROVIDED BY THE ORGANIZERS OF DOMESTIC BOND LOANS IN RUSSIA

	Issuers:					
	corporate bonds			regional bonds		
	Public financial organizations	Private financial organizations	Total	Public financial organizations	Private financial organizations	Total
2007						
Million rubles	169.668	298.302	467.970	7.551	45.481	53.032
Share, %	36.3	63.7	100.0	14.2	85.8	100.0
2008						
Million rubles	219.892	249.900	469.792	42.227	29.716	71.943
Share, %	46.8	53.2	100.0	58.7	41.3	100.0
2009						
Million rubles	620.044	373.978	994.022	133.325	22.511	155.836
Share, %	62.4	37.6	100.0	85.6	14.4	100.0
2010						
Million rubles	393.743	461.292	855.035	86.613	28.288	114.901
Share, %	46.0	54.0	100.0	75.4	24.6	100.0
2011						
Million rubles	620.698	374.146	994.844	7.767	46.177	53.944
Share, %	62.4	37.6	100.0	14.4	85.6	100.0
2012						
Million rubles	734.697	502.831	1.237.528	61.925	57.637	119.562
Share, %	59.4	40.6	100.0	51.8	48.2	100.0

Source: The ratings of bond placement organizers, see www.cBonds.ru for 2007–2012.

THE STATE DEFENCE ORDER: A NEW LAW THAT FOLLOWS THE OLD TREND

V.Zatsepin

At the end of 2012, Russia adopted the Law 'On the State Defense Order'. In its present form, that Law does not have any direct effect in the RF legal system. Moreover, it contains so many blanket and reference norms that analysts have begun to doubt the true intentions behind this legislative act. The Law totally ignores the RF President's calls for the creation of a 'transparent' defense economy and his demands that the authorities should streamline the management of the defense-industrial complex and introduce order into its pricing policy.

On 1 January 2013, just one day after it was officially published, the new Law 'On the State Defense Order' entered into force¹. Public opinion had been focused on the Law's passage through the RF Federal Assembly since early March 2012, when the corresponding draft had been introduced into parliament by the RF Government, in the person of the apparatus of the Military-Industrial Commission (MIC). The Draft Law was considered by the relevant Committees of the RF Federal Assembly, including in the course of field hearings carried out in Russia's regions². Throughout all the stages in the consideration of the Draft Law, the circle of discussants invariably included members of the Civic Chamber of the Russian Federation, the Union of Machine Builders, and the League of Assistance to Defense Enterprises.

Despite all this activity, no significant alterations had been made to the content of the Draft Law since March 2012. Thus, the wording of the Law as signed by the RF President generally coincided with that of the Draft Law submitted, on 16 May 2012, to the first reading in the State Duma by First Deputy Chairman of the MIC Yuri Borisov. It should be noted that those who promoted the Draft Law had utterly failed to prove the necessity of its becoming law, while a number of progressive amendments (including public competitor negotiations) put forth after the first reading by the State Duma Defense Committee and actively advertized by its Chairman, Vladimir Komoedov³, were rejected by his own First Deputy, Sergey Zhigarev, in the course of the second reading on 19 December 2012 – under the pretext that their content 'fall outside the scope of the Draft Law's concept adopted in the first reading'⁴. However, Zhigarev promised that 'these innovations will be included in the text of the new draft law on state policy in the field of resource provision for national defense and state security'⁵.

Thus, the 'conservative' version of the Law – a direct descendant of its March version developed by the MIC – has finally gained the upper hand over the 'progressive' version that had emerged and circulated in May and June in the State Duma⁵. Unfortunately, all the principal drawbacks

1 For the state defense order, see Federal Law of the Russian Federation, of 29 December 2012, No 275-FZ; adopted by the State Duma of the Federal Assembly of the Russian Federation on 19 December 2012; approved by the Federation Council of the Federal Assembly of the Russian Federation on 26 December 2012 // *Rossiiskaia Gazeta* [The Russian Gazette]. 31 December 2012.

2 See, for example, Yu. Avdeev. *Oboronnoe 'veche' v Tule* [A defense Pow Wow at Tula] // *Krasnaia Zvezda* [The Red Star]. 6 June 2012 (No 99).

3 *Komitet Gosudarstvennoi Dumy po oborone provel vyezdnye parlamentskie slushaniia na temu: 'O proekte federal'nogo zakona «O gosudarstvennom oboronnom zakaze»' v g. Tule* [The State Duma Defense Committee Has Carried Out Its Field Parliamentary Hearings, in the City of Tula, Entitled 'On the Draft Federal Law 'On the State Defense Order'] // *Novosti Komiteta po Oborone Gosdumy* [News of the State Duma Committee]. 29 May 2012. URL: <http://www.komitet2-15.km.duma.gov.ru/site.xp/052057124055049057.html> (date of notification: 1.06.2012).

4 Minutes of the State Duma meeting on 19 December 2012. URL: <http://transcript.duma.gov.ru/node/3764/> (дата обращения: 14.01.2013).

5 See *Joint Opinion on Draft Federal Law, No 31990-6, 'On the State Defense Order and the Introduction of Alterations into Some Legislative Acts of the Russian Federation'* (second reading) [Entered under No 3.14-6/479, of 8 June 2012]. Moscow, Legal Administration of the State Duma Apparatus, [s.d.] URL: <http://asozd2.duma.gov.ru/main.nsf/%28SpravkaNew%29?OpenAgent&RN=31990-6&02> (date of notification: 20.06.2012).

of the Draft Law immediately exposed by the MPs in the course of the first reading¹ were later included in the Federal Law.

First of all, the case in point is the strengthening of the ‘frameworkness’ of the new Law – the number of references to some as yet non-established procedures to be determined either by legislative means or by the government has risen by 25%. In his interview on 21 January 2013, Deputy Prime Minister and Head of the MIC Dmitry Rogozin confirmed that the quality of the new Law was indeed low: ‘The Law has been adopted. Now we have to prepare about ten resolutions on how to enforce this Law and what kinds of contacts are needed; we will accomplish this work, we are working hard, but it will take some time...’². According to his (rather optimistic) estimate, ‘it would take two or three months to create a legal framework’ for the state defense order.

It is not very difficult to understand why the Government needed this new Law: it has not restricted the Government’s powers and has not made any mention of the state authorities’ responsibility for failure to perform obligations, as formulated in Article 10 of the old Law³; nor of the Government’s responsibility to submit for presidential approval the key indicators of the state defense order for a corresponding year simultaneously with the draft federal budget for that year being introduced into the RF State Duma; nor of the RF President’s responsibility to approve those indicators simultaneously with the signing of the law on the federal budget (as was stipulated in Part 3, article 3 of the old Law).

This trend towards strengthening the discretionary powers of the authorities can be traced throughout the entire text of the document. It manifests itself, on the one hand, by the absence of any concrete timelines, terms or substantiations for decision making; and, on the other hand, by the frequent use of the term ‘has the right to’ when determining the competence of the RF Government, state customers, chief executors, and executors of the state defense order (the term is used five times vs. one time in the old Law). All these factors can be considered to be corruption-causing⁴. Although they have become much stronger in the new Law, the Legal Administrations of the State Duma Apparatus and the Federation Council Apparatus have somehow failed to detect them (or simply did not want to do so for some obscure reason).

The new version of the Law lacks the previous one’s provisions concerning the concept of a state armaments program (Parts 1 and 2 of Article 3 of the old Law, ‘The Federal Program for the Development, Creation and Production of Military Equipment for the Ten-Year Period’). Maybe, it is exactly for that reason that the state armaments program has slipped one position down in the list of the basic elements for the formation of the state defense order (Article 4), being superseded by the ‘Plans for Building and Developing the Armed Forces’. Although it is hard to say whether this relegation of the state armament program has indeed been caused by a real decline in its influence on the composition of the state defense order,⁵ or by a simple slip of the pen, the trend itself is clear and indisputable.

In the course of the Draft Law’s second reading in the State Duma, the state regulation of the prices of the products included in the defense order was presented as a major legislative innovation. It should be noted that the proposed price regulation – or rather its principles and methods – abound in tautologies and have an excessive emphasis on registration. All the key aspects of pricing, including the selection of price types (i.e. the choice between the guiding price, the fixed price and the cost-plus price, as specified in Article 11) and the terms of their use are determined by the Government. The need to ensure the transparency of statistics relating to contracts, prices and supplies is not mentioned at all. Moreover, statistical transparency is simply ignored as a method of regulation.

1 Minutes of the State Duma meeting on 16 May 2012. URL: <http://transcript.duma.gov.ru/node/3633/> (date of presentation: 24 May 2012).

2 *Zamestitel’ Predsedatelia Pravitelstva Dmitrii Rogozin dal interv’iu telekanalu ‘Vesti’ po itogam selekturnogo soveshchaniia o gosoboronzakaze* [Deputy Head of the Government Dmitry Rogozin Gave an Interview to the ‘Vesti’ TV Channel]. URL: <http://government.ru/docs/22478/> (date of presentation: 21.01.2013).

3 For the state defense order, see RF Federal Law, of 27 December 1995, No 213-FZ; adopted by the State Duma of the Federal Assembly of the Russian Federation on 24 November 1995 (as amended by RF Federal Law, No 409-FZ, of 6 December 2011) // *Rossiiskaia gazeta* [The Russian Gazette]. 4 January 1996; 9 December 2011.

4 P. 3. *Methods for the Conduct of Anti-Corruption Expestimation of Normative Legal Acts and Draft Normative* (approved by Decree of the RF Government, of 26 February 2010, No 96).

5 The federal budget for 2013 envisages expenditures on the state defense order both within and outside of the framework of the state armaments program. It should be noted that purchases of armaments can also be carried out outside of the framework of the state defense order.

For the sake of objectivity, however, we should note that the new Law strictly and specifically envisages that all the executors of contracts should keep separate accounting records for any contract concerned with the state defense order. This provision will make it much easier to implement the RF President's Decision of 25 November 2010, No Pr-3443, designed to put an end to the uncontrolled price rise of military-purpose products.

Also, the Law contains two noteworthy and rather strange innovations, which are similarly concerned with pricing: first, the 5% ceiling on price growth in excess of the official price index or the implicit price deflator, imposed by Russia's anti-monopoly agency; second, a certain vagueness in the procedure for changing the price of a state contract.

In the first case, the documents accompanying the Draft Law do not contain any economic justifications for the ceiling on price growth being set at 5% (this ceiling can be considered to be too high – bearing in mind that, for example, in 2011 the actual price index for military-purpose products amounted to 109.0%¹, which was 2.1 pp. higher than the official forecast made in 2010). Moreover, the imposition of a 30-day limit for submitting information to the anti-monopoly agency implies that this (rather unexplainable) 5% ceiling will be automatically exceeded. It is quite possible that the ceiling was initially imposed at around 0.5% – which made at least some sense; but that later on, in the process of further elaborating the Draft Law, the decimal point 'somehow got lost'. As a result, Russia has obtained a very effective inflationary mechanism, prettily disguised as state regulation of prices.

In the second case, according to the text of the Law (Part 5, Article 6; Item 7, Article 7; Item 9, Part 1, Article 9), a change in the price of a product takes place spontaneously and rather mysteriously, so that everybody is presented with a *fait accompli*. As a result, it only remains for the state customer (or the chief executor of a contract) to require justification for the price change, for the chief executor (or the executor) – to justify the price change, and for the Government – to agree with the price change...

Thus, the Law has definitely failed to 'achieve the transparency of all its articles', let alone 'to establish strict parliamentary control in this field', as was expected by some members of the State Duma Defense Committee². President Putin's demand remains unfulfilled – the demand that 'the state defense procurement system must be made as open and transparent as possible. Such an approach will be beneficial for establishing fair competition within the industry'³.

As regards the exaggerated indicators of state defense order implementation in 2012 (99% for the RF Ministry of Defense), after the 'adjustment' of some of its parameters (bearing in mind that 94.3% of the RF Ministry of Defense's contracts had been placed shortly before the submission of its annual plan⁴), the 'breakdown' during the finishing spurt⁵, the discontinuation⁶, from November 2012, of any updates of the information on the Military-Industrial Commission membership on the government website⁷, and from December 2012 – of any publications of the agendas of its meetings, are only a few new examples of the ongoing reversal to old Soviet practices and to the predominance of the Military-Industrial Complex's interests over the interests of both the Armed Forces and the country as a whole. ●

1 For the price indices and deflator indices used in the forecasts of the prices of military-purpose products, see *Letter of the RF Deputy Minister of Economic Development* No 21684-AK/DO3i, of 9 October 2012. URL: http://www.economy.gov.ru/minecl/activity/sections/macro/prognoz/doc20121009_0002 (date of presentation: 10 October 2012).

2 Yu. Avdeev. *Gosoboronzakaz na marshe* [The State Defense Order on the March] // *Krasnaya Zvezda* [The Red Star]. 6 June 2012 (No 99).

3 Minutes of the Conference on the Implementation of State Policy in the Field of Defense-Industrial Complex Development for the Period Until 2020 and for a Further Perspective – Komsomolsk-on-Amur, 20 February 2012. 2012. URL: <http://government.gov.ru/docs/18194/> (date of presentation: 21 February 2012).

4 Minutes of the Business Meeting with Deputy Chairman of the RF Government Dmitry Rogozin – Novo-Ogarevo, 19 November 2012. URL: <http://news.kremlin.ru/news/16859> (date of presentation: 19 November 2012).

5 See Dmitry Rogozin's interview to the *Vesti* news TV channel.

6 In this connection, the propaganda activity of Deputy Prime Minister Dmitry Rogozin on Facebook and Twitter can cause surprise and even consternation. According to the Federal Law of 9 February 2009 'On Guaranteeing Access to Information on the Activities of State Authorities and Local Self-Government Bodies', this activity is definitely detrimental to his official duties as head of a body of state authority.

7 The Military-Industrial Commission under the Government of the Russian Federation. URL: <http://government.ru/gov/agencies/134/> (date of presentation: 28 January 2013).

REVIEW OF THE ECONOMIC LEGISLATION¹

I.Tolmacheva, Yu.Grunina

Late in December 2012 and January 2013, the following amendments were introduced in the legislation: Part 1 of the Civil Code of the Russian Federation was revised; the list of socially oriented non-profit organizations' activities carried out with state support has been supplemented; amendments have been introduced in the legislation on the legal status of foreign nationals¹.

I. Federal Laws of the Russian Federation

1. Federal Law No. 302-FZ of December 30, 2012 on AMENDMENT OF CHAPTERS 1, 2, 3 AND 4 OF PART ONE OF THE CIVIL CODE OF THE RUSSIAN FEDERATION

The approved Law is the first “package” of amendments to the Civil Code of the Russian Federation within the frameworks of the civil legislation reform which is carried out at present and it is aimed at substantial upgrading of the most general and principal provisions of the Russian civil law. The Federal Law provides, in particular, for the following amendments into:

- fundamental principles of the civil legislation (the notion of a “common practice” is introduced, that is, apart from business practice any practice which is not limited to a line of business is specified among the sources of the civil law; the civil legislation is supplemented by an obligation of every person to act in good faith);
- procedure for state registration of titles to property (new Article 8.1 is introduced and it determines the main guidelines for state registration of property titles (primarily, real property titles); it is required to specify in the state register the data which permits to determine the following: the project to which the title is established, the holder of the title, the scope of the title and the grounds on which it arises; also the person who knew or was to be in the know of the invalid data of the state register has no right to refer to the respective data of the register);
- procedure for state registration of deals (from March 1, 2013 registration of such transactions with real estate as are listed in Part Two of the Civil Code of the Russian Federation, that is, the existing system of double registration (titles and transactions) of real-estate projects is abolished);
- limits of fulfillment of civil rights (Article 10 was revised. It bans evasion of law for illegal purposes which activity is deemed as a sort of abuse of right; the same implications that were established for abuse of right will be applied to activities aimed at evasion of law unless otherwise is specified in the Civil Code of the Russian Federation – a complete or partial refusal by the court to protect the right and other measures; if abuse of right resulted in violation of the right of another person, the latter is in a position to demand compensation for the damage caused);
- instances and procedure for compensation of damage caused by lawful actions of public authorities and local authorities (new Article 16.1 was introduced – up to the present day the obligation to compensate such damages was imposed on public and legal establishments only for such activities carried out by them as carriers of power authorities as were recognized as inconsistent with the law; amendments now permit to demand compensation in cases where public and legal authorities issue a legal act and commit a lawful action);
- procedure for recognition of a person as disabled and limitation of disability of a person, establishment of trusteeship and fulfillment by guardians and trustees of their obligations (in respect of persons with mental disorders who are able to understand implications of their actions a possibility is provided for to recognize them as partially disabled persons and, as a result, they will be able to participate to a limited extent in civil turnover, as well as carry out individual transactions on their own account; grounds for limitation of a person's ability

¹ The review was prepared with assistance of the KonsultantPlus legal system.

consist in the fact that as a result of taking to gambling, alcohol and drugs a person puts his/her family in a difficult financial situation due to which his/her ability to act can be limited by a court of law and it is only the court of law that can change the extent of the person's ability to act);

- general procedure for establishment of peasant's (farming) enterprises (the main novelty consists in the fact that a peasant's (farming) enterprise can be registered as a legal entity; in terms of regulation of a peasant's (farming) enterprise it resembles an economic partnership; a person can be a member of only one peasant's (farming) enterprise established as a legal entity; members of a peasant's (farming) enterprise established as a legal entity are subsidiary responsible for liabilities of the enterprise).

The Federal Law will become effective from March 1, 2013, except for individual provisions. For the purpose of exclusion of unjustified obstacles and difficulties for participants in civil turnover in carrying out by them of their rights and obligations, the Law provides for transition provisions. It has been envisaged that no re-registration of earlier established peasant's (farming) enterprises and titles to real property will be required due to coming into effect of the Federal Law.

2. Federal Law No. 325-FZ of December 30, 2012 on AMENDMENT OF ARTICLE 31.1 OF FEDERAL LAW ON AMENDMENT OF ARTICLE 31.1 OF FEDERAL LAW ON NON-PROFIT ORGANIZATIONS

The list of socially-oriented non-profit organizations' activities carried out with state support has been supplemented. So, it is envisaged that public authorities and local authorities may render support to socially orientated non-profit organizations, provided that the latter carry out, among other things, activities related to:

- formation of intolerance to corrupt practices;
- development of inter-ethnic cooperation, preservation and protection of identity, culture, languages and traditions of peoples of the Russian Federation.

3. Federal Law No. 320-FZ of December 30, 2012 on AMENDMENT OF FEDERAL LAW ON THE LEGAL STATUS OF FOREIGN NATIONALS IN THE RUSSIAN FEDERATION

The most important changes consist in the fact that foreign nationals who temporarily reside in the Russian Federation do not have to secure a work permit. Earlier the above norm was applied only to foreign nationals with residence permit.

The procedure for attraction of high-skilled foreign experts (HSE) and foreign workers to ship crews has been somewhat upgraded. So, in particular, employers (consumers of work and services) are granted the right to send to the Federal Migration Service of the Russian Federation requests for attraction of high-skilled foreign experts (applications for renewal of work permits issued to such persons) in the form of an electronic document with use of information and telecommunications technologies in general use, including the Internet and the Single Web-Site of Public and Municipal Services.

II. Resolutions of the Government of the Russian Federation

Resolution No. 19 of January 21, 2013 on AMENDMENT OF THE RULES OF MIGRATION REGISTRATION OF FOREIGN NATIONALS AND STATELESS PERSONS IN THE RUSSIAN FEDERATION

A notification of the arrival to the Russian Federation of high-skilled experts and members of their families can be submitted through a multifunctional center for provision of public and municipal services (MFC). It is envisaged that the receiving party should submit a notification of the arrival to the territorial agency of the Federal Migration Service of the Russian Federation directly or through the MFC (except for individual instances established by the Federal Law on Migration Registration of Foreign Nationals and Stateless Persons in the Russian Federation) or by mail.

A notification on arrival is to be submitted to the territorial agency of the FMS of the Russian Federation through a MFC within one business day following the day it was submitted to the MFC. The person who submits a notification on arrival to the MFC has to produce an identification document. ●

REVIEW OF THE MEETINGS OF THE GOVERNMENT OF THE RF IN JANUARY 2013

M. Goldin

In January 2013, at the meetings of the Presidium of the Government of the Russian Federation the following draft laws were approved: (1) the draft law which specifies the right of the Central Bank of the Russian Federation to impose by agreement with the Government of the Russian Federation limitations on credit institutions with foreign investments to carry out banking operations; (2) the draft law which is meant to strengthen control to prevent the abuse in provision of the maternity capital funds to people.

On January 17, at the meeting of the Government of the Russian Federation the draft federal law which specifies the authorities of the Central Bank of the Russian Federation to impose by agreement with the Government of the Russian Federation limitations on credit institutions with foreign investments to carry out banking operations was discussed. In accordance with Article 16 (6) of Federal Law No. 395-1 of December 2, 1990 on Banks and Banking, the Central Bank of the Russian Federation has the right to impose by agreement with the Government of the Russian Federation limitations on credit institutions with foreign investments and branches of foreign banks to carry out banking operations if in respective foreign states restrictions as regards establishment of banks and banking activities are applied to banks with Russian investments and branches of Russian banks. The draft law excludes from that authority the possibility to apply measures specified in that norm to credit institutions with foreign investments from those countries where the so-called reciprocity principle is abolished, that is, the countries in whose legislation there is no norms on limitations (retorsion) by analogy with measures listed in Article 18 (6) of Federal Law No. 395-1 of December 2, 1990 on Banks and Banking.

On January 25, the draft law of the Government of the Russian Federation on Amendment of Article 8 and Article 10 of the Federal Law on Additional Measures of State Support to Families with Children was discussed. The draft law sets the list of types of institutions to which the principal debt and interests on loan agreements on purchasing (building) of housing can be paid by means of the maternity (family) capital. Also, the draft law specifies the grounds for refusal to accept the application for utilization of funds (a portion of funds) of the maternity (family) capital for repayment of liabilities under the specified loan agreements.

The funds (a portion of funds) of the maternity (family) capital can be used on repayment of the principal debt and interests on the loan granted for purchasing (building) of housing to individuals under loan agreements concluded with the following types of entities:

- 1) credit institution in accordance with Federal Law No. 395-1 of December 2, 1990 on Banks and Banking;
- 2) micro-financial institution in accordance with Federal Law No. 151-FZ of July 2, 2010 on Micro-Financial Activities and Micro-Financial Institutions;
- 3) credit consumers' cooperatives in accordance with Federal Law No. 190-FZ of July 18, 2009 on Credit Cooperatives;
- 4) In addition to that, the funds of the maternity (family) capital can be granted in connection with payment of the debt and interests under a loan agreement with any other institution which provides a mortgage-secured loan. ●

AN OVERVIEW OF NORMATIVE DOCUMENTS ON TAXATION ISSUES FOR DECEMBER 2012–JANUARY 2013

L. Anisimova

Over the period under consideration, Russia's economic problems more than once became the focus of public discussion with the participation of the country's leadership and eminent Russian and foreign experts – at the Gaidar Forum hosted by the Russian Presidential Academy of National Economy and Public Administration and the annual meeting of the World Economic Forum (WEF) at Davos. Tax issues were scrutinized in the context of a search for potential ways for overcoming economic stagnation and in view of Russia's request for accession to the OECD.

Chairman of the RF Government Dmitry Medvedev disagreed with the development scenarios suggested to the Russian Federation for the next few years by the experts' meeting at Davos. They voted 75% in favor of the first scenario – Regional Rebalancing. This scenario is geared for a situation that may emerge as a result of declining prices for oil and natural gas, stagnation in the central bodies of authority and economic and political changes at regions' level. Medvedev said: 'The Russian economy's dependence on raw materials exports is great, but is also exaggerated'. In this connection, Russia's Prime Minister believes that external risks are by no means a major factor. The key threats, in fact, are presented by the inadequate competitive capacity of Russian businesses, low labor productivity and high energy inputs. Thus, 'the government's priorities are to improve the authority's performance level, promote competition and carry on a dialogue with civil society'¹. In the experts' opinion, so far no sectors have become visible in the Russian economy that could really be regarded as the locomotives of competition and labor productivity². The experts are similarly cautious in their estimates concerning the role of the defense industry in providing solutions to that problem – in view of the recent exposure of financial violations committed by the RF Ministry of Defense coupled with the fact that the bulk of funding to be received by the defense industry is earmarked for the period of 2016–2020, i.e., beyond that of the currently approved budget. So, they believe that, at present, as far as the task of promoting the economy's competitive capacity is concerned, the RF Government has indeed no option other than to allocate money to modernizing the existing infrastructure in an attempt to bring down the cost of doing business in Russia.

Russia is also faced with some serious problems in connection with her planned accession to the OECD in 2014. Speaking at the Gaidar Forum 2013, Secretary-General of the Organization for Economic Cooperation and Development (OECD)³ Angel Gurría suggested that, in order to comply with the membership criteria, Russia should bring down the poverty level⁴, abandon a flat tax scale, and increase the volume of healthcare expenditure.

The response to this proposal among the economists' community has been by no means unanimous. Some believe that Russia must very carefully consider the recommendations of the OECD's

1 E. Karpenko. *Pravda Medvedeva* [Medvedev's Truth]. See www.gazeta.ru, 23 January 2013.

2 *Vlasti ishschut tormoz ekonomiki. Tsentrobank okhladil pyl pravitel'stva po povodu rosta VVP.* [The Authorities Are Trying to Pinpoint the Culprit Behind the Slackening of Economic Growth. The Central Bank Has Cooled Down the Government's Enthusiasm About GDP Growth.] See www.ng.ru of 17 January 2013.

3 A. Bashkatova, I. Naumov. *Rossii vypisali retsept bor'by s bednost'iy. Put' v elitnyi klub lezhit cherez progressivnoe nalogooblozhenie.* [Russia Was Issued a Prescription for Tackling Poverty. The Way to the Elite Club Lies through Progressive Taxation.] See www.ng.ru of 21 January 2013.

4 The OECD's Secretary-General recommended Russia to vigorously target poverty and to address the issue of personal and regional income inequality. According to the OECD's data, 17% of the population in the Russian Federation are poor, whereas in the OECD member countries this index, on the average, amounts to only 10%. The introduction of a progressive tax scale, when the rate of tax increases in proportion to the size of a taxpayer's income, represents one of the mechanisms whereby the gap between the income levels of different population groups can be narrowed. Besides, Angel Gurría mentioned another social issue existing in Russia – the insufficient funding of the health care system. The authorities must increase the size of government allocations earmarked for the funding of that sphere.

Secretary-General, although they really are no more than ‘remarks offered by way of advice’. According to Igor Nikolaev, Director of FBK’s Strategic Analysis Department, this is actually the case when ‘a piece of advice’ may be more important than the formally established conditions for a country’s entry into the OECD. Other experts – for example, *Sberbank CIB*’s Chief Economist Evgeny Gavrilin noted that the proposal concerning the introduction of a progressive tax scale voiced by the OECD’s Secretary-General was ‘by no means binding’. Gavrilin added that the situation in the tax sphere cannot be considered outside of the whole context, including, first of all, the quality of the country’s institutions of state authority.

It should be reminded that Russia’s accession to the OECD, as explained by the RF Ministry of Finance, is expected to yield some practical benefits in addition to raising Russia’s international prestige. If, however, Russia fails to comply with the established criteria, it will be treated by the OECD member countries in their mutual deals as an offshore territory.

So, the conditions for the accession to the OECD include increased government expenditure earmarked for the health care sector and the introduction of a progressive personal income tax scale, similar to the standards applied in the European countries. Indeed, the RF Government will have to make a tricky choice between accepting Russia’s status if an offshore zone for the developed countries ‘club’, or giving up the currently enjoyed competitive advantages for the sake of acceding to the OECD.

The existing situation can be analyzed as follows. In order to increase, in nominal terms, the share of health care expenditures to the European level it will be necessary either to revise the by-sector distribution of government expenditure, or to additionally increase the tax load. The recommendations concerning government expenditure cuts in regard of state corporations or power structures belong to spheres beyond the subject of our present discussion. It can hardly be possible to change the existing tax load on commodity producers. The experience of altering, in 2010, the rates of insurance contributions to the RF Pension Fund has demonstrated that, if the level of costs incurred by domestic commodity producers is pushed up as a compulsory measure, then the prices of their products also go up above their existing market level. As a result, domestic producers are ousted from the market and their businesses are ruined, while the market is being taken over by imported commodities. So it is unlikely that the RF Government will actually make an attempt to experiment in a similar way with the rates of insurance contributions to the Federal Fund for Compulsory Medical Insurance (FFCMI).

It would be equally useless, from the point of view of economics, to increase the taxes on consumption (by raising the rate of VAT or introducing a sales tax) in combination with an administrative decision to increase the allocations to health care. By simply increasing the VAT rate (or by introducing, in addition to VAT, also a sales tax) and letting the health care officials handle the resources thus made available, the government may actually disrupt the existing balance on the market for medical services. If the medical services introduced in this manner meet no demand on the consumer market, the ‘simple equivalence’ in the exchange of goods (or work, or services) will be destroyed¹, and so there will emerge an almost forgotten phenomenon – the presence on the market of the so-called ‘unwanted’ commodity items (goods, or work, or services for which no demand is displayed by the population, but which nevertheless are produced under previously approved plans for some specific purpose)². As a result, if the pattern of effective demand is altered in an enforced procedure (by introducing tax measures), the market (that is, the environment directly involved in free trade) will begin to shrink in response to the upset balance in the supply of goods (or work, or services), while prices will begin to rise (because market demand gives way to non-market demand). The volume of demand will remain the same, but the ‘equivalent’ for its ‘replaced’ component will be lost. Without ‘equivalence’ there will be no free trade, which means that the supply of goods (or work, or services) on such a market will inevitably be declining, while prices will be on the rise. If a market can offer nothing for an equivalent exchange, products will flow away to

1 The market represents the environment where free exchange of commodities is carried out, and where labor also behaves as a commodity and thus is assigned a free market price. A basic component of market exchange is the balance between supply and effective demand, because one and the same subject in the framework of each commodity exchange transactions simultaneously acts (either directly or through an absolute equivalent) as a buyer and a seller.

2 In this particular case – for the purpose of complying with the criteria for Russia’s accession to the OECD.

other markets, while the market in question will begin to experience deficit – a phenomenon that many of the older readers are actually familiar with, when demand for certain goods (or work, or services) is there, but the wanted items are actually lacking. The deficit of goods on a free market is compensated for by their growing prices, one example of which is the situation typical of the Russian market in the 1990s.

The measure recommended by the OECD officials – to increase the volume of expenditure on health care for the low-income strata by applying a progressive personal income tax scale to the high-income groups of the population and thus redistributing part of their income in favor of the former – is aimed, first of all, at removing ‘luxury commodities’ from the market. But the scale of income redistribution needed for complying with the aforesaid criteria is such that it will also (and inevitably) affect the savings and investments made by society’s middle strata. This, in its turn, may have some very undesirable effects from the point of view of the prospects of developing a modern market in this country. It should be remembered that a fixed low rate of income tax represents one of Russia’s most important competitive advantages on the investment market. Besides, a low rate of personal income tax (PIT) helps, to a certain extent, to bridge the existing gap between the levels of personal incomes in Russia and the European economies, thus bringing down the outflow of qualified workforce from Russia. One vivid negative example was the surge in the specialist outflow from East Europe to the West. Besides, a low rate of PIT makes it possible – provided that the size of net earnings per employee (after PIT) is comparable (that is, competitive) – to bring down the prices of goods (or work, or services), thus increasing their market competitive capacity. And this difference in the tax levels will by no means be regarded as a subsidy granted in the framework of the World Trade Organization (WTO), because the Russian Federation makes no exceptions for its tax residents who are citizens of other states.

Thus, there will be no one-time and painless solution to the problem posed by the need to increase the share of health care expenditures in GDP. This task can only be accomplished by gradually changing the structure of government expenditure. Any other solutions imply the introduction of tax reforms, the necessity of which at present is by no means obvious.

In view of the difficulties involved in the process of elaborating the federal budget and providing the sources of financing to cover budget expenditure in 2013, coupled with the accelerated growth (by comparison with that of the inflation rate) of Russia’s foreign debt¹ by 15.4% (to \$ 624bn, mostly contributed to by the private banking sector) and the growth of domestic bond debt by 14.6% (to Rb 4.06 trillion)², it is not easy to understand the logic behind the acts of Russia’s financial agency, which grants financial aid to certain member states of the European Union in violation of the agreement concerning their accession to the EU. One example is Cyprus, a member country of the European Union since 2004, which at the moment of its accession thereto assumed certain responsibilities. By issuing government loans to Cyprus³ without due regard to the European Union’s standpoint on this issue, Russia runs the risk of altogether losing her money. In fact, the authorities of the European Union are refusing to consider the issue of granting financial aid to Cyprus until Russia revokes or annuls her loans to that country, because any financial aid received by Cyprus may effectively be used for redeeming Cyprus’s debts to third countries, in this case – to the Russian Federation. And since the European authorities are denying any financial aid to Cyprus, the prospect of redemption of Russia’s loans to Cyprus is also questionable. The amount of money given (in all evidence, irrevocably) by Russia to Cyprus (€ 2.5bn, or Rb 100bn) would have been more than enough to repay the debt of Riazan Oblast (Rb 22bn, or 75% of the regional budget)⁴ – and also the debts of some other regions. Although Russia’s federal budget for 2013 and the planning period of 2014–2015 is formed on the basis of the budget rule, and so it has a rather high ‘safety margin’ as a precaution against unforeseen

1 See www.rg.ru of 11 January 2013.

2 In 2012, Russia’s domestic government debt rose by 14.6%. See Kommersant.ru of 17 January 2013.

3 A. Bashkatova. *Minfin s ponimaniem otnessia k problemam Kipra*. [The RF Ministry of Finance Treated Cyprus’s Problems with Understanding.] See www.ng.ru of 14 January 2013.

4 N. *Bashlykova*. *Riazanskuii oblast’ zhdiet sud’ba Gretsii i Ispanii. Regionu grozit bankrotstvo*. [Riazan Oblast Will Share the Destiny of Greece and Spain. The Region Is Faced with the Threat of Bankruptcy.] See Kommersant.ru, No 4/P 5035, of 14 January 2013.

expenditures, as well as some additional reserves that can play a compensatory role in an event of losses from inefficient placement of budget resources on external markets¹, it must not be forgotten that the only compelling reason behind the RF Government's decision to launch pension reform and carry forward the expenditures envisaged in the RF President's Edicts beyond a current budget period was the lack of sufficient funds to meet domestic obligations. Against this background, Russia's potential losses as a result of granting financial aid to Cyprus appear to be untimely. Moreover, the RF Ministry of Finance is delaying the transfer of financial resources to the regions in the amount of Rb 1 trillion (promised by former RF President Dmitry Medvedev), reasoning that there is no real possibility to effectuate any cuts in federal budget expenditure, and that it can only be feasible, for technical reasons, to transfer any resources to the regions only if they are coupled with corresponding liabilities².

Among the documents adopted over the period under consideration, the most noteworthy are the following ones.

1. Over that period, Russia adopted Federal Law of 29 December 2012, No 282-FZ 'On Introducing Alterations into the Federal Law "On the Securities Market", whereby some serious clarifications were introduced with regard to the issues of levying taxation on the securities of Russian issuers the rights to which are confirmed by foreign securities (meaning here foreign issuers' depository receipts for shares issued by Russian organizations). The afore-mentioned issues need to be further regulated, but the mechanism envisaged in the new Law may indeed be qualified as an important step towards the final accomplishment of the comprehensive task of determining the tax base for each type of income from securities of Russian issuers, the rights to which are confirmed by securities of foreign issuers. It appears that so far the procedure for estimating tax bases with regard to sales of shares in privatized enterprises where subsequently IPOs were held has remained unregulated. However, bearing in mind that the Agreements for Elimination of Double Taxation have preserved the right of the Russian Federation to the taxes levied on the sale of shares of Russian issuers secured by Russian immovable property in the amount of 50% or more (tax is levied on the income generated by the sale of such shares in accordance with the rules established for the sale of immovable property – that is, at the place where the relevant immovable property is situated), and that the new Law has established the responsibility to disclose, to the Register keeper, information on the holders of shares of Russian issuers, it is highly likely that the principal risks for the Russian budget associated with the possibility of revenue losses as a result of tax-free disposal of incomes generated by the right of ownership with regard to the mineral resources situated in RF territory have finally been eliminated.

By the newly introduced Law, some serious amendments were made to a number of laws designed to protect the economic interests of the Russian Federation: the law on banks and banking activities; the law on securities and financial markets, the law on the State registration of juridical persons and individual entrepreneurs; the law on the Bank of Russia; and some other laws. In particular, it is established that, if as a result of one or several transactions carried out by one and the same juridical or physical person a stake in a bank's capital is acquired in the amount of 1%, and/or transactions carried out by a group of persons (recognized to be a group in accordance with Federal Law of 26 July 2006, No 135-FZ "On the Protection of Competition") and resulting in the acquisition of control over shareholders owning a total of more than 1% of shares (or stakes) in a bank, the Bank of Russia should be notified of such transactions, and if the acquired share exceeds 20% – a preliminary consent of the Bank of Russia should be obtained.

By Federal Law of 29 December 2012, No 282-FZ some details were specified with regard to the procedure for the disclosure of information on foreign holders of securities of Russian issuers and the payment of income from the equity securities kept at the Depositary, the latter being charged with the mandatory task of keeping such securities on a centralized basis. It is established that the Register keeper should compile, as of a certain date, the list of persons exercising the rights to

1 P. Netreba. *Ne nado stroit' vozduzhnye zamki. Ministr finansov Anton Siluanov o finansovykh perspektivakh 2013 goda.* [No Castles in the Air to Be Built. Minister of Finance Anton Siluanov Speaks of the Financial Prospects for 2013.] See Kommersant.ru of 25.12.2012.

2 Ibid.

the aforesaid securities, or the list of registered persons. In this connection, the Depository, in the capacity of a person acting in the interests of other persons, is not allowed to issue orders concerning the placement of securities of Russian issuers emitted in RF territory on an account opened for the Depository with a foreign organization. The persons for whom a depo account for depository programs is opened may exercise the right to participate in a general shareholder meeting with regard to shares, the rights to which are confirmed by securities of a foreign issuer, only on condition that the holders of the aforesaid securities of a foreign issuer and other persons exercising the rights to those securities of a foreign issuer have instructed those persons as to how to vote at the general shareholder meeting, and the Russian issuer have been informed concerning those persons and the number of shares, the rights to which are confirmed by securities of a foreign issuer, held by each of those persons.

With due regard for the responsibility to disclose information on foreign holders of rights to Russian securities, the RF Tax Code has been augmented by norms whereby it is established that, if the information on the holders of rights to Russian securities is not disclosed, tax on the income paid to such holders will be levied at a maximum rate, the ceiling for which for physical persons is established by Item 2 of Article 224 of the RF Tax Code and amounts to 35%; and for organizations – by Item 3 of Article 224 of the RF Tax Code and amounts to 30%. The specific features of the taxation of income paid to foreign organizations acting in the interests of third parties with regard to securities of Russian issuers are established as follows: for physical persons – by the newly introduced Article 214.6 of the RF Tax Code; and for organizations – by the newly introduced Article 310.1.

The amount of the State duty to be charged for the preliminary consideration of documents necessary for the State registration of an issue (or an additional issue) of securities – Rb 100,000, and for the State registration of the main part of a securities prospectus – Rb 200,000 (amendments to Subitem 53 of Item 1 of Article 333.33 of the RF Tax Code).

2. By Federal Law of 29 December 2012, No 279-FZ many significant alterations are introduced in Chapter 23 of the RF Tax Code concerning the procedure of paying personal income tax (PIT).

In accordance with Item 16 of Article 214.1 and Article 220.1 of the RF Tax Code, the losses incurred on operations with marketable securities and financial instruments traded on an organized financial market can be carried forward, which is not allowed for the losses on non-marketable securities and financial instruments. For its part, the new Law specifies that it is necessary to keep separate records of the financial results for marketable and non-marketable securities and instruments, as well as for closing short positions in repo operations. Thus, the rules for forming tax bases for operations with securities carried on by physical persons have been made uniform.

The new Law envisages more liberal application of some ‘social’ deductions: the tax exemptions established for the payments made by employers from their ‘after taxes’ profit to cover the cost of medical care for their employees (including the cost of pharmaceuticals), the employees’ spouses, parents, and children are now also extended to adopted children.

The ‘social’ tax deductions (if the cost of medical care, including voluntary individual medical insurance, was covered by taxpayers on their own, and not by their employers) are now extended to adopted children and their wards, but within an established limit of Rb 120,000 over a given tax period.

It is now legislatively established that ‘social’ deductions may be granted in respect of medical care provided not only by a medical institution, but also by an individual entrepreneur with a license issued in accordance with Russian legislation for services included in the list of medical services approved by the RF Government. Previously, the right to grant such deductions was established by Ruling of the RF Constitutional Court, of 14 December 2004, No 447-O.

The amount of tax deduction in respect of expensive types of medical care provided by medical institutions and individual entrepreneurs is to be equal to the actual cost of the aforesaid medical care, i.e., in excess of the standard ‘social’ deduction. The list of expensive types of medical care is to be established by the RF Government’s decree.

3. Over the period under consideration, one very important decision was made by the RF Constitutional Court. In the text of Item 4.2 of the RF Constitutional Court’s Ruling of 17 January 2013, No 1-P on the case involving the verification of compliance with the RF Constitution of the

provisions of Part 5 of Article 19.8 of the Code the Russian Federation on Administrative Offenses (CAO) in connection with the complaint filed by Limited Liability Company *Maslianskiy khlebo-priemnyi punkt* [Maslian Grain Collection Point] it is stated that Part 5 of Article 19.8 of the Code on Administrative Offenses, whereby it is envisaged that a juridical person may, without any alternative, be brought to administrative responsibility in the form of a fine whose floor is set at a rather high level (from Rb 300,000 to 500,000), is contrary to the international rules and the RF Constitutions, because ‘it does not rule out the possibility of transforming that administrative fine from a measure designed to prevent administrative violations into an instrument for suppressing economic independence and initiative and for imposing excessive restrictions on both the freedom of entrepreneurial activity and the right of ownership’.

In Item 4.3, the RF Constitutional Court noted that ‘the high floor established for the administrative fine in the existing legal regulation system, which does not allow that an administrative punishment should be imposed in an amount below the floor established for a relevant administrative sanction, makes it impossible to give full consideration to the committed administrative violation, the property and financial status of the juridical person, and other significant circumstances relevant for a given case, and thus does not ensure the imposition of a just and appropriate administrative punishment’.

We believe this Ruling of the RF Constitutional Court to be very important¹ also in terms of preventing the recently emerged practice of the legislative authorities to establish fines with a very high floor for other violations committed by physical persons. Such fines restrict the right of disposal of property not only for those individuals on whom administrative sanction are imposed, but also for their families, including children who do not have dispositive legal capacity. Thus, such fines effectively deprive those persons who are not directly involved in committing administrative violations but are next-of-kin to the guilty person, of their means of subsistence and opportunities for covering the cost of educational, medical and other social services provided to them (kindergartens, schools, the services of private nurses, etc.).

Another important component of the Ruling of the RF Constitutional Court is the recognition of the need to coordinate, from the point of view of economic, the size of an administrative fine with the consequences of the committed administrative violation. It is precisely this requirement, in conjunction with the necessity to give consideration to financial status and other relevant circumstances, that creates the fundamental difference between an administrative fine and tax.

4. In January 2013, the RF Federal Tax Service published, on its official website, the control figures describing the ratios between the indices applied in the established forms of tax and accounting reports used by tax agencies in their audits in order to verify the correctness and reliability of data entered by taxpayers and tax agents in their tax declarations. The corresponding mathematical and logical formulae for the twelve basic types of tax declarations are not available to taxpayers in the section ‘Tax Reports’, subsection ‘Control Ratios for Tax Declarations’. The RF Federal Tax Service explains that it expects these formulae to be applied in the existing accounting software, so that taxpayers would be able to identify on their own their errors committed whilst preparing their tax reports, the probability of disputes arising in this connection could be brought to a minimum, and the cost of tax control the Russian Federation could be reduced. This decision can only be welcomed, as it is aimed at supporting honest taxpayers and lowering the administrative costs of doing business.

5. In the situation determined by Russia’s accession to the WTO, it appears to be very reasonable to postpone (so far – until 1 November 2014) the entry into force of the provisions of Federal Law of 6 April 2011, No 68-FZ concerning the introduction of alterations in the RF Budget Code in the part of regulating the payments in compensation for the harm done to public motor roads of federal importance by transport vehicles with a mass of over 12 tons. This payment belongs to the category

¹ Many experts agree the Ruling of the RF Constitutional Court has created a precedent that will be very important for legal practice in the Russian Federation – their opinions are cited in E. Berezina. *Shtraf vne konkurentsii*. [An Incomparably High Fine]. *Rossiiskaia Biznes-gazeta* [The Russian Business Newspaper], No 880 (2). See www.rg.ru of 22 January 2013.

of 'pseudo'-taxes and has a distinctly fiscal purposes; it is established with no consideration for the potential ceiling for the tax load imposed on commodity producers and its multiplication effect. Thus, it will, first of all, result in an increased share of transport and circulation costs in the cost structure of domestic producers. ●

CHANGES IN THE REGULATORY BASE OF THE BUDGETARY PROCESS

M. Goldin

In January 2013, the procedure for drawing up and maintaining of the composite budget outlay of the federal budget and budget outlays of the main administrators of federal budget funds was amended.

By Order No.172i of December 24, 2012 of the Ministry of Finance of the Russian Federation the procedure for drawing up and maintaining of the composite budget outlay of the federal budget and budget outlays of the main administrators of federal budget funds (main administrators of the sources of financing of the federal budget deficit) approved by Order No.159n of November 23, 2011 of the Ministry of Finance of the Russian Federation (hereinafter, the Procedure) was amended; under those amendments formation of the composite budget outlay of the federal budget as regards budget investments in capital construction projects included in the federal target investment program (hereinafter, FTIP) and introduction of amendments therein was adjusted.

In accordance with amendments introduced, within seven business days from the day of receipt from the Ministry of Economic Development of the Russian Federation of the approved data for the current fiscal year and the planned period on capital construction projects included in FTIP (hereinafter, the data on FTIP projects) the Ministry of Finance of the Russian Federation carries out verification of the data on FTIP projects, prepares the Information on the composite budget outlay of the federal budget and the limits of budget obligations as regards budget investments in capital construction projects in accordance with FTIP for the current fiscal year and the planned period without break-down of the data by capital construction projects included in the state defense order as per the form approved as an annex to the regulatory statutory act in question and sends them to the Federal Treasury.

It is to be noted that in amending the parameters of the composite outlay and (or) limits of budget obligations as regards capital construction projects included in FTIP in addition to the package of documents which are normally supplied for making amendments to the composite outlay and the limits of budget obligations the main administrators have to submit to the Ministry of Finance of the Russian Federation the certificate of changes in budget investments in capital construction projects in accordance with FTIP for the current fiscal year and the planned period as per the form approved as the annex to the Procedure.

In amending the data on FTIP projects which does not affect the parameters of the composite outlay and the limits of budget obligations, the main administrator submits to the Ministry of Finance of the Russian Federation the certificate of changes in budget investments in capital construction projects in accordance with FTIP which does not affect the parameters of the composite budget outlay of the federal budget and the limits of budget obligations in the current fiscal year and the planned period as per the form approved as the annex to the Procedure and specifying changes in the expenditure of budget funds within the limits of the approved parameters of the budget outlay for the year.

It is to be noted that approval of proposals on introduction of the data on FTIP projects is to be secured by the main administrator of budget funds from the Ministry of Economic Development of the Russian Federation.

Within seven business days, the Ministry of Economic Development of the Russian Federation has to submit to the Ministry of Finance of the Russian Federation the approved amendments of the data on FTIP projects and after that it updates the data on FTIP projects preparing the above certificates depending on the result. ●