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# RUSSIAN ECONOMIC DEVELOPMENTS

## No.11 2013

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## THE POLITICAL AND ECONOMIC RESULTS OF OCTOBER 2013

### S.Zhavoronkov

*The political highlight in October became the mass ethnic riot in a Moscow's uptown district of Birulyevo. The unrest proved the rise of ethnic problems in big cities. While the authorities met the rioters' local claims (they found the killer and shut down the vegetable warehouse with a bunch of illegal migrants therein), no decision was made in the wake of the riot, and it was local authorities who were held responsible for it. Quite predictably, Mr. A. Navalny, an opposition politician, was not put behind the bars after hearing his case at the courts of appeal. However, he was deprived of an active electoral right and will now have to take a lot of pains to stake out his niche in the opposition politics where the electorate engaged in some projects easily flows to other ones. Despite Mr. V. Putin's vows, the newly established Agency for Research Institutions will be led not by Mr. V. Fortov, the head of RAS, but by Deputy Finance Minister Mr. M. Kotyukov.*

Developments in a Moscow's uptown district of Biryulevo became a major political scoop in October. Soon after an illegal Azeri immigrant stabbed a Russian man who was protecting a young lady, local residents called for mass mobilization and were joined by a number of henchmen from other Moscow districts. What started as a popular rally soon turned into riot, with a pogrom of a local shopping mall and a huge vegetable warehouse which had long been a source of ethnic crime. The scenario replicated what had happened in a Moscow downtown square several years ago. Like at that time, the protesters' demands were satisfied – the police went after the killer and promptly found him, and the warehouse was shut down – so far under the pretext of breaching sanitary standards (it was found out that the owner, JSC Novye Cherepushki, partly rent the site from the City Hall and also owns a fraction of that). The local police brass were dismissed, the warehouse owners were charged with a string of counts of organization of illegal immigration, and some local rioters were detained. The events in Birulyevo show that Moscow is not the only crisis region as long as ethnic conflicts are concerned and that what happened in the center of the city few years ago was not a unique provocation or an odd incident. The visa-waiver regime with the Middle Asian countries whose GDP per capita is far lower than Russia's and the flux of millions of their culturally different residents in Russian megapolices, plus a mass corruption-driven practice of re-classification of violent crimes against the local Slavic residents (e.g. to Art. 109 of the Criminal Code "Voluntary manslaughter", which enables killers to be on the loose) fuel the potential of future ethnic conflicts, as long as the authorities turn a blind eye on the problem and hold undestrappers responsible.

Last October saw regular amendments be introduced in the electoral law. The purpose of the exercise

is to once again modify the fundamentals of nomination of candidates to regional legislature and municipal councils. Now that the novelty has been passed, the minimum representation quota of party lists on the regional level is 25% against the previous 50%. Meanwhile, party lists on the municipal level are no longer mandatory (while in the past, they were an imperative for 20+-strong municipal councils). In the mid-2000s, the compulsory introduction of party lists even in jurisdictions where they clearly were a white elephant (e.g. in small-size municipalities) aimed at depriving unsuitable, "out-of-system" candidates of a chance to seek nomination. Nowadays, it becomes evident that in the frame of the proportional system United Russia is simply incapable of winning majority in many local jurisdictions. Meantime, Moscow and St. Petersburg that boast the most advanced party system, on the contrary, by a local legislature's ruling may fully dampen party lists. In all fairness, the law was passed for the sake of the next year's Moscow City Council election. That said, elections in St. Petersburg were held fully by the proportional system and United Russia does not enjoy a majority in the local Council, so the city is likely to retain either the mixed system or the proportional one.

The court of appeals rendered its verdict on Mr. Navalny's case on charges of fraud. Quite predictably, after letting Mr. Navalny run for the Moscow Mayor office in the summer, the sentence proved a conditional one. In compliance with the effective law, Mr. Navalny has lost the right to run for any office; however, he may engage in other numerous activities, such as, for instance, campaigning for a party list or candidates associated with him. It can be asserted that the authorities do not dare to take on the opposition and opt for an indefinite revamping of the election law instead. As to Mr. Navalny, he faces a grave challenge of maintaining his current rating in a situation when he

is barred from election. The upcoming Moscow City Council election, which traditionally is perceived of as a rehearsal of the parliamentary one, should answer the question whether Mr. Navalny has found a way to consolidate the opposition and grown as its mediator, or his rating would prove as easy transferrable to another strong candidate as Mr. Prohorov's one did in the wake of the 2012 presidential campaign.

In October, there came to an end a long-lasting intrigue with regard to establishment of a federal agency to manage the RAS's assets. The urgent work had been underway since the summer 2013 under the pretext of the need for sorting out the mess in the area. To this effect the Duma passed an ambiguous law with references to not yet promulgated RF Government's normative acts. However, while passing the law, it was found out that in addition to assets the new agency would also oversee research organization's performance, approve their operational plans, etc. Facing the outraged scientific community and mass rallies in the summer, Mr. Putin allegedly opted for a compromise and publicly offered Mr. V. Fortov, President of RAS, to head the agency over a "transitional period". After Mr. Fortov agreed, already in October Mr. Putin broke his vow, as it was Deputy Finance Minister Mr. Kotyukov who was picked to run the agency. Interestingly, a 37 year-old prodigy does not even hold an academic degree. It seems that the key factor became the RAS leadership's acquiescence to the extent that one does not need to count them in and to be certain there would be no resistance but a publicly expressed support of whatsoever initiative from the top. With that he intrigue is not over, however, for following the classical redistribution logic, Ms. L. Ogorodova, the Deputy Minister of Education and Science, announced that the newly established agency would run all the scientific organizations rather than those under the auspices of RAS – that is, all the universities, research centers, etc., including those having founders of their own, including, *inter alia*, the RF President, the federal government, and government agencies. The scandalous final of the reform leaves little doubts as to its ultimate goal being property redistribution, rather than improvement of the situation in the research sector. Furthermore, the reform will give rise to further conflicts between different government instances, as many of them will not be happy to transfer their research organizations under the new agency's control. As to a longer-term perspective, the country leadership's prestige among the national research community will plummet like it did among the military one during Mr. A. Serdyukov's tenure.

The month of October saw several other personal changes. Specifically, Mr. G. Onischenko, the infamous head of Rospotrebnadzor, whose name is associated

with bans on Moldovan wines, Georgian mineral water, and other political actions, bowed out to take a ceremonial post of adviser to the Chairman of the RF Government. It looks like that Mr. Onischenko has exceeded authority with his recent moves, including claims against dairy imports from Lithuania, which currently holds the EU presidency, and Belarus, which has for long been at odds with Russia, while remaining an information sponsor to the Russian authorities as far as a flamboyant concept of the "Union State" is concerned. Hopefully, his leave would help minimize various sorts of the domestic lobbyism – yet another infamous feature of his agency.

The oil-and-gas sector also faced several critical decisions. The RF Government approved a bill on a minor liberalization of gas exportation. Gazprom has been a recognized monopoly in this regard since 2006, bar a few production sharing agreements. Under the circumstances, gas producers find themselves in a politico-economic trap, as they are forced to sell their produce to Gazprom, which can dictate monopolistic prices to them. The bill provides for granting the right to other state-owned corporations (i.e. Rosneft and Zarubezhneft), as well as companies operating LNG projects (which de-facto means an individual privilege to Novatek). Meanwhile, Rosneft and Transneft settled a long-lasting conflict about expansion of a China-bound pipeline. The oil behemoths were bickering about which of them should bankroll the subject – whether it should be Transneft at the expense of royalties payable by the whole national sector, or Rosneft as a final beneficiary of the pipeline. The compromise proves Rosneft's victory, as it agreed to capitalize a relatively minor fraction of the pipeline.

Mr. Putin submitted to the State Duma a bill to abrogate a two year-old procedure of opening criminal cases on charges of tax arrears. At the time, it was established that such criminal cases could be opened only upon a tax office's presentation, which helped reduce the number of such cases many-fold. That was rightly lauded as relief of the state pressure on businesses and had a rationale behind it, with the Tax Service exercising the respective authority with regard to the *corpus delicti* concerned. The new bill suggests to once again grant the authority to the Ministry of Interior. Given open criticisms Mr. V. Kolokoltsev, the incumbent Minister of Interior, throws at the 2008–2012 reform of the Ministry, one can note that the Ministry, which has for long been tagged as a major enemy to the small- and medium-sized businesses, tends to regain its omnipotent status it used to enjoy under the notorious para. 25 Art. 10 of the federal law "On militia" which would form a perfect rationale for checking anyone for compliance with anything. ●

## INFLATION AND MONETARY POLICY IN SEPTEMBER 2013

A.Bozhechkova

*In September 2013, the Consumer Price Index (CPI) amounted to 0.2% (against 0.6% in September 2012), which is by 0.1 pp. higher than its value recorded in August 2013. Thus, the inflation rate in per annum terms, as seen by the results of the first 9 months of 2013, increased above 6.1%. Over the first 23 days of October, the CPI amounted to 0.4%. In spite of a slowdown in economic activity, the RF Central Bank has not reduced its target interest rate.*

In September, the inflation rate in the Russian Federation accelerated: the Consumer Price Index (CPI), as seen by the month's results, amounted to 0.2% (against 0.1% in August 2013), whilst still remaining by 0.4 p.p. below its index for 2012. As a result, the inflation rate in per annum terms climbed to 6.1% (Fig. 1). The core inflation rate<sup>1</sup> in September 2013 was 0.7%, which is similar to its index for the same period of last year.

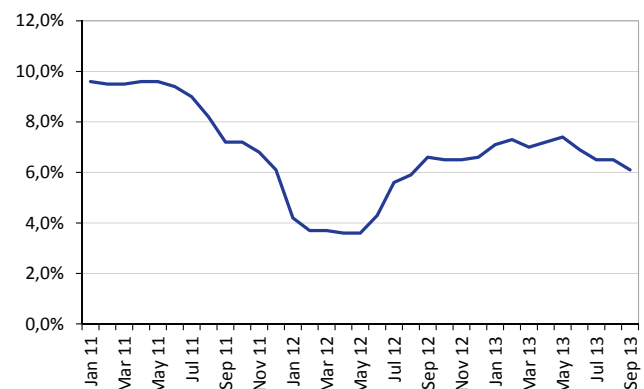
Prices of foodstuffs in September remained unchanged by comparison with August 2013 (Fig. 2). Prices of fruit and vegetable products continued to decline (from -11.3% in August to -7.6%). The growth rate of prices for granulated sugar became slower (going down from 4.4% in August to 1.1% in September), eggs (from 7.4% in August to 6.5%). At the same time, the growth rate of butter prices increased (from 2.6% in August to 2.9% in September), as did that of prices for milk and dairy commodities (from 1.2% in August to 2.7% in September), fish and seafood (from 0.7% in August to 1.2% in September). The growth rate of prices for bread and bakery products, as well as that of alcoholic beverages, amounted to 0.5% in September.

The growth rate of the prices and tariffs established for commercial services rendered to the population in September was 0.1%, thus plummeting below its August level (0.9%). Due to the start of the new school year, the prices for services in the education system increased significantly (+3.8%). The growth rate of the housing and utilities tariffs in September amounted to 0.3%. Growth was demonstrated by the prices for services in the sector of sports and physical culture (+1.8%), entertainment (+1.2%), personal consumer services (+0.5%), medical services (+0.4%). The prices of passenger transport services and out-bound tourism, on the contrary, dropped by 2.7% and 0.8% respectively.

1 The core consumer price index reflects the level of inflation on 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. This index is also calculated by the RF Statistics Service (Rosstat).

In September, the growth rates displayed by prices of nonfood commodities amounted to 0.5% – similar to their August 2013 level. In this commodity group, the steepest upward movement was demonstrated by the prices of tobacco products – by +3.0% (against +2.0% in August), motor gasoline – by 1.5% (against +3.1% in August), footwear – 0.7% (against 0.3% in August), clothes and underwear – 0.6% (against 0.3% in August), pharmaceuticals +0.5% (against +0.5% in August), and those of radio and television sets (+0.4%) (against 0.3% in August).

In October, the inflation rate sped up in response to a halt in the seasonal rapid decline of prices for fruit and vegetable products and a leap of the prices of eggs. Over the first 23 days of October, the CPI amounted to 0.4% (against 0.5% over the same period of 2012). As a result, the cumulative inflation rate since the year's beginning rose to the level of 5.2% (against 5.7% over the same period of 2012). It should be noted that the leap of prices by 0.2 p.p. in the third week of October point to the possibility of the year-end inflation index rising above 6%. The main factors working against the inflation rate's upward movement are the absence of a marked pressure of demand on the level of prices and the relatively favorable situation with regard to the crops of the main agricultural products.



Source: Rosstat.

Fig. 1. The CPI Growth Rate in 2011–2013 (% Year-on-Year)



In September 2013, the broad monetary base increased by 2.5% to Rb 9,116.5bn (Fig. 3). Among the increased components of the broad monetary base one may point to the monies kept on commercial banks' correspondent accounts with the RF Central Bank (growth by 33.9% to Rb 1,097.8bn), banks' deposits (growth by 9.0% to Rb 143.7bn), and required reserves (growth by 0.9% to Rb 506.1bn). The volume of cash in circulation, including the cash balances of credit institutions, displayed movement in the opposite direction (decline by 1% to Rb 7.369 bn).

The narrow monetary base (currency issued by the Bank of Russia plus required reserves) over September shrank by 0.9%, amounting to Rb 7,875.1bn (Fig. 4).

In September 2013, the surplus reserves held by commercial banks<sup>1</sup> rose by 30.4% to Rb 1,241.5bn, while the amount of banks' repo debt increased by 14.1% – to a level in excess of Rb 2.5 trillion. As of 28 October, banks' repo debt amounted to Rb 2.3 trillion. In a situation of continuing structural liquidity deficit in the banking sector, the interest rate in the interbank market<sup>2</sup> in September was on the average at the level of 6.25% (against 6.11% in August 2013), thus increasing above its January index by 16.4% (against 5.4% in January). Over the period from 1 through 28 October, the average interest rate was 5.97% (Fig. 5). It is noteworthy that the decline of the interbank interest rate observed over the course of October occurred in part due to the auctioning, by the Bank of Russia, of three-month loans secured by non-marketable assets at a floating interest rate, in the total volume of Rb 500bn, the average cost of newly-issued debt being 5.76%.

Thus, a considerable portion of the funding attracted by banks from the monetary regulator remains in the correspondent accounts of credit institutions kept with the Bank of Russia – a phenomenon reflecting a slowdown of the rate of crediting issued to the non-financial sector in conditions of stagnation in Russia's national economy.

As of 1 October 2013, the Bank of Russia's international reserves volume amounted to \$ 522.6bn, having shrunk since the year's beginning by 2.8% (Fig. 4). At the same time, the reserves backed by monetary gold over the month of September dropped by \$ 2,3bn due to a downward adjustment of asset value.

As seen by the month-end results, the scale of currency interventions by the Bank of Russia in September was \$ 3,178.4m and € 214.96m, their purpose being to

1 The surplus reserves held by commercial banks at the RF CB are understood as the aggregate balance of their correspondent accounts, deposits with the RF CB and the bonds issued by the RF CB and held by commercial banks.

2 The interbank interest rate is the average monthly interest rate on overnight ruble-denominated interbank loans (Moscow Interbank Actual Credit Rate - MIACR).

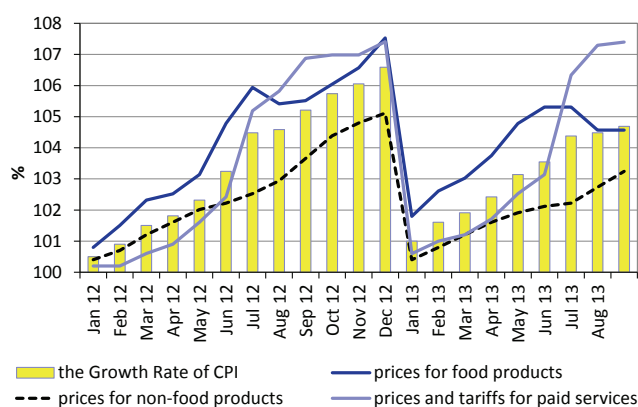


Fig. 2. The CPI Growth Rate in 2012–2013 (as % on December of Previous Year)

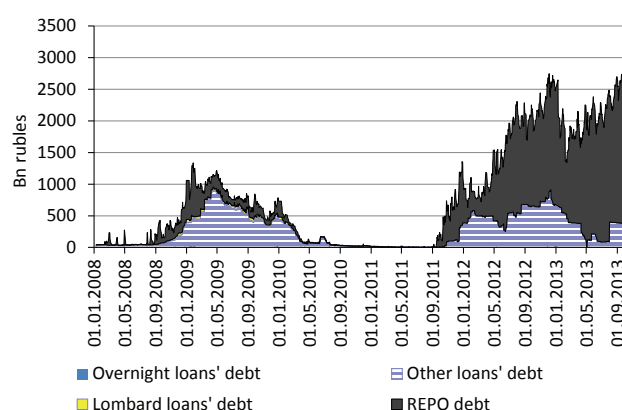


Fig. 3. The Movement of Commercial Banks' Debt to the Bank of Russia in 2008–2013

level down the volatility of the ruble's exchange rate (Fig. 6). Over that month, the state regulator repeatedly revised the boundaries of the bi-currency basket's floating corridor by 5 kopecks. As of 30 September, the boundaries of the bi-currency basket's floating corridor were set at Rb 32.30–39.30. Over the period from 1 through 25 October, the volume of foreign currency sales by the Bank of Russia amounted to \$ 2,042m; at the same time, the regulator's purchases of foreign currencies in order to back up the replenishment or spending, by the Federal Treasury, of the RF sovereign funds denominated in foreign currencies amounted to \$ 183m. The one-time upward adjustment of the bi-currency basket's corridor by 5 kopecks in October pushed the corridor boundaries up, to the level of Rb 32.35–39.35.

According to the Bank of Russia's preliminary estimates, net capital outflow from Russia in Q3 2013 increased to \$ 12.9bn, and on the whole for the first nine months of 2013 this index amounted to \$ 48.1bn, which is by \$ 1.7bn higher than the same index for the first nine months of 2012. Over the period from January through September 2013, net capital outflow from

the banking sector was \$ 10.1bn, while that from the other sectors amounted to \$ 38.2bn.

In September, the ruble's real effective exchange rate gained 1.3% (against -1.8% in August 2013) (Fig. 7). As seen by the results of the first three quarters of 2013, the ruble's real effective exchange rate declined by 2.6%.

Over the course of September, the exchange rate of the US dollar against the ruble dropped by 2.7%, to Rb 32.3. The decline of the euro's exchange rate against the ruble over September amounted to 0.7% (Rb 43.6). In September, the average exchange rate of the euro against the US dollar amounted to 1.33. The value of the bi-currency basket over September shrank by 1.7% to Rb 37.4. As seen by the results of the first 25 days of October, over that period the USD/ruble exchange rate declined by 2.5%, to Rb 31.7., the euro/ruble exchange rate - by 0.2%, to Rb 43.7. As a result, the bi-currency basket's value increased by 1.3%, to Rb 37.1. The ruble's strengthening was boosted by the receding investors' fear that the US Federal Reserve System's third round of quantitative easing (QE3) was soon going to be halted. Thus, the average euro/ USD exchange rate for October amounted to 1.36. It should also be noted that the euro's strengthening occurred due to the end of recession in the eurozone, as well as the uncertainty with regard to the US government debt ceiling.

The Bank of Russia's monetary policy decisions taken in October 2013 were aimed in the main towards increasing the exchange rate's flexibility. From 1 October 2013, the Bank of Russia adjusted its exchange-rate policy mechanism, and so the parameters of its currency purchase and sale operations on the domestic foreign currency market are now to be determined with due regard for the Federal Treasury's operations of replenishing or spending the RF sovereign funds denominated in foreign currencies. Thus, in particular, the volumes of currency purchase and sale operations carried on by the Bank of Russia on the domestic foreign currency market, which are determined with the purpose of leveling down the volatility of the ruble's exchange rate, will from now on be increased or downgraded by a figure equal to the actual volume of purchase (or sale) of foreign currencies by the Federal Treasury from (or to) the Bank of Russia, effectuated in order to replenish or spend the RF sovereign funds denominated in foreign currencies.

The recent adjustment of the exchange-rate policy mechanism is one of the components of the process of creating a framework for the transition to a floating currency exchange rate. This newly introduced measure will help to more or less neutralize the effect of the Federal Treasury's operations relating to replenish-

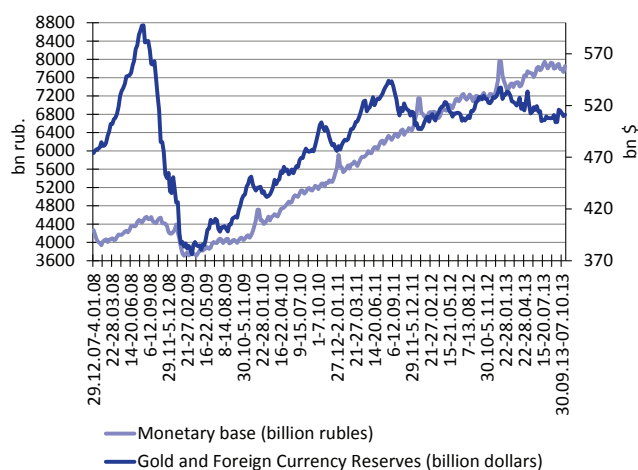


Fig. 4. Behavior of Russia's Narrow Monetary Base and Gold and Foreign Currency (International) Reserves in 2007–2013

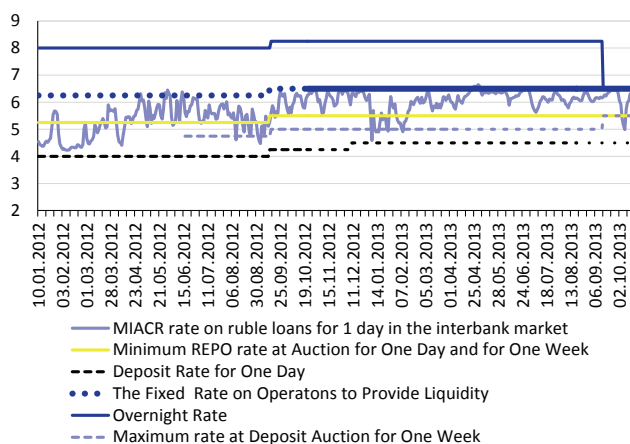
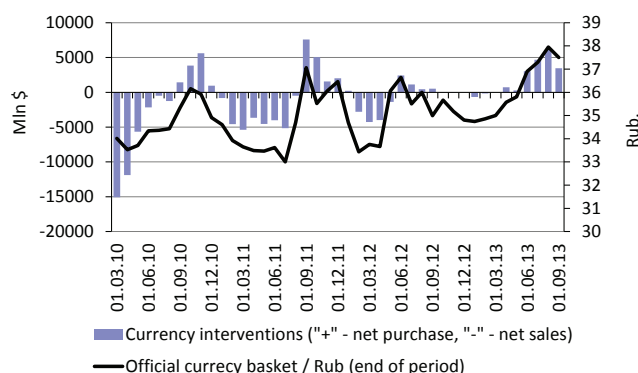
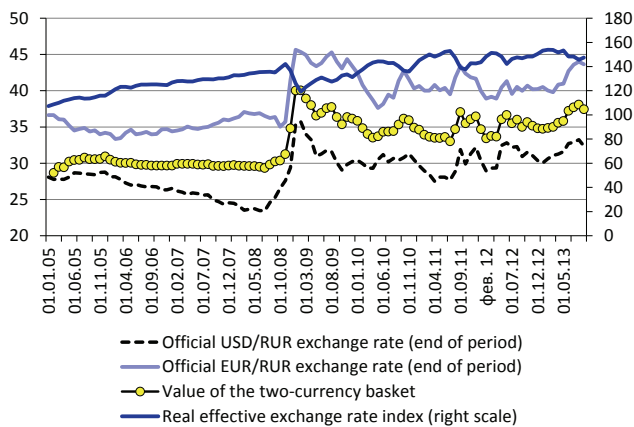


Fig. 5. The Bank of Russia's Interest Rate Corridor and the Interbank Market's Behavior in 2012–2013 (% per Annum)



Source: RF CB; the author's calculations.

Fig. 6. The Bank of Russia's Currency Interventions and the Ruble Exchange Rate against the Bi-currency Basket in March 2010 – September 2013



Source: RF CB; the author's calculations.

Fig. 7. Behavior of the Ruble's Exchange Rate Indicators in January 2005 – September 2013

ing or spending the RF sovereign funds denominated in foreign currencies on the banking sector's liquidity level.

On 7 October 2013, the Bank of Russia widened the neutral range of the operational bi-currency band to Rb 3.1 from Rb 1, while keeping the general operating range of the bi-currency basket (Rb 7) unchanged.

It should be reminded that the neutral range is set inside the bi-currency basket's operating range. The currency exchange rate's fluctuations within that range do not prompt the regulator to resort to currency interventions. In the event of the exchange rate leaping beyond the neutral range, the Bank of Russia launches currency purchase (or sale) operations, whose volume increases as the exchange rate approaches the operating range's boundaries.

This decision will result in a decline in the volume of interventions conducted by the Bank of Russia in response to negligible fluctuations of the bi-currency basket's value. On the whole, such a decision is quite compatible with goal of gradually increasing the exchange rate's flexibility in order to strengthen the effect of the regulator's interest rate policy aimed at ensuring price stability.

From 21 October 2013, the Bank of Russia reduced the daily volume of its targeted currency interventions to \$ 60m. This adjustment will result in increased sensitivity of the operational band borders to Bank of Russia interventions aimed at cushioning the excessive volatility of the ruble's exchange rate. Such policy alterations, all other conditions being equal, will reduce the scale of the Bank of Russia's direct presence on the domestic currency market. ●

## FIANACIAL MARKETS IN OCTOBER 2013

N.Andrievsky, E.Khudko

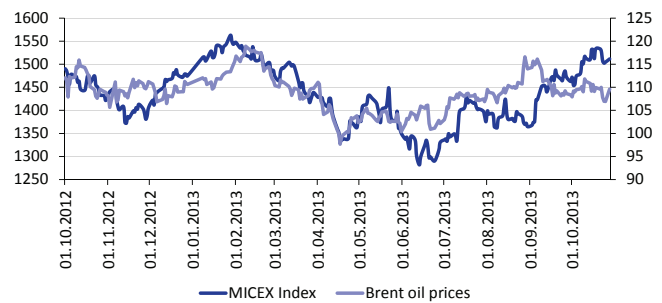
Oil prices increase in the beginning of October 2013 was followed by a 4.2% growth in the MICEX index in the first half of the month. As of October 28, 2013, the MICEX index increased 2.7% since the start of the month and reached 1511 points. OJSC Norilsk Nickel's stocks showed maximum growth among blue chips, having increased by 7.09% over the 28 days in October 2013. The MICEX stock market capitalization reached Rb 25,38 trillion (39.12% of GDP) by October 28, 2013. The domestic corporate bond market saw positive trends in October 2013. The key market indicators were driven by an uptrend: market volume, corporate bond market index, weighted average yield, issuers' activity.

### Dynamics of Russian stock market basic structural indices

A growth of 3.58% (up to \$111,8 per barrel) in prices of Brent crude oil in the first decade of October 2013 determined a growth of 4.2% in the MICEX index in the period of October 1, 2013 thru October 21, 2013. It was Gazprom stocks that pushed up the index at that period. Crude oil price correction up to \$109,9 per barrel by October 22, 2013 had no effect on the MICEX index, because Gazprom stocks decline was compensated by growth in Sberbank stocks. A drastic fall of crude oil prices by \$2,17 per barrel (-1.97% during the day) on October 23, 2013 triggered a fall of 1.4% of the MICEX index during the day.

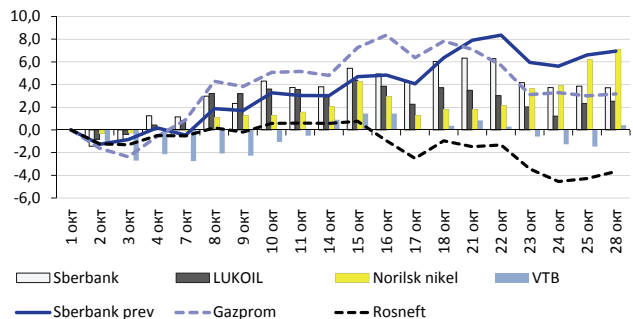
Gazprom and Sberbank stocks became principal growth drivers for the MICEX index in September 2013. Gazprom stocks increased significantly in the first half of the month. Growth rates of these stocks reached 8.35% since the beginning of the month to October 16, 2013 and were followed by downward correction which allowed Gazprom stocks to gain as little as 3.17% in the period of October 1, 2013 thru October 28, 2013. Sberbank preferred stocks also gained 8.35% since the beginning of the month. Norilsk Nickel stocks were leading in growth by the end of the month and gained 7.09% in the period of October 1, 2013 thru October 28, 2013. VTB and Rosneft stocks saw a downtrend during the month, with the latter having lost 3.67% of its early-in-the-month value by the end of October.

Positive trends for blue chips resulted in 6.76% p.a. of annual yield of Norilsk Nickel (in the period of October 29, 2012 thru October 28, 2013). Sberbank stocks also demonstrated substantial yield at a level of 12.2% and 23.0% for common stocks and preferred stocks respectively. Growth in the value of Gazprom stocks during the month failed to change negative annual results (less than 0.34%). However, it was VTB whose stocks saw most negative calendar year and a 22% drop in value.



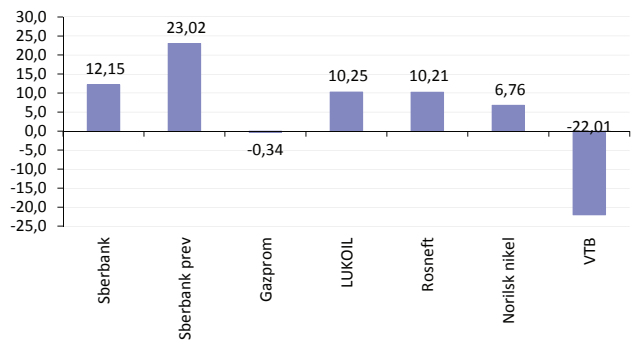
Source: RBK Quote.

Fig. 1. Dynamics of the MICEX index and futures Brent oil prices in the period of October 1, 2013 thru October 28, 2013



Source: RBK Quote, author's estimates.

Fig. 2. Blue chips growth rates in the Moscow Stock Exchange in August 2013 (over a period since the beginning of the month)



Source: RBK Quote, author's estimates.

Fig. 3. Blue chips growth rates in the Moscow Stock Exchange in the period of October 29 2012 thru October 28, 2013



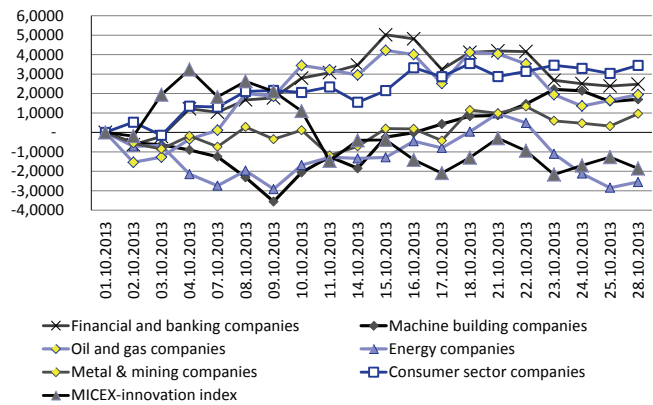
The consumer sectoral index, which increased by 3.44% by September October 28, 2013 since the beginning of the month, was leading in growth among sectoral indices. The consumer sectoral index's uptrend was driven basically by Magnit, Grappa Cherkizovo, Farmstandard and stocks, as well as M.Video Company. It was only energy companies' stocks that saw downtrend in October 2013, mainly in response to a fall in InterRao and Russian Grids stocks, and the MICEX-innovation index which was affected by a drop in prices of NPO NAUKA stocks.

According to the Emerging Portfolio Fund Research (EPFR), Russian market-oriented foundations saw a capital inflow of \$62m in the period of October 1, 2013 thru October 23, 2013. Russia's stock market (MICEX) capitalization totaled 25,38 trillion (39.12% of GDP) as of October 28, 2013, having shown an increase of Rb 444bn (1.7%) against the value observed on October 1, 2013. The mineral extraction sector accounted for less than 50% of total capitalization during the month. The share of companies operating in retail sales, transport and communications sectors, as well as manufacturing sector, increased up to 9%, 8.8%, and 12.3% respectively since the beginning of the month.

**Corporate bond market**

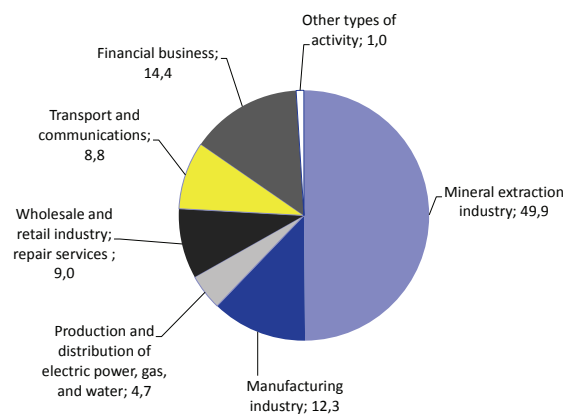
The domestic corporate bond market in Russia (measured by the par value of outstanding securities denominated in the national currency, including those issued by non-residents) saw a considerable growth in October 2013. By the end of October 2013 the value reached Rb 4945,6bn, having shown an increase of 3.5% against the value observed by the end of September 2013<sup>1</sup>. The increase in market capacity was determined exclusively by increase in the number of bond issues (1022 corporate bond issues registered in the national currency against 1002 issues at the previous month end), whereas the number of bond issuers remained unchanged (346 issuers). In addition, there are outstanding 12 USD-denominated bond issues of Russian issuers (a total of more than \$1.8bn), and a JPY-denominated bond issue.

Investment activity in the corporate bond secondary market increased significantly in October 2013 after a long-lasting period of stabilization. For instance, in the period of September 24, 2013 thru October 23, 2013, total volume of market transactions in the Moscow Stock Market amounted to Rb 184,9bn (to compare, the corresponding volume amounted to Rb 152,3bn in the period of August 22, 2013 thru September 23, 2013), and the number of transactions increased up to 28,700 and amounted to 27,400 (against 27,000 in the previous period) in the period under



Source: RBK Quote, author's estimates.

Fig. 4. Growth rates in various sectoral stock indices at the Moscow Stock Exchange (over a period since the beginning of the month)



Source: The Moscow Stock Exchange's official website, authors' estimates.

Fig. 5. Stock market capitalization structure by type of economic activity

review)<sup>2</sup>. It should be noted that higher investment activity in the market is generally typical of Q4 2013.

The Russia corporate bond market index (IFX-Cbonds) kept growing. Its value increased by 2.7 points (or 0.7%) by the end of October 2013 as compared to the value observed at the previous month end. The corporate bond average weighted yield also saw a positive trend, having dropped from 8.07% late in September 2013 to 8.02% by the end of October 2013 (Fig. 6), having shown its minimum over the past two years<sup>3</sup>.

In spite of the current challenges faced by the Russian economy and the world economy, the current environment in the corporate bond market is fairly conducive. Investors' activity in the corporate segment has not yet been affected by the recent mid-term forecasts with regard to a relatively slow growth in the Russian economy and capital outflow (in particular, the World Bank's and S&P's estimates show that structural con-

1 According to Rusbonds information agency.

2 According to Finam Information Company.

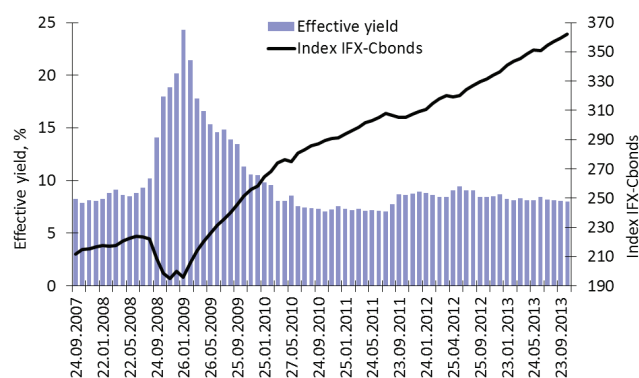
3 According to Cbonds Information Agency.

straits are expected not to allow Russia to grow at annual rate faster than 3% in the near-term, while Moody's still predicts that development prospects of the Russian banking system are 'negative'<sup>1</sup>). Furthermore, the Central Bank of Russia revoked banking license of a few Russian banks in the previous month (the most notorious revocation was related to PUSHKINO BANK) and downgraded ranking for Svyaznoi Bank and St. Petersburg Bank. However, the foregoing had no significant impact on the bond market. According to some experts, a relatively sustainable position of the bond market is determined by growth in ruble liquidity in October 2013 and gradual diversification of investors<sup>2</sup>.

The corporate bond portfolio duration value remained unchanged. The duration was 691 days as of the end of September 2013, being 26 days beyond the value observed as of the previous month end. Relative stabilization of the duration value against insignificant decline of interest rates in the market is indicative of invariance of maturity of flow of payments on bonds and, therefore, maturity of outstanding bond issues in the corporate segment.

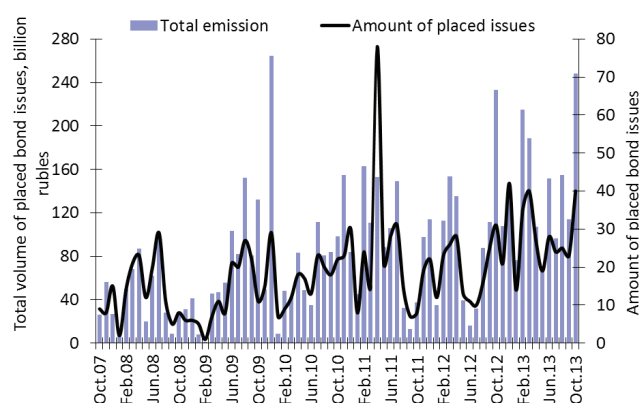
The most liquid segment of the corporate bond market kept being exposed to different trends with regard to the yield, although dynamics of interest rates saw low volatility. Like in the previous month, it was only financial corporate issuers that experienced most significant changes in the yield (between 0.5 p.p. and 0.6 p.p.), some towards contraction, like OJSC ALFA-BANK (series 01) and OJSC ZENIT Bank (series BO-04), others towards growth, like OJSC Russian Agricultural Bank (series 05) and OJSC Bank Petrocommerce (series 05). The yield of high-tech companies' most liquid issues contracted too (by an average of 0.1 p.p.)<sup>3</sup>.

The positive market trend which has been persisting over the last few months, prevents the activity of Russia's issuers in terms of bond issue registration at a fairly high level, although new issue registration values declined against September 2013. For instance, 14 issuers placed 38 bonds at an aggregate par value of Rb 123,3bn in the period of September 24, 2013 thru October 23, 2013 (to compare, 36 bond issues at Rb 341,3bn were placed within a period of August 22, 2013 thru September 23, 2013). Major issues were registered by OJSC UralSib Bank (5 series of listed bonds at a total of Rb 21bn), OJSC TMK (3 series of listed bonds at a total of Rb 20bn), OJSC Tyumenenergo (4 series of listed bonds at a total of Rb 20bn) and LLC RESO-Leasing (5 series of listed bonds at a total of



Source: According to Cbonds Information Agency.

Fig. 6. Dynamics of the Russian corporate bond market index and average weighted yield



Source: According to Rusbonds information agency.

Fig. 7. Dynamics of initial public offerings of corporate bonds denominated in the national currency

Rb 14bn)<sup>4</sup>. Listed bonds accounted for more than two thirds of the registered issues.

Unlike bond issue registration values, investment activity in the primary market increased considerably in October 2013 against the previous year. For instance, 34 issuers placed 40 bonds at an aggregate par value of Rb 248,3bn in the period of September 24, 2013 thru October 23, 2013, having reached the highest value over the last four years (to compare, 23 series of bonds at Rb 113,8bn were placed within a period of August 22, 2013 thru September 23, 2013) (Fig. 7). Major bond issues were placed by Bank of Development and Foreign Economic Affairs (at a total of Rb 30bn), OJSC Russian Railways (Rb 25bn), OJSC VTB Bank (Rb 20bn) OJSC Gazprombank (Rb 14,9bn), OJSC Federal Grid Company UES (Rb 20bn)<sup>5</sup>. Such companies as Federal Grid Company UES and Russian Railways managed to borrow for a period of 35 and 20 years respectively, and a few other issues for 10 years.

1 According to Cbonds Information Agency.

2 According to Cbonds Information Agency.

3 According to Finam Investment Company.

4 According to Rusbonds information agency.

5 According to Rusbonds information agency.

In October 2013, the Bank of Russia Financial Markets Service declared void 11 bond issues for non-placement of a single bond (as compared to 15 series in the preceding period)<sup>1</sup>. However, nine issues of a single major issuer (TransFin-M) were declared void, in which case the reason for that were changes in the company's fundraising plans, rather than lack of the demand for these securities.

Fifteen bond issuers were to redeem their debt at an aggregate par value of Rb 70,5bn in the period of September 24, 2013 thru October 23, 2013. However, one issuer failed to redeem its debt on the date of maturity (two issuers declared a technical default in the preceding period). Seventeen issues of corporate

bonds at a total of Rb 60,4bn are to be redeemed in November 2013<sup>2</sup>.

Nevertheless, the situation with the issuers' compliance with their obligations to bond holders improved in general in October 2013. No real defaults<sup>3</sup> on coupon yield payment were declared in the market in the period of September 24, 2013 thru October 23, 2013 (two issuers declared real default on coupon yield payment in the corresponding period of the previous year). Likewise, no real defaults in repayment of the par value of bond issues and early redemption of securities on put date were reported<sup>4</sup>.

1 According to the Bank of Russia Financial Markets Service.

2 According to Rusbonds company.

3 It means that the issuer was unable to pay to bondholders even during the grace period.

4 According to Rusbonds company.

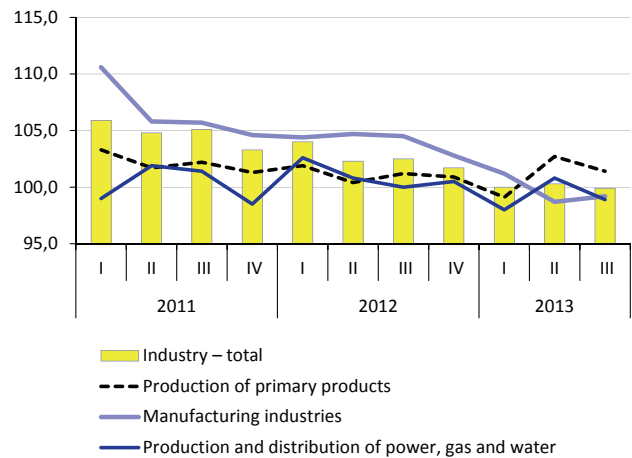
## RUSSIA'S REAL SECTOR OF ECONOMY: FACTORS AND TRENDS IN JANUARY–SEPTEMBER 2013

O.Izryadnova

*The results of January–September 2013 point to the continued trend in economic growth slowdown. Within the above period, the industrial production index amounted to 100.1% on January–September 2012, including that of manufacturing industry which was equal to 99.7%. The index of agricultural industry happened to be below the expected mid-year values and was at the level of 101.8% as compared to January–September 2012. In the building and investment complex, a slump intensified by quarters of the current year. In January–September 2013, investments in capital assets decreased by 1.9%, while in the 3<sup>rd</sup> quarter, by 1.2% on the respective period of the previous year. A dramatic slowdown of the dynamics of GDP takes place with preservation of the trend towards growth in wages and salaries which situation increases the risks of downfall of financial indices of economic activities.*

In 2013, the macroeconomic situation is characterized by gradual weakening of the economic dynamics and worsening of growth prospects in the remaining two months of 2013. Stagnation of the Russian economy is justified by simultaneous negative effect of external and internal factors. The domestic market is affected by reduction in the volumes of domestic output of goods and services for internal consumption, as well as slowdown of growth rates of import supplies. In January–September 2013, the volume of industrial output increased by the mere 0.1% against the respective period of the previous year. It is to be noted that in the past five months of 2013 in manufacturing industries which are mainly aimed at the domestic market negative annual and quarterly growth rates were registered as compared to the respective periods of the previous year. In January–September, a slump in manufacturing industries amounted to 0.3%, while in September, to 0.7% as compared to the respective periods of 2012. From the 2<sup>nd</sup> quarter of 2013, weak growth in production of primary products started to affect the industrial dynamics which situation was justified to a great extent by growth in fuel reserves on the domestic market and in traditional importer-countries in expectation of the beginning of the heating season with unfavorable climate forecasts made for the 2013–2014 winter.

Other real sector industries had a negative effect on the general economic dynamics, too. In September, the output index in agricultural industry was much below the expected values and amounted to 98.6% and 101.8% on September 2012 and January–September 2012, respectively. Due to slowdown of solvent demand, during the nine months of 2013 dynamics of the volumes of freight turnover fell by 0.4%, including railway carriage which accounted for a larger portion of freight carriage (a 2.6% drop on January–September 2012).



Source: Rosstat.

Fig. 1. Dynamics of individual types of economic activities in industry in the 2011–2013 period as % of the respective quarter of the previous year

Further drop in investment activities throughout this year has had a negative effect on economic processes in the Russian economy. In January–September, in the building complex the volume of work decreased by 1.1% against the respective index of the previous year. In the 3<sup>rd</sup> quarter, a drop in investments in capital assets amounted to 1.2%, while generally in January–September 2013, to 1.9% on the respective period of 2012. Declining financial results of enterprises and entities increased limitations as regards financing of investments in capital assets. In January–August 2013, the consolidated financial result as regards the economy as a whole amounted to 82.1% of the index for the respective period of the previous year, including that in production of primary products (97.0%), manufacturing (70.5%), production and distribution of power, gas and water (85.3%) and transport (86.8%).

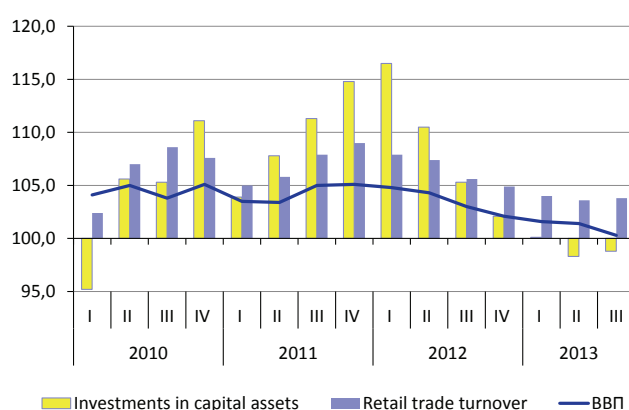
With the existing dynamics of the results of financial activities and scaling down of investment programs, it is hard to expect a burst of investment activities with large companies in the last quarter of 2013.

Worsening of the investment prospects coincided with growth in the net capital outflow for 9 months of 2013 to \$48.2bn against \$46.4bn a year earlier. It is to be noted that in nine months of 2013 a drop in the current account balance to \$29.5bn against \$61.6bn in the same period of 2012 was registered. A sudden reduction of the current account balance in January–September 2013 as compared to the respective period of 2012 was related to growth in the import of goods and services by \$8.1bn and \$16.6bn, respectively.

On the domestic market, the main factor which restrained the negative effect of output shrinkage in industry and the building and investment complex was the retail trade and the sector of paid services to households. In January–September 2013, growth in the volume of retail trade and paid services to households amounted to 3.9% and 2.4%, respectively as compared to the same period of the previous year. In the 3<sup>rd</sup> quarter of 2013, growth in retail trade turnover in food products and non-food products amounted to 3.2% against 2.2% a year earlier and 4.1% against 8.5%, respectively.

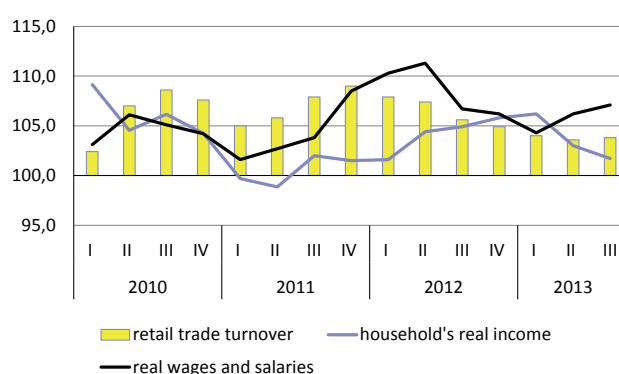
A positive effect on the economic dynamics of growth in retail trade turnover related to the policy of adjustment of the labor remuneration in the state sector with average economic indices has dramatically diminished this year. In January–September 2013, households' real income and real wages and salaries increased by 3.6% and 5.9%, respectively, as compared to the same period of the previous year. From the 2<sup>nd</sup> quarter of 2013, the speed-up of the dynamics of real wages and salaries turned out to be insufficient enough to motivate growth in retail trade turnover in May–September 2013. In addition to the above, from the 2<sup>nd</sup> quarter of 2013 slowdown of growth rates of households' real income to 101.7% in the 3<sup>rd</sup> quarter of 2013 against the respective period of the previous year – which slowdown had a negative effect on the consumer market situation during that period – was registered. It is to be noted that growth in retail trade turnover in the past two years was justified to a great extent by growth in consumer lending and slowdown of growth rates of lending to individuals which was registered from October 2012 and resulted in slowdown of growth rates of the consumer market.

The analysis of the main indices of production and utilization of GDP in the first six months of 2013 shows that the main factor behind low economic growth



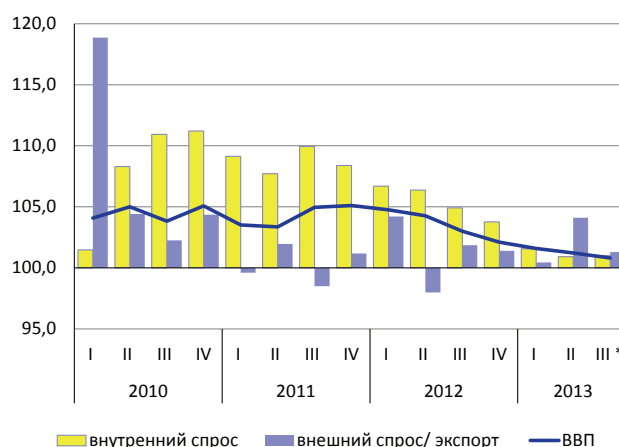
Source: Rosstat.

Fig. 2. Growth rates of GDP, investments in capital assets and retail trade turnover in the 2011–2013 period as % of the respective quarter of the previous year



Source: Rosstat.

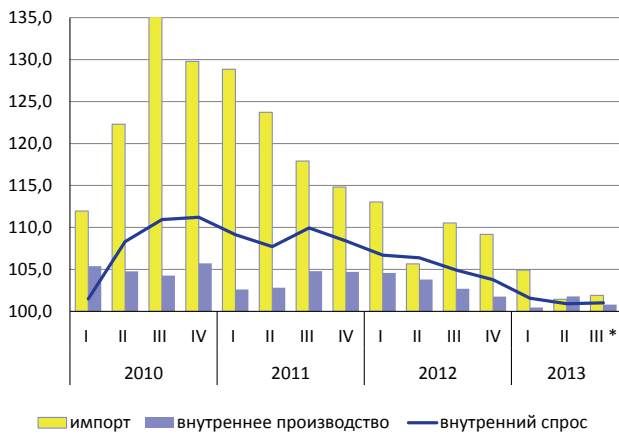
Fig. 3. Growth rates of households' real income, real wages and salaries and retail trade turnover in the 2011–2013 period as % of the respective quarter of the previous year



Source: Rosstat.

Fig. 4. Dynamics of GDP by the component of the domestic and external demand in the 2010–2013 period as % of the respective quarter of the previous year





Source: Rosstat.

Fig. 5. The dynamics of the domestic demand by the component in the 2010–2013 period as % of the respective quarter of the previous year

rates in 2013 is slowdown of the rates of the domestic demand from the 4<sup>th</sup> quarter of 2011. In 2013, the rates of slowdown of the domestic demand sped up dramatically and only the export of goods and services became a factor which permitted to preserve the positive dynamics of GDP.

It is to be noted that the International Monetary Fund revised downward for the third time the forecast of Russia’s GDP growth rates to 1.5% and increased the inflation rate forecast to 6.2% in 2013. The Russian economy exhausted the growth reserves



\*The preliminary data

Source: Rosstat.

Fig. 6. The dynamics of domestic production by the component in the 2010–2013 period as % of the respective quarter of the previous year

and is in need of structural reforms. The analysis of functioning of the Russian economy in 2013 shows that the domestic market situation is determined by the advanced rates of the import as compared to the domestic production (Fig. 5). Sudden slowdown of domestic production is justified both by low competitiveness of domestic goods and services as compared to foreign ones and the low level of efficiency of production in the segment of non-tradable goods and services as compared to export-oriented sectors of the economy.

## RUSSIAN INDUSTRIAL SECTOR IN SEPTEMBER 2013

S.Tsukhlo

According to the Gaidar Institute's business survey data<sup>1</sup>, the September performance score proved pessimistic rather than otherwise. The dynamics of demand and output underwent no fundamental change which discouraged enterprises and resulted in a lower satisfaction with demand and an increase in the inventory excess rate. That said, the industrial sector kept raising prices, which would hardly fuel demand. A continuous exodus of employees from enterprises leads to labor force shortages even in the conditions of stagnation. Corporate investment plans signal a further cutting back on investment in production.

### Demand for Industrial Produce

The September dynamic of demand underwent no fundamental change. Both initial and cleared-of-seasonality data displayed a slight acceleration of decline in sales, which interrupted a positive (for the current conditions) trend towards slowdown of the demand decline rate, which would manifested itself between July and August (Fig. 1). The September balance of assessments (satisfaction rate) of current sales plummeted nearly to zero after hitting twelve-month highs back in August. The industrial sector proved unhappy with results of Q3 and is likely to keep looking for volumes of production and output which would be normal for conditions of a continuous stagnation.

The initial projections of demand have been in a steady (except for a natural, since this year, intermezzo in May) decline since the beginning of the year (after they sky-rocketed in January from -19 to +28 points) and had lost 30 points by September. However, their formal clearing of seasonality displays their relative stability in the range between +2..+11 points and improvement up to +7 points in the month in question.

### Inventories

In September, inventories estimates likewise underwent a negative adjustment (Fig. 2). Weak demand, an increasing dissatisfaction with its volumes coupled with the unpredictability of even the nearest prospects of Russia's economy forced enterprises to once again radically revise their inventories estimates. While they improved by 10 points at once in July and added yet another two points in August, in September their balance plunged 6 points, thus having them lose a half

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%.

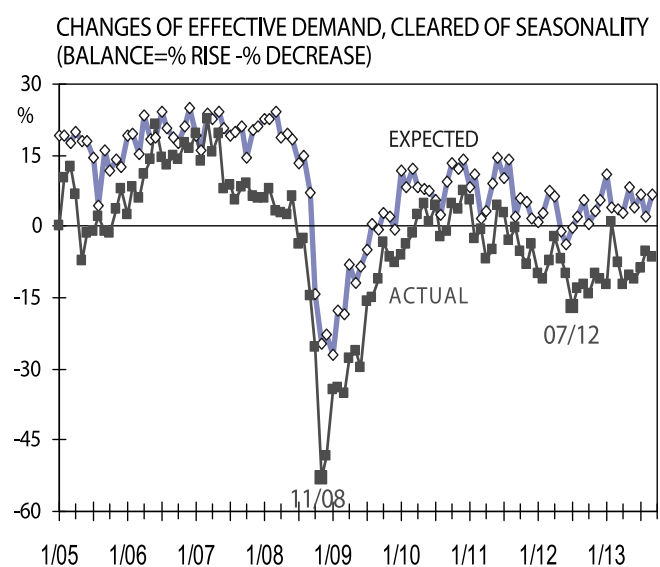


Fig. 1

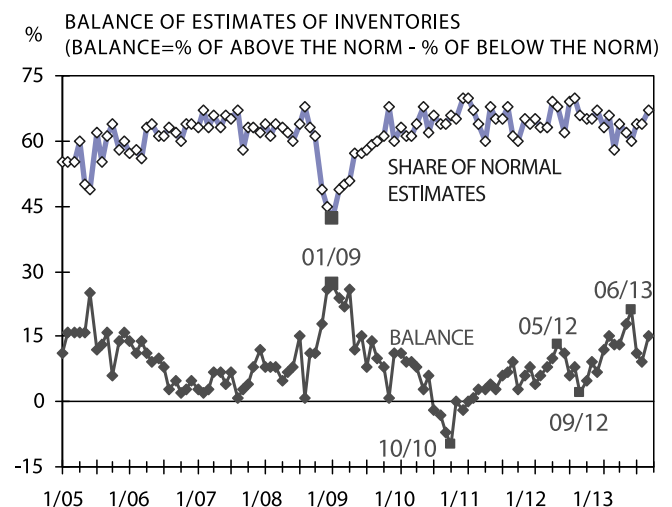


Fig. 2

of their previous achievements. Meanwhile, the June results have remained so far the worst ones over the period after the peak of the crisis was over, which is quite notable, for according to data of the IET's (anti-) crisis monitoring, the domestic industrial sector gives importance to minimization of inventories while gearing up for a second wave of the crisis – enterprises rank this move second or third in the overall rating of anti-crisis measures, and as many as 28% of plants currently, in Q3, practices it.

**Output**

Like demand, the industrial output in September did not see neither clearly positive changes, nor certainly negative ones (Fig. 3). Initial data displayed a drop by a minimum number of balance points, while cleared of seasonality, the data evidenced an acceleration of the rate of rise in output. Consequently, the data for Q3 showed a symbolic 3-point improvement of the indicator. The output plans display an amorphous dynamic in 2013 and have remained in the range between +12..+18 balance points from the beginning of the year.

**Producer Prices**

Having started in August 2013, the producer price rise in the industrial sector continued into September, with the rate of change remaining the same. Last year, the H2 price rise started in July, but nearly faded away in August, and in November 2012, there was registered an absolute price downfall (Fig. 4). For the time being, the price rise proves most intense in the forestry, food processing, and the ferrous metallurgy. None of the industries reported an absolute decline in prices over August and September, albeit prices of machine-engineering and chemical plants, as well as construction enterprises, rose slightly above the zero mark.

The price rally in H2 2013 is fueled by plans of their change. In September, the balance of expectations climbed up by 7 points, which signals corporations' intent to continue raising prices, or, at least, to keep the price rise in place through the end of the year. Nothing like this was noted back in 2012 and 2011 – at the time, the November and December surveys typically registered forecasts of a minimum price rise.

**The Actual Dynamic and Plans of Lay-offs**

According to the survey data, the exodus of labor force was still underway. In September, the balance (intensity) of the change in the actual number of employees at enterprises remained at a level of the three summer months and accounted for -7 points (Fig. 5). In May 2013, it sank to -13 points, while in January – to -26. So, it is the months with the greatest number of

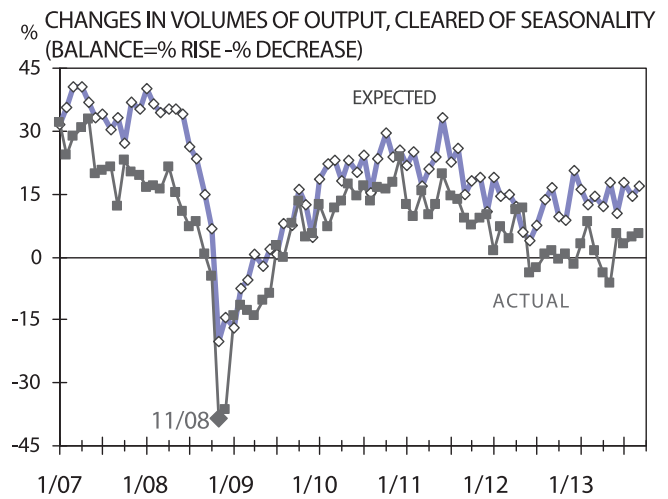


Fig. 3

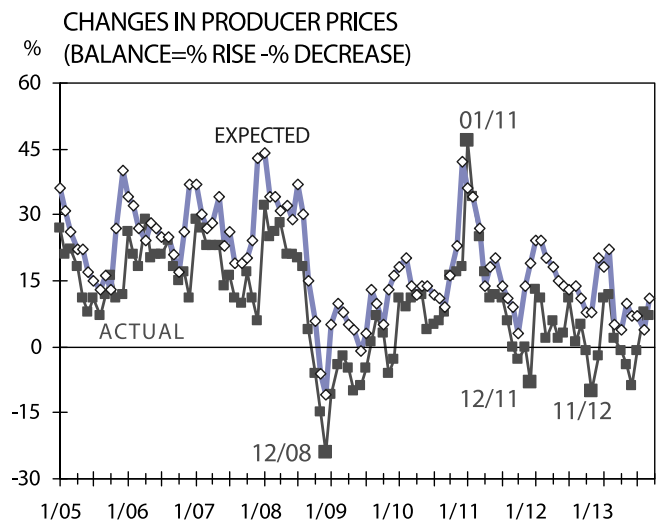


Fig. 4

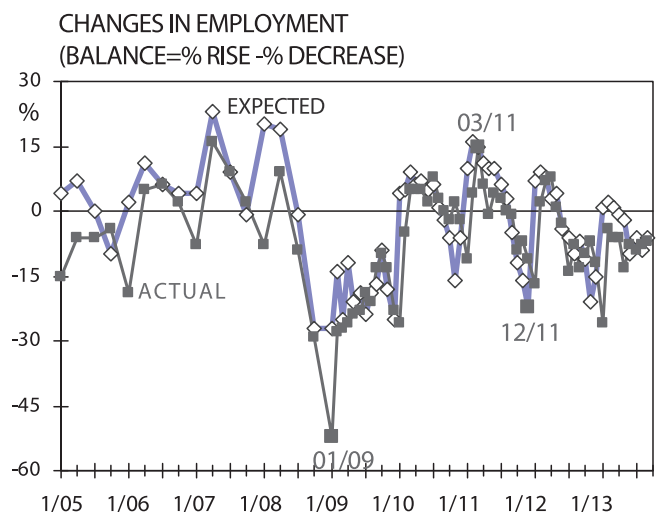


Fig. 5

idle days when the industrial sector typically loses the greatest number of work force. Notably, the domestic industrial sector has seen a steady loss of employees since June 2012, and the process is still underway. The dynamic of forecasts shows that enterprises basically no longer expect an increase in the number of employees.

Typically, it is the beginning of the year when the industry displays the highest hopes for a rise in the number of employees. In 2013, such hopes were able to hit just the zero balance of projections and steered the industrial sector, in mid-2013, to the greatest post-crisis shortage of workforce, with the proportion of responses about an insufficient number of employees having hit 22%. In the period prior to the 2008 crisis, i.e. when the economy's heat-up was at its peak, the indicator would hit the level of 26-27%. However, at the time, both the industrial sector, as well as the economy as a whole, displayed high growth rates and radiated self-confidence, which generated a quite natural need in new labor force to meet the growing demand for industrial output. That said, with the industrial sector stagnating, the current shortage of cadres appears quite unnatural...

**Corporate Investment Plans**

It is for the second month in a row that corporate investment plans remained at their post-crisis lows. The domestic industrial sector has never been so pessimistic about investment since December 2009. As a reminder, back in the summer of 2011, the balance of the plans was +26 points, while currently it accounts for -14 points and the proportion of reports on the intent to cut back on investment was up 32% on a year-on-year basis. So, nearly one-third of the sector is going to reduce its investment activity in the end of the year, while authorities, on the contrary, trust in a bravura investment-wise ending of 2013.

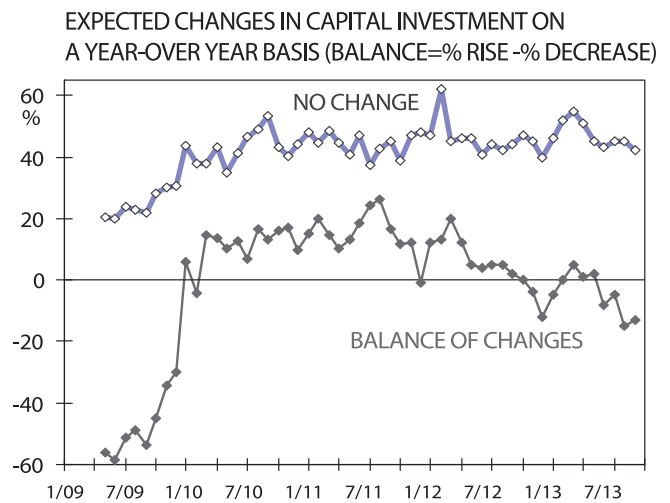


Fig. 6

There is nothing in the industrial sector's investment policy which may be construed as the unexpected. According to data of the IET's (anti-) crisis monitoring, the imperative to scale back on investment in a move to gear up for the crisis is appreciated by an increasing number of enterprises. While in 2012 the proportion of corporations planning to reduce their investment programs accounted for 20%, the figure grew to - 24% in the early 2013, while in August 2013 already as many as 26% of corporations believed that such measures were appropriate. In the domestic industrial sector's list of anti-crisis measures this particular one proved second to cutting down costs and prices, and minimizing inventories. But the popularity of the top-of-the-list measures appears just slightly different from the widespread of the cutting back on investment, with the search for more profitable suppliers (atop of the list) having steadily earned appreciation on the part of 32% of enterprises.

## THE STATE BUDGET IN Q3 2013

T.Tishchenko

According to data released by the RF Federal Treasury, in Q3 2013 the decline in federal budget revenues was occurring at a slightly slower rate than previously. Thus, over the course of January–September 2013, the federal budget's revenue and its oil and gas revenues dropped by 1.7 p.p. of GDP and 0.9 p.p. of GDP respectively on the same period of 2012, while over the course of the first half year of 2013 they had dwindled by 2.1 p.p. of GDP and 1.6 p.p. of GDP respectively on the first half year of 2012. In January–August 2013, the consolidated budget revenue of RF subjects amounted to 12.1% of GDP, which represented a 0.3 p.p. of GDP rise on their consolidated budget revenue in January–June 2013. At the same time, Russia's budget system has very small potential for further growth in revenues, which is especially true of the consolidated budgets of those RF subjects that are not engaged in the export of carbohydrates. Therefore, apart from taking measures designed to optimize federal budget spending, the RF Government must pay special attention to the state of regional budgets and, maybe, to revise its approach to the sphere of inter-budget relations.

#### Analysis of the Main Parameters of Federal Budget Execution in January–September 2013

According to data released by the RF Federal Treasury, federal budget revenues registered over the period of January–September 2013 amounted to Rb 9,603.5bn (or to 74.6% of their planned annual volume) or to 19.6% of GDP, which represented a 1.7 p.p. of GDP drop on the corresponding period of 2012 (Table 1). Over the course of that period, the federal budget's oil and gas revenues dropped by 0.9 p.p. of GDP against the first nine months of 2012. At the same time, oil and gas revenues were growing faster than non-oil and gas revenues: over the course of the first nine months of 2013, the federal budget received 80.6% of the planned annual volume of oil and gas revenues and only 69.9% of that of non-oil and gas revenues.

Over the course of January–September 2013, the volume of federal budget expenditure amounted to Rb 9,010.3bn (with the cash basis execution of the federal budget at 67% of its planned annual volume)

or 18.4% of GDP, which represented a 1.4 p.p. of GDP drop against the same period of 2012.

The RF federal budget for the first nine months of 2013 was executed with a surplus of Rb 593.2bn (or 1.2% of GDP), which represented a 0.2 p.p. of GDP drop on the January–September period of 2012. The volume of the non-oil and gas deficit dwindled by 0.8 p.p. of GDP (or 8.5% of GDP) on the corresponding period of 2012.

The first nine months of 2013 saw a decline in most of the tax and non-tax receipts of the federal budget compared with the same period of 2012. Thus, the shrinkage of federal budget revenues was noted with regard to profits tax (-0.1 p.p. of GDP); VAT on domestically produced goods (-0.4 p.p. of GDP); VAT on imports (-0.2 p.p. of GDP); tax on mineral resources extraction (-0.3 p.p. of GDP); and revenue from external economic activity (-0.8 p.p. of GDP) (Table 2). Revenue growth over the period of January–September 2013 was demonstrated by the receipts of excises on do-

Table 1

#### MAIN PARAMETERS OF THE RF FEDERAL BUDGET IN JANUARY–SEPTEMBER 2012–2013

	January–September 2013		January–September 2012		Deviation, p.p. of GDP
	bn Rb	% of GDP	bn Rb	% of GDP	
Revenue, including:	9,603.5	19.6	9,384.5	21.3	-1.7
Oil and gas revenues	4,774.2	9.8	4,739.6	10.7	-0.9
Expenditure, including:	9,010.3	18.4	8,746.7	19.8	-1.4
interest	300.3	0.6	274.2	0.6	0.0
non-interest	8,711.9	17.8	8,472.5	19.2	-1.4
Federal budget surplus (deficit)	593.2	1.2	637.8	1.4	-0.2
Non-oil and gas deficit	-4,182.9	-8.5	-4,101.8	-9.3	0.8
GDP estimate		48,869		44,077	

Source: RF Ministry of Finance; RF Federal Treasury; Gaidar Institute's calculations.



**THE DYNAMICS OF THE RECEIPTS OF THE MAIN TAXES IN THE FEDERAL BUDGET  
IN JANUARY–SEPTEMBER 2012–2013**

	January–September 2013		January–September 2012		Deviation, p.p. of GDP
	bn Rb	% of GDP	bn Rb	% of GDP	
1. Tax receipts, including:					
Tax on profits of organizations	259.4	0.5	286.3	0.6	-0.1
VAT on goods sold in RF territory	1,406.4	2.9	1,438.1	3.3	-0.4
VAT on goods imported into RF territory	1,210.0	2.5	1,206.1	2.7	-0.2
Excises on goods produced in RF territory	334.3	0.7	246.2	0.5	0.2
Excises on goods imported into RF territory	42.2	0.09	37.6	0.08	0.01
Tax on mineral resources extraction	1,870.3	3.8	1,810.6	4.1	-0.3
2. Revenue from external economic activity	3,625.1	7.4	3,625.7	8.2	-0.8

Source: RF Ministry of Finance; RF Federal Treasury; Gaidar Institute's calculations.

mestically produced and imported goods – by 0.2 p.p. of GDP and 0.01 p.p. of GDP respectively against the same period of 2012.

An analysis of federal budget expenditure (*Table 3*) indicates that over the course of the first nine months of 2013 a number of spending cuts (expressed hereby as a percentage of GDP) were applied to the following budget items: 'Nationwide Issues' (-0.1 p.p. of GDP); 'National Economy' (-0.4 p.p. of GDP); 'Health Care' (-0.2 p.p. of GDP); 'Social Policy' (-0.9 p.p. of GDP); and 'Interbudgetary Transfers' (-0.1 p.p. of GDP).

The period of the first nine months of 2013 saw a rise in federal spending (as a percentage of GDP) on a number of budget items compared with the January–September period of 2012. The beneficiaries of that spending rise were as follows: 'National Defense' (+0.1 p.p. of GDP); 'National Security and Law-enforcement

Activity' (+0.1 p.p. of GDP); 'The Housing and Utilities Sector' (+0.1 p.p. of GDP); and 'Physical Culture and Sports' (0.02 p.p. of GDP. Federal spending on the rest of the budget items remained at last year's level.

As of 1 October 2013, the volume of the RF Reserve Fund amounted to Rb 2,795.8bn, and that of the RF National Welfare Fund amounted to Rb 2,847.35bn.

Execution of the Consolidated Budget of RF Subjects in January–August 2013.

As reported by the RF Federal Treasury, the consolidated budget revenue of RF subjects in January–August 2013 amounted to Rb 5,161.6bn, or 12.1% of GDP, which is by 1.6 p.p. of GDP below its level recorded in the same period of 2012 (*Table 4*).

Over the first eight months of 2013, the consolidated budget expenditure of RF subjects dropped by 0.7 p.p. of GDP on the same period of 2012 - to 11.9%

Table 3

**FEDERAL BUDGET EXPENDITURE IN JANUARY–SEPTEMBER 2012–2013**

	January–September 2013		January–September 2012		Deviation, p.p. of GDP
	bn Rb	% of GDP	bn Rb	% of GDP	
Expenditure, total	9,010.3	18.4	8,746.7	19.8	-1.4
including					
Nationwide Issues	557.1	1.1	521.9	1.2	-0.1
National Defense	1,444.7	2.9	1,256.5	2.8	0.1
National Security and Law-enforcement Activity	1,332.7	2.7	1,131.2	2.6	0.1
National Economy	1,049.6	2.1	1,126.1	2.5	-0.4
Housing and Utilities Sector	87.5	0.2	68.7	0.1	0.1
Environment Protection	18.6	0.04	15.9	0.04	0.0
Education	523.6	1.1	475.9	1.1	0.0
Culture and Cinematography	52.7	0.1	54.4	0.1	0.0
Health Care	299.3	0.6	378.6	0.8	-0.2
Social Policy	2,781.1	5.7	2,923.0	6.6	-0.9
Physical Culture and Sports	42.9	0.09	30.6	0.07	0.02
Mass Media	51.9	0.1	57.7	0.1	0.0
Government Debt Servicing	300.0	0.6	274.2	0.6	0.0
Interbudgetary Transfers	468.4 -73.4	0.9	432.0	1.0	-0.1

Source: RF Ministry of Finance; RF Federal Treasury; Gaidar Institute's calculations.

Table 4

**MAIN PARAMETERS OF THE CONSOLIDATED BUDGET OF RF SUBJECTS IN JANUARY–AUGUST 2012  
AND JANUARY–AUGUST 2013**

	January–August 2013		January–August 2012		Deviation, p.p. of GDP
	bn Rb	% of GDP	bn Rb	% of GDP	
Revenue, including:	5,161.6	12.1	5,213.1	13.7	-1.6
- tax on profits of organizations	1,112.4	2.6	1,384.8	3.6	-1.0
- PIT	1,550.6	3.6	1,405.5	3.7	-0.1
- excises, domestic	321.8	0.7	292.5	0.8	-0.1
- tax on aggregate income	219.4	0.5	201.1	0.5	0.0
- tax on property	614.2	1.4	535.0	1.4	0.0
- gratis transfers from other budgets of RF budgetary system	929.1	2.2	989.1	2.6	-0.4
Expenditure, including:	5,080.6	11.9	4,817.8	12.6	-0.7
Surplus (deficit) of consolidated budget of RF subjects	81.0	0.2	395.3	1.0	-0.8
GDP estimate	42,676		38,057		

Source: RF Federal Treasury; Gaidar Institute's calculations.

of GDP, or Rb 5,080.6bn. Their budgets for January–August 2013 were executed with a surplus of Rb 81.0bn, or 0.2% of GDP, which is by 0.8 p.p. of GDP below the surplus recorded in the same period of 2012.

A noticeable decline in the revenue receipts of regional budgets, expressed as a percentage of GDP, over the first eight months of 2013 as compared with the same period of 2012 was demonstrated by tax on profits of organizations (-0.1 p.p. of GDP); PIT (-0.1 p.p. of GDP); excises on domestically produced goods (-0.1 p.p. of GDP); and gratis transfers from other budgets (-0.4 p.p. of GDP). Over the course of the first eight months of 2013, the consolidated budget ex-

penditure of RF subjects dropped against the same period of 2012 with regard to the following budget items: 'Nationwide Issues' (-0.1 p.p. of GDP); 'The National Economy' (-0.1 p.p. of GDP); 'The Housing and Utilities Sector' (-0.2 p.p. of GDP); 'Health Care' (-0.3 p.p. of GDP); 'Social policy' (-0.2 p.p. of GDP); and 'Interbudgetary Transfers' (-0.01 p.p. of GDP). The volume of RF subjects' expenditure on the rest of the budget items remained at last year's level.

As of the end of July 2013, the amount of government debt owed by RF subjects in January 2013 was Rb 1,3522.9bn, or 16.4% of their annual revenue. Government debt servicing accounted for approximately

Table 5

**EXECUTION OF THE CONSOLIDATED BUDGET EXPENDITURE OF RF SUBJECTS IN JANUARY–AUGUST 2012 AND  
JANUARY–AUGUST 2013**

	January–August 2013		January–August 2012		Deviation, p.p. of GDP
	bn Rb	% of GDP	bn Rb	% of GDP	
Expenditure, total	5,080.6	11.9	4,817.8	12.6	-0.7
including:					
Nationwide Issues	327.7	0.7	307.0	0.8	-0.1
National Defense	0.2	0.0005	0.2	0.0005	0.0
National Security and Law-enforcement activity	53.7	0.1	50.1	0.1	0.0
National Economy	888.1	2.1	825.8	2.2	-0.1
Housing and Utilities Sector	440.1	1.0	462.8	1.2	-0.2
Environment Protection	13.0	0.03	10.6	0.03	0.0
Education	1,432.1	3.3	1,258.4	3.3	0.0
Culture and Cinematography	170.6	0.4	155.1	0.4	0.0
Health Care	777.9	1.8	796.6	2.1	-0.3
Social Policy	806.3	1.9	796.4	2.1	-0.2
Physical Culture and Sports	91.5	0.2	80.0	0.2	0.0
Mass Media	25.0	0.06	22.1	0.06	0.0
Government and Municipal Debt Servicing	48.1	0.1	39.4	0.1	0.0
Interbudgetary Transfers	4.1	0.01	11.1	0.03	-0.01

Source: RF Federal Treasury; Gaidar Institute's calculations.

1.1% of the consolidated budget revenue of RF subjects, obtained from their own sources. Although the consolidated budget revenue of RF subjects, expressed as a percentage of GDP, slightly increased in July and August of 2013 as compared with the first half year of 2013, the current downward trend in their consolidated budget revenue may indeed turn out to be a long-term trend capable of increasing the risks threatening the sustainability of the entire system of regional budgets.

The long-term character of the ongoing decline in the regional budgets' internally generated 'own revenue' makes it necessary for regional authorities to cut budget expenditure in general and investment spending in particular. Therefore, apart from taking measures designed to optimize federal budget spending, the RF Government should find ways to radically improve inter-budget relations. ●

## THE RUSSIAN BANKING SECTOR IN Q3 2013

M.Khromov

*In Q3 2013, the banking sector faced a shortage of customer resources. The major source of liabilities became refinancing on the part of the Bank of Russia and MinFin's deposits. Meanwhile, by results of the lending market's performance in Q3, it was for the first time this year that lending to corporate borrowers consumed volume of resources greater than loans to individuals.*

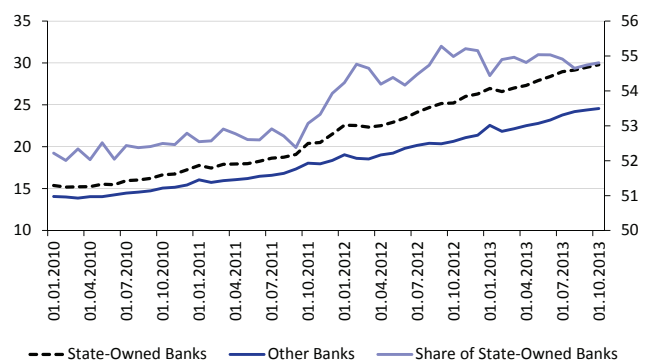
In September, banks' assets posted a 1.4% growth<sup>1</sup>, which proved greater a figure compared to the two prior months (in August, the rise was 0.8%, and in July – 0.9%). Nonetheless, the volume of assets added just 3.2% over Q3, while their annual growth rate as of end-September slid to 17.2%. Without regard to each Q1 of a year during which, affected by seasonality, growth rates of financial indicators slow down, the growth rate in bank assets in Q3 2013 has proved the lowest one since mid-2010.

It was monetary authorities' resources that formed a significant contribution to dynamics of the banking sector's indicators in Q3 – they secured 46% of the sector's resources<sup>2</sup>. Without account of these resources, the dynamic of expansion of banks' assets would have accounted: in September -0.5%, in Q3 – 1.1%, and in the last 12 month – 14.6%.

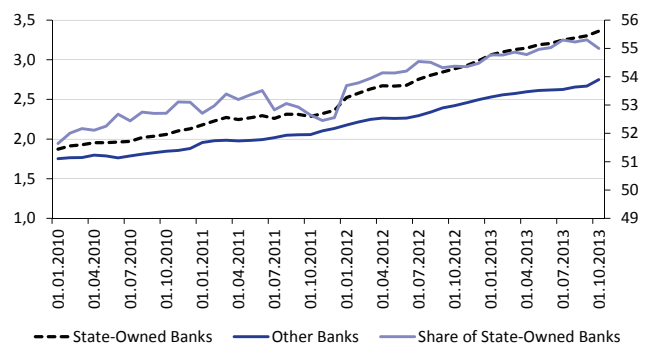
As to active bank operations, in the last quarter, the banking sector increased the proportion of funds dedicated to lending to individuals and corporations, with the proportion of those operations having hit 72% of the volume of redistributed resources (a peak level in a period after 2009). That became possible largely at the expense of corporate lending, whose prominence among other directions of use of resources also became record-breaking over the whole post-crisis period.

The banking sector's regulatory capital<sup>4</sup> posted a 1.3% growth in September, with risk assets having remained practically unchanged, as they expanded by a meager 0.1%. The capital adequacy rate by end-September accounted for 13.4%.

The banking sector's earnings in September 2013 accounted for Rb 98bln, equivalent of a ROTA rate of 2.2% annualized and a 19.4% rate in terms of return on eq-



*Fig. 1. Dynamics of Assets of State-Owned and Other Banks (as Rb Trln) and the Share of State-Owned Banks in Assets (as %, the right scale)*



*Fig. 2. Dynamics of Capital Base<sup>3</sup> of State-Owned and Other Banks (as Rb Trln) and the Share of State-Owned Banks in Capital (as %, the right axis)*

1 Hereinafter growth rates of balance-sheet ratios are cited with adjustment to the re-valuation of the forex component unless indicated otherwise.

2 In this context, the resources are construed as a quarterly growth in liabilities and fall in assets, while the active use of resources constitutes a quarterly growth in assets and decrease in liabilities.

3 Calculated on the basis of balance-sheet accounts (form № 101).

4 Calculated by credit organizations' statement № 134.

uity, which proved slightly above the respective figures on a year-on-year basis (2.0% and 17.2%, respectively). The healthy performance in September should be ascribed to both a high profit prior to creation of reserves (Rb 134bln with an average figure over the 9 months of the year being Rb 127bln) and a slowdown in deductions in contingency provisions, which in September added just Rb 36bln, with the average monthly level since the beginning of the year accounting for Rb 44 bln. That said, even with account of the above factors, the banking sec-

tor's earnings in Q3 (Rb 751bln) have remained practically unchanged on a year-on-year basis (Rb 750bln over the same period in 2012).

### Attracted capital

The volume of private individuals' deposits rose just 0.4%, or by Rb 70bln, in September (2.1%, or Rb 328bln over Q3, and 19.8% – in annualized terms. That said, the September rise was practically fully fueled by forex-denominated accounts: while the volume of Rb-denominated savings added just 0.1% in September, forex-denominated accounts increased 2.2% in USD equivalent (USD 2.0bln).

In all, the growth in bank deposits over Q3 2013 accounted for 3.3% of households' real disposable incomes, which proved slightly less than the figure reported over the respective period of the prior year (3.6%). However, with account of an increase in cash, the savings ratio shrank practically by 1 p.p., i.e. down from 3.7% to 2.8% of the population's real disposable incomes over the quarter concerned.

The average private bank deposit yield rate (without account of current and checking accounts) in Q3 2013 was at a level of 6.8% annualized vs. 6.2% reported a year ago. Interest payments on private individuals' accounts totaled Rb. 228bln in Q3 2013, meaning that over two-thirds of the influx of private capital into banks over the quarter was secured by interest accrued on deposits.

Corporate clients' capital on their accounts grew just by 0.9% (Rb 109bln.) in September 2013 (by merely 0.5%, or Rb. 61bln over Q3), with the annual growth rate having plummeted to 15.3% vis-à-vis 16.8% reported in the prior month.

Like private individuals, corporate clients in September preferred forex-denominated accounts, whose volume rose 4.5% (USD 3.7bln), over Rb-denominated ones (down 0.1%).

The monetary authorities' capital has recently formed the basis of the banking sector's resource base. In September, the banks' debts to the Bank of Russia grew by Rb 311bln, and those before the MinFin – by Rb 211bln. As of October 10, 2013, the aggregate volume of the banking sector's liabilities before the Bank of Russia and MinFin exceeded Rb 4trln, which proved greater than the peak volume of the government cushion during the crisis, which at the time in nominal terms accounted for Rb 3.7trln.

Relative value-wise, the banking sector refinancing volume has so far fell short of hitting the level of early 2009 (12.3% of assets and 8.2% of GDP), albeit it proved a maximum one for a period since early 2010 (7.4% of banking assets and 6.1% of GDP).

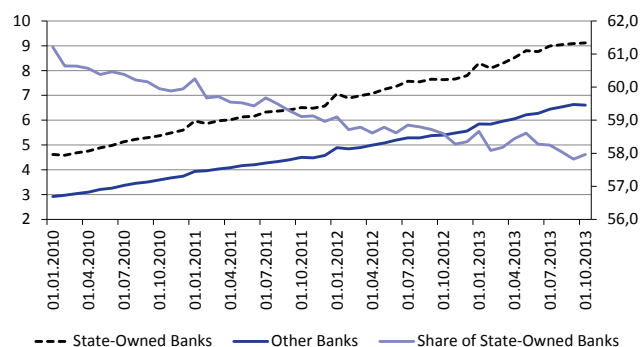


Fig. 3. Dynamics of the Residents' Deposits with State-Owned and Other Banks (as Rb. Trln.) and the State-Owned Banks' Share on the Market for Private Deposits (as %, the right scale)

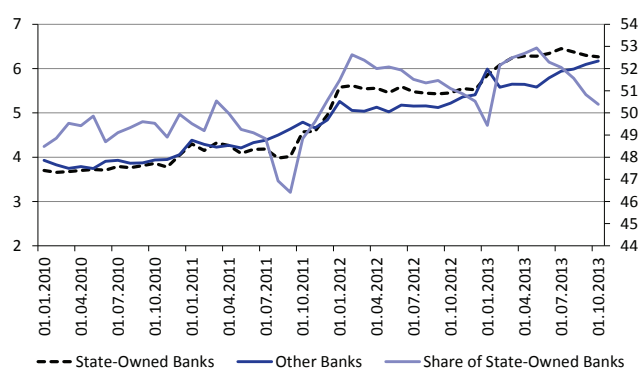


Fig. 4. Dynamics of Corporate Accounts with State-Owned and Other Banks (as Rb. Trln) and the State-Owned banks' Share on the Market for Corporate Accounts (as %, the right scale)

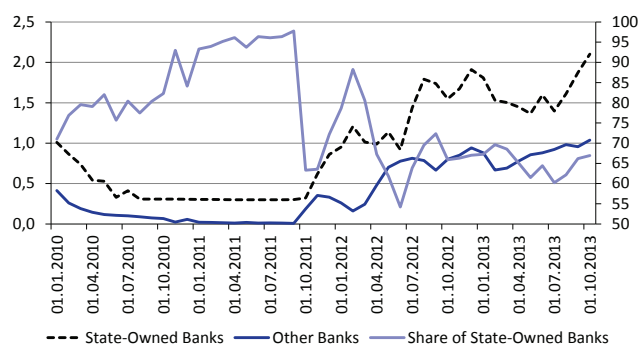


Fig. 5. Dynamics of the Bank of Russia's Lending to State-Owned and Other Banks (as Rb. Trln.) and the State-Owned Banks' Share in the Bank of Russia's Lending (as %, the right scale)

### Placed Capital

In September, the increase rate in the residents' credit exposure continued to decelerate in annualized terms. Over the month, the banks' retail credit portfolio was up 1.5% (Rb 148bln), while the annual increase rates having slid to 30.2% compared with 31.7% a month before and 39.1% as of the beginning of the year.



Table 1

**THE STRUCTURE OF LIABILITIES OF RUSSIA'S BANKING SYSTEM  
(AS OF END-MONTH), AS % TO RESULT**

	12.08	12.09	12.10	12.11	06.12	12.12	03.13	05.13	06.13	07.13	08.13	09.13
Liabilities, Rb bln..	28022	29430	33805	41628	44266	49510	49839	51587	52744	53353	53876	54348
Own capital	14.1	19.3	18.7	16.9	16.8	16.2	16.7	16.5	16.3	16.3	16.3	16.5
Bank of Russia's loans	12.0	4.8	1.0	2.9	5.1	5.4	4.5	4.8	4.4	4.9	5.3	5.8
Interbank transactions	4.4	4.8	5.5	5.7	4.8	5.6	5.4	4.9	5.2	5.1	5.1	5.1
Foreign liabilities	16.4	12.1	11.8	11.1	11.3	10.8	10.4	10.7	10.8	10.6	10.4	10.1
Private individuals' capital	21.5	25.9	29.6	29.1	29.4	28.9	29.6	29.5	29.6	29.6	29.6	29.3
Corporate capital	23.6	25.9	25.7	26.0	24.0	24	23.9	23.5	23.5	23.2	23.0	22.9
Accounts and deposits of public administration agencies and local governance	1.0	1.0	1.5	2.3	1.5	1.6	1.4	2.0	2.4	2.6	2.7	2.9
Securities issued	4.1	4.1	4.0	3.7	4.5	4.9	5.2	5.1	5.1	4.9	4.9	4.7

Source: CBR, IEP calculations.

The quality of the portfolio in question continued to exacerbate. Increase rates of both overdue debts and loan loss provisions with regard to private borrowers proved more than twice as much as the loan increase rate (3.1 and 3.4%, respectively). Consequently, both the proportion of outstanding debt and the reserves to payables ratio were also up – to 4.5% and 7.1%, respectively.

The average loan yield rate with respect to private customers hit the mark of 18.3% annualized in Q3 2013, up 2.2 p.p. over the quarter and 0.9 p.p. since the beginning of the year. The recent decline in rates of newly extended loans has not yet resulted in a lower value of the whole volume of debt, as borrowers keep servicing loans extended at higher rates.

In Q3 2013, private individuals spent Rb 417bln in interest payments on bank loans, while the figure having hit Rb 1.15trln since the beginning of the year, which is in excess of the final result of the whole 2012. Let us also note that by results of the quarter in question the volume of interest payments proved greater than the volume of influx of deposits.

Corporate lending in Q3 saw some upturn. In September, the corporate borrowers' debt was up 1.9% (Rb 384bln), while the quarterly aggregate added 5.6%, which has become a peak quarterly rate since late 2011. Meanwhile, the annual increase pace remained at a fairly low level of 13.6%.

The September quality of corporate lending retained a slight trend to improvement. The share of overdue loans was down 0.1 p.p. and accounted for 4.2%, while the loan loss provisions ratio with regard to corporations, less banks, was also down by 0.1 p.p. and slid to 7.0%.

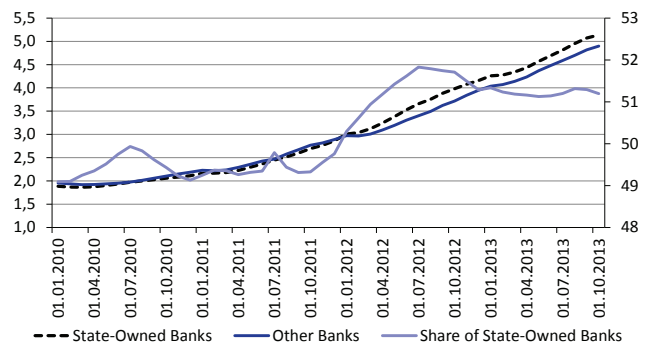


Fig. 6. Dynamics of Loans to the Population of State-Owned and Other Banks (as Rb Trln) and the Share of State-Owned Banks in Loans to the Population (as %, the right scale)

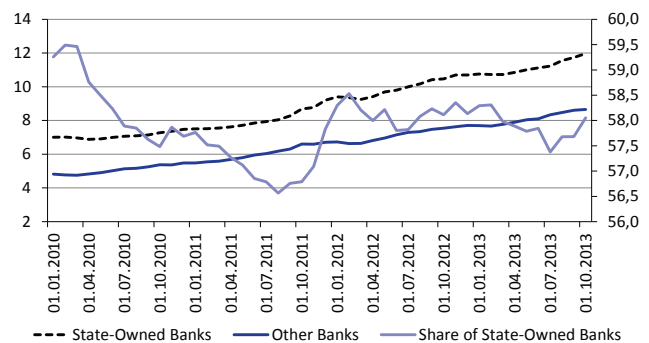


Fig. 7. Dynamics of Lending by State-Owned and Other Banks to the Corporate Sector (as Rb Trln) and the Share of State-Owned Banks on the Market for Corporate Lending (as %, the right scale)

Table 2

**THE STRUCTURE OF THE RUSSIAN BANKING SYSTEM'S ASSETS БАНКОВСКОЙ СИСТЕМЫ РОССИИ  
(AS OF END-MONTH), AS % TO RESULTS**

	12.08	12.09	12.10	12.11	06.12	12.12	04.13	05.13	06.13	07.13	08.13	09.13
Assets, Rb bln	28022	29430	33805	41628	44266	49510	50 693	51587	52744	53353	53876	54348
Cash and pre- cious metals	3,0	2,7	2,7	2,9	2,5	3,1	2,7	2,4	2,4	2,3	2,3	2,3
Deposits with the CBR	7,5	6,9	7,1	4,2	3,0	4,4	3,0	3,1	3,3	3,0	2,9	3,5
Interbank transactions	5,2	5,4	6,5	6,4	5,8	6,8	6,1	6,0	6,0	5,9	5,8	5,8
Foreign assets	13,8	14,1	13,4	14,3	14,2	13,0	15,0	15,6	15,1	15,0	14,5	13,6
Residents	15,5	13,1	13,0	14,4	16,0	16,8	17,7	17,8	17,9	18,1	18,4	18,5
Corporate sector	44,5	44,5	43,6	44,0	43,6	41,3	41,5	40,9	40,9	41,0	41,1	41,2
Government	2,0	4,2	5,1	5,0	3,8	3,2	2,9	2,8	3,2	3,4	3,0	2,9
Property	1,9	2,7	2,6	2,3	2,3	2,2	2,2	2,2	2,2	2,1	2,1	2,1

Source: CBR, IEP calculations.

## MORTGAGE IN RUSSIAN FEDERATION IN SEPTEMBER 2013

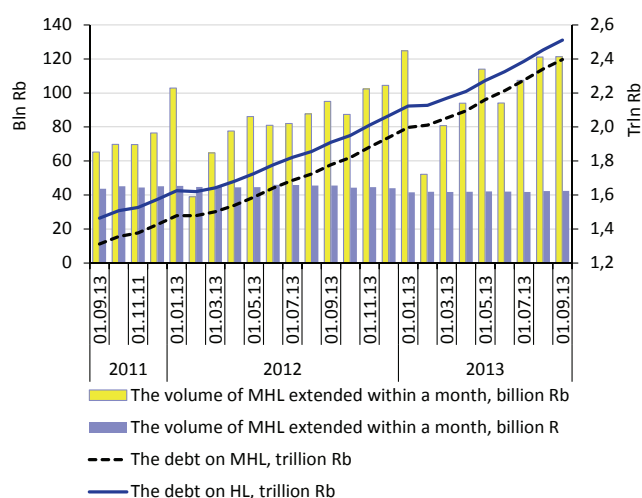
G.Zadonsky

According to the data of the Central Bank of the Russian Federation, in January–August 2013 Rb 784,924bn worth of mortgage housing loans were extended which figure exceeds 1.28 times over the volume of lending in the respective period of 2012. As of September 1, 2013, the outstanding debt of Rb 2.4 trillion exceeded by 34.76% the debt as of September 1, 2012. A positive trend of both reduction of the share of the overdue debt on MHL in rubles in the outstanding debt (1.77% as of September 1, 2013) and growth in the volume and share of the debt on MHL without overdue payments (96.45% as of September 1, 2013) in the total debt prevails. In August 2013, the monthly average rate on MHL in rubles fell by 0.1 p.p. and amounted to 12.4% against 12.9% as of April 1, 2013.

According to the data of the Central Bank of the Russian Federation, as of September 1, 2013 Rb 813,399bn worth of 518,399 housing loans (HL) were extended from the beginning of the year, including Rb 784,924bn worth of 485,430 mortgage housing loans which figure exceeds by 28.02% in value terms the volume of loans extended as of September 1, 2012. In August 2013, the outstanding debt on HL rose by 2.35% to Rb 2.51 trillion, while that on MHL, by 2.37% to Rb 2.4 trillion. The latter exceeds by 34.76% the debt on MHL as of September 1, 2012. As of September 1, 2013, the overdue debt on HL amounted to Rb 47,932bn, while that on MHL, to Rb 42,448bn (Fig.1).

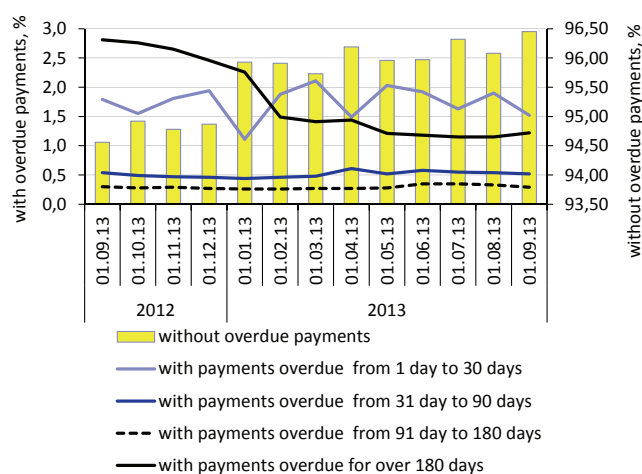
According to the data of the Central Bank of the Russian Federation, as of September 1, 2013 the debt on MHL with a period of delay in payments for over 180 days (defaulted loans) (Fig. 2) amounted to Rb 29.24bn or 1.22% of the total debt amount which figure is 1.59 p.p. lower and 0.07 p.p. higher than that as of September 1, 2012 and August 1, 2013, respectively. In August 2013, the debt on MHL without overdue payments increased in value terms to Rb 2,312 trillion, while that as a percentage of the total debt, by 0.37 p.p. and amounted to 96.45% (Fig. 2). In August 2013, the overdue debt on MHL rose (Fig. 1) by 0.33% in value terms, while that as a percentage of the outstanding debt fell by 0.04 p.p. and amounted to 1.77%.

As regards the number of MHL extended from the beginning of the year with a cumulative result per 1,000 persons of the population, both as of September 1, 2013 and as of September 1, 2012 the leaders were the Yamalo-Nenets Autonomous Region, Khanty-Mansiysk Autonomous Region and the Tyumen Region (Table 1). The overdue debt of the above regions is also much lower than the average nationwide value. Among federal districts, as regards the number of loans per 1,000 persons the leader is still the Urals Federal District – the aggregate 15<sup>th</sup> place against the 9<sup>th</sup> place in 2012; the district in question retains the



Source: the basis of the data of the Central Bank of the Russian Federation.

Fig.1. The dynamics of mortgage housing lending



Source: the data of the Central bank of the Russian Federation.

Fig. 2. Grouping of the debt on MHL by the period of delay in payments in 2013 as a percentage of the total amount of the debt

**DISTRIBUTION OF REGIONS BY THE NUMBER OF MHL PER 1,000 PERSONS EXTENDED  
FROM THE BEGINNING OF THE YEAR WITH A CUMULATIVE RESULT**

Region	Number of MHL per 1,000 persons	Overdue debt as % of the outstanding debt	Place of the region		Place of the region		Place of the region	
			Number of MHL per 1,000 persons	Overdue debt as % of the out- standing debt	Number of MHL per 1,000 persons	Overdue debt as % of the out- standing debt	Number of MHL per 1,000 persons	Overdue debt as % of the out- standing debt
Yamalo-Nenets Au- tonomous Region	6,732	0.15	1	6	2	8	2	9
Khanty-Mansiysk Au- tonomous Region	6,156	0.22	2	9	1	11	1	8
Tyumen Region	6,116	0.36	3	16	3	17	3	18
Republic of Udmurtia	5,699	0.97	4	55	6	59	19	64
Republic of Komi	5,334	0.26	5	11	11	12	11	14
Novosibirsk Region	5,251	1.35	6	70	13	67	20	65
Republic of Tatarstan	5,168	0.47	7	24	5	32	4	33
Ulyanovsk Region.	5,146	0.52	8	30	16	19	13	24
Magadan Region	5,120	0.03	9	2	17	5	24	6
Perm Territory	5,085	2.31	10	83	15	80	16	78
Volgograd Region	4,953	0.97	11	54	10	52	17	57
Chelyabinsk Region	4,948	1.93	12	80	8	81	9	76
Nenets Autonomous Region	4,931	0.12	13	4	4	3	5	3
Republic of Chuvashia	4,833	0.64	14	35	18	46	15	45
Urals Federal District	4,731	0.88	15	51	9	55	7	44
Privolzhsky Federal District	4,232	1.12	21	61	23	61	22	62
Siberian Federal District	4,050	1.19	25	64	26	65	25	68
North-Western Federal District	3,536	1.29	37	69	43	66	45	60
The Russian Federation	3,386	1.77	41	78	44	73	39	74
St. Petersburg	3,255	1.77	46	77	51	75	50	67
Moscow Region	3,232	4.06	47	90	59	89	59	88
Far Eastern Federal District	3,126	0.50	56	28	38	29	33	34
Central Federal District	2,846	3.30	64	88	68	87	65	85
Southern Federal District	2,469	1.57	79	75	76	68	73	72
Moscow	2,086	4.68	82	91	83	90	78	90
North-Caucasian Fed- eral District	1,172	1.54	89	74	87	82	87	81

Source: the basis of the data of the Central Bank of the Russian Federation.

2<sup>nd</sup> place as regards the level of the overdue debt (the aggregate 51 place) after the Far Eastern Federal District. The Central Federal District has the 64<sup>th</sup> place and the 88<sup>th</sup> place as regards the number of loans extended and the overdue debt, respectively, while Moscow, the 82<sup>nd</sup> place and the 91<sup>st</sup> place, respectively.

According to the data of the Central Bank of the Russian Federation, as of September 1, 2013 the weighted average rate on MHL in rubles extended from the beginning of the year fell by 0.1 p.p. against 12.7% in May, June and July 2013 (Fig. 3). The weighted average rate on MHL in rubles extended within a month fell by

0.1 p.p. in August 2013 and amounted to 12.4% keeping going down from the maximum value of 12.9% in March. In August 2013, the weighted average rate on MHL extended from the beginning of the year in foreign currency fell by 0.2 p.p., too, and amounted to 9.6%.

The weighted average period of lending as regards MHL in rubles extended from the beginning of the year keeps reducing in 2013 and as of September 1 amounted to 14.8 years. As regards loans in foreign currency, in August 2013 the weighted average period of lending gained six months and amounted to 13.5 years (Fig. 3).

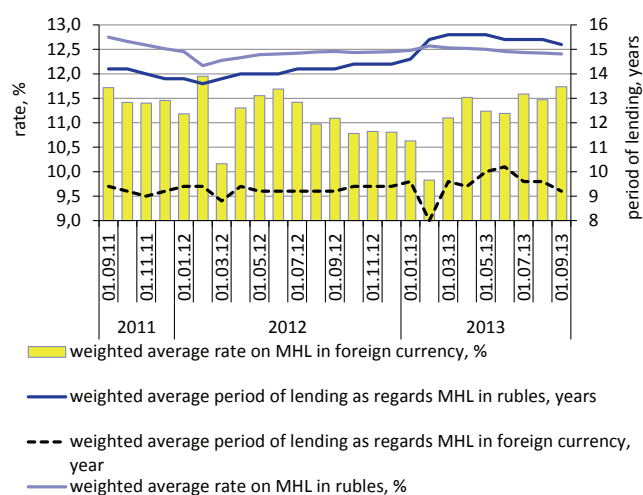
In 2013, the average value of MHL in rubles extended from the beginning of the year increased to Rb 1.6m as of September 1 (Fig. 4) having gained 10.22% as compared to September 1, 2012. Within the same period of time, the respective value in foreign currency and starting from March 2013 rose by 16.13% and amounted to Rb 7,973m as of September 1, 2013.

As of September 1, 2013 the share of loans in foreign currency in the volume of MHL extended from the beginning of the year amounted to 1.33% (Fig. 5). The low volume of lending in foreign currency results in a sustained decrease in the share of foreign currency in the debt on MHL which amounted to 5.02% as of September 1, 2013. Along with that, the share of the overdue debt on MHL in foreign currency in the total overdue debt even increased a little in 2013 and as of September 1 amounted to 35.51%, which is 2.7 p.p. higher than the minimum value as of February 1, 2013 (Fig.5). So, the share of the overdue debt on MHL in foreign currency in the total overdue debt exceeds seven times over the share of the debt on MHL in foreign currency in the total debt.

In January–August 2013, the share of the five largest banks (the first group of credit institutions ranged by the value of assets (in descending order)) in the total number of MHL extended to individuals rose to 75.3% (Fig. 6) against 58.92% in the same period of 2012. For reference: as of September 1, 2011 that share amounted to 68.83%. In January–August 2013, as compared to the respective period of 2012 the overdue debt as a percentage of the outstanding debt of the first group decreased from 2.28% to 1.47%, which figure is lower than the average value of 1.77% by all the groups (the nationwide average value). As compared to the previous year, the average value by all the groups fell by 0.79 p.p. The lower quality MHL portfolio is with the second group: the share of the overdue debt exceeds by 4.4% the average value by all the groups (Fig. 6). A factor behind such a worsening can be a decrease in the volume of newly extended loans by the group with growth in the total volume of lending in the period under review.

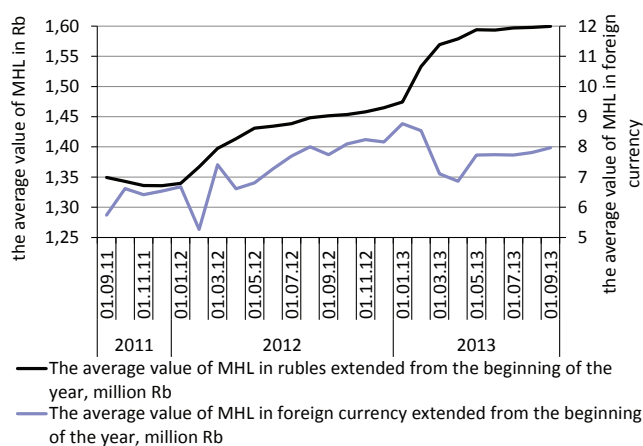
From January–September 2013, the OAO AHML refinanced Rb 29,827bn worth of 22,821 MHL (Fig. 7) which is 30.66% lower than the volume of the refinanced loans in the same period of 2012. As of October 1, 2013, the share of the standard product in the total volume of the repurchased mortgage amounted to 40.65% which is 12.62 p.p. lower than the respective value in 2012; the share of military mortgage amounted to 33.68% against 8.68% the “maternity mortgage”.

In August 2013, the share of mortgage loans refinanced by AHML in the total number of mortgage



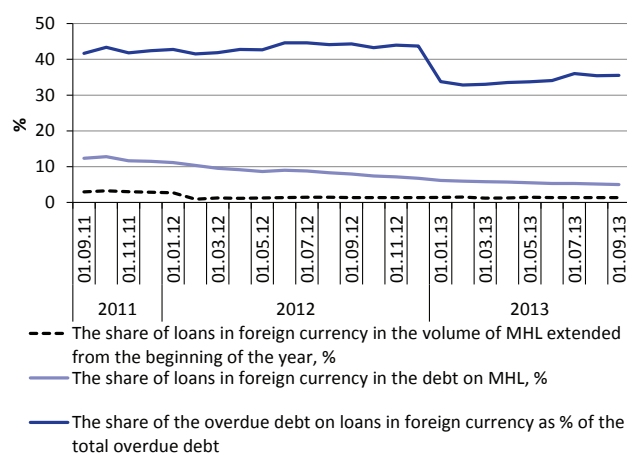
Source: the basis of the data of the Central Bank of Russia.

Fig. 3. The dynamics of weighted average rate on and the weighted average period of lending as regards MHL extended from the beginning of the year



Source: the basis of the data of the Central bank of the Russian Federation.

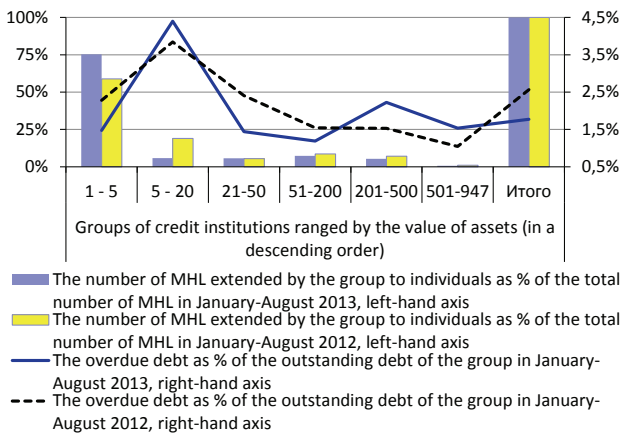
Fig. 4. The dynamics of the average value of MHL extended from the beginning of the year



Source: the basis of the data of the Central Bank of the Russian Federation.

Fig. 5. The dynamics of the rubles/foreign currency ratio in mortgage housing lending





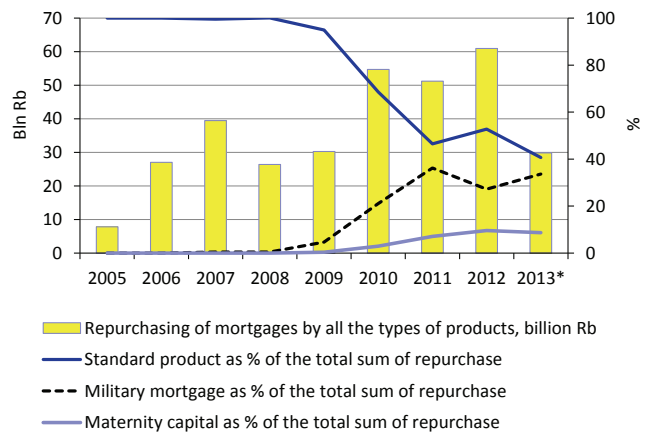
Source: the basis of the data of the Central Bank of the Russian Federation.

Fig. 6. The dynamics of volumes of MHL extend and the overdue debt by the group of credit institutions ranged by the value of assets

loans extended amounted to 2.86% which is 4.01 p.p. higher than in August 2012 (Fig. 8).

As a result of reduction of risks of securitization ensured by approval of amendments to the Federal Law on Mortgages in December 2012, the Moody's Investors Service, an international rating agency revised upwards the credit rating of the senior classes of five bond issues with AHML backing (class A) issued by ZAO Ipotekny Agent AHML 2010-1, ZAO Ipotekny Agent AHML 2011-2 and ZAO Ipotekny Agent AHML 2012-1. On the basis of the results of the meeting of the Presidium of the Council on Carrying Out of Priority National Projects and Demographic Policy under the President of the Russian Federation held on October 11, 2013, it was decided to instruct the OAO AHML to expand the practice of implementation of special mortgage programs for families with three and more children. In December, AHML plans to issue bonds secured with mortgage portfolios of several partners with the volume of about Rb 3bn; the share of AHML in the issue amounts to about 50%.

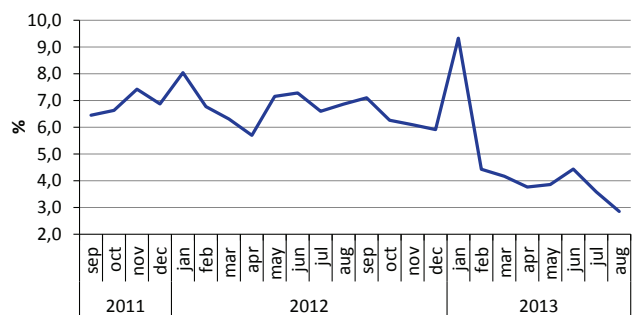
British banks have started to carry out a mortgage lending scheme proposed by the government. Under the above scheme, the initial contribution amounts to 5% of the cost of housing if the price does not ex-



\*January–September 2013.

Source: the basis of the data of the OAO AHML.

Fig. 7. The dynamics of repurchasing of mortgages by the OAO AHML



Source: the basis of the data of the OAO AHML.

Fig. 8. The share of mortgage loans refinanced by AHML in the total number of mortgage loans extended within a month

ceed 600,000 pounds. Within the frameworks of the program whose volume amounts to 12bn pounds, it is expected to extend 180,000 mortgage loans within three years. The US Federal Agency for Financing Housing Development reported that for the purpose of securitization of mortgage loans and consolidation of some functions which are currently duplicated by state mortgage companies, that is, Fannie Mae and Freddie Mac, a new company – the Common Securitization Solutions – was established. ●

## RUSSIA'S FOREIGN TRADE IN AUGUST 2013

N.Volovik, K.Kharina

*From April 2012, the Russian foreign trade has been in stagnation. In the past few months, growth rates of both export and import fluctuated near the zero level. Russia turned down the EU's request to the WTO to convene a panel of arbitrators to consider the issue of the existing mechanism of the utilization duty in Russia as there is still a chance to reach an amicable settlement.*

In August 2013, the Russian foreign trade turnover calculated on the basis of the methods of the balance of payments amounted to \$70.5bn which is 0.9% lower than the respective index of 2012. In August 2013, export amounted to \$42.2bn having increased by 2.3% as compared to last August. The import fell by 5.3% to \$28.4bn. As a result, the surplus of the trade balance increased: in August 2013 it amounted to \$13.8bn which is 22.5% higher than in August 2012.

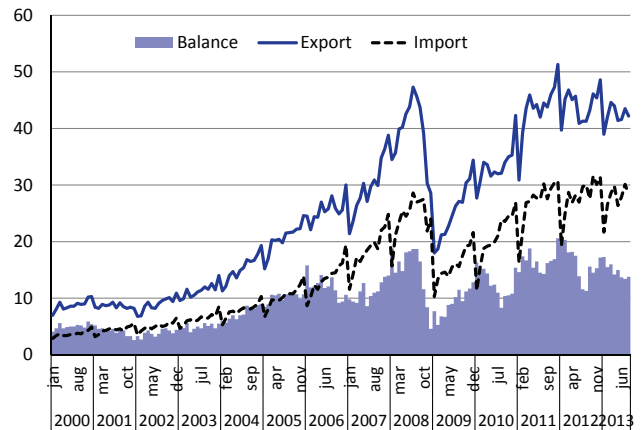
The global oil market is still under the effect of the following two main factors: low growth rates of the global economy and geopolitical risks. As due to a concern over possible full-scale hostilities by Western countries in Syria, on August 27, 2013 the Brent oil price rose on a single day by 3% to the maximum value of \$114.36 a barrel from February 2013. In August, the average Brent oil price was formed in the amount of \$110.96 a barrel which is 3% higher and 2.1% lower than in July 2013 and the index of August 2012, respectively.

In August 2013, the average Urals oil price amounted to \$111.11 a barrel which is 1.8% lower as compared to the price in August 2012. In January–August 2013 the price decreased by 3.3% to \$107.34 a barrel as compared to the same period of 2012.

In January–September 2013, the average price of the Russian Urals oil amounted to \$107.73 a barrel which is 3.0% lower as compared to the same period of 2012.

According to the oil price monitoring carried out by the Russian Ministry of Finance, from September 15 till October 14, 2013 the average Urals oil price amounted to \$108.7 a barrel (\$793.8 a ton). As a result, from November 1, 2013 the export duty on crude oil will decrease by 4.9% to \$395.9 a ton from \$416.4 a ton in October. From November 1, 2013, the single rate of export duty on light and dark oil products, except for petrol, will amount to \$261.2 a ton against \$274.8 a ton in October. It is to be noted that in November the duty on petrol will be cut to \$356.3 a ton (\$374.7 a ton in October 2012).

The decision of the US Federal Reserve to preserve at the previous level the programs of repurchasing of



Source: Central Bank of the Russian Federation.

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

US government bonds stopped a drop in prices on non-ferrous metals; the above drop continued from February 2013. In August 2013, as compared to the previous month prices on all the nonferrous metals increased: aluminum appreciated by 2.7%, while copper and nickel, by 4.1% each. It is to be noted that as compared to August 2012, aluminum, copper and nickel cost 1.5%, 4.3% and 9% lower, respectively.

For four months running, the FAO food price index has kept falling: in August 2013 its average value amounted to 201.8 points which is 4 points and 11 points lower than in July 2012 and August 2012, respectively. A decrease registered in August is related to a continued drop in global prices on grain and oil, while prices on dairy products, meat and sugar increased somewhat.

In January–August 2013, the foreign trade turnover of the Russian Federation amounted to \$558.6bn which is 0.3% lower than the respective index of 2012. It is to be noted that the Russian export decreased by 2.1% to amount to \$338.2, while the import rose by 2.6% to \$220.4bn. In January–August 2013, the trade balance surplus of the Russian Federation amounted to \$117.9bn which is 9.9% lower than in January–August 2012.

## MONTHLY AVERAGE GLOBAL PRICES IN AUGUST OF THE RESPECTIVE YEAR

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Oil (Brent), USD/a barrel	27.2	29.9	42.8	61.9	71.7	72.1	118.3	73.06	77.18	109.9	113.3	110.96
Natural gas*, USD/1 m BTU	3.01	3.98	4.34	6.56	8.71	8.34	14.64	6.92	8.45	10.81	11.18	11.64
Copper, USD/a ton	1480.0	1731.0	2835.8	3800.0	7689	7510.5	7645.6	6165.3	7284	9001.0	7515.5	7192.9
Aluminum, USD/a ton	1292.0	1457.0	1694.3	1868.0	2460	2515.2	2780	1933.8	2118.4	2379.0	1845.4	1817.6
Nickel, USD/a ton	6720.0	9365.0	13723	14894	30872	27600	18581	19642	21413	21845	15735	14315

\* The Markets of Europe, the average contract price, Franco-border.

Source: calculated on the basis of the data of the London Metal Exchange (London, the UK) and the Intercontinental Oil Exchange (London).

A decrease in the export took place due to a considerable drop in export supplies of metals and metal articles, as well as food products and agricultural primary products. In January–August 2013, the cost of the volume of export of those groups of commodities fell by 12% and 11.3%, respectively as compared the same period of 2012. It is to be noted that a drop took place both in physical volumes of exported goods and their export prices.

Despite the fact that the export of oil fell by 5.6% due to growth in the export of oil products (9.8%) and gas (6.8%), the export of fuel and energy commodities remained at the level of the previous year.

Export supplies of wood and pulp and paper products, machines, equipment and transportation vehicles and chemical products rose insignificantly by 2.4%, 1.9% and 0.1%, respectively.

Growth in the import took place due to higher purchases of textile, textile products and footwear (7.6%), food products and agricultural primary products (5.1%), chemical products (5%) and metals and metal articles (5%). The import of machines, equipment and transportation vehicles decreased by 1.6%. It is to be noted that the share of that group of commodities in the total volume of the Russian export decreased from 50.3% in January–August 2012 to 48.7% in January–August 2013.

On October 9, 2013, the eighth meeting of the Council of the Eurasian Economic Commission took place. At the above meeting, decisions were passed as regards technical regulation, competition and anti-trust policy, customs and tariff regulation and trade in member-states of the Customs Union.

Technical regulations of the Customs Union on Safety of Milk and Dairy Products and On Safety of Meat and Meat Products were approved.

Due to accession of the Russian Federation to the WTO, the process of reduction of the rates of the sin-

gle customs duty of the Customs Union keeps going on. So, by Decision No.58 of October 9, 2013 of the Council of the Eurasian Economic Commission the rate of the import duty on Prunus plum puree and spreads in a primary package with net weight of over 100 gr. for industrial processing were reduced to 13% against the present 13.7% of the customs value.

Also, the rate of the import duty on ethylene copolymers with vinyl acetate was reduced from 8.8% to 6.5% as well as that on paving slabs and finish tiles (from 13% to 12%). In addition to the above, the rate of the import duty on electronic players (deca) and other sound-reproducing equipment without a sound-recording device is reduced from 12.3% to 11%. The decision becomes effective from December 31, 2013.

In October 2013, the period of 60 days established in accordance with the WTO rules in order to achieve an amicable agreement with the EU as regards the latter's claim in respect of the utilization duty introduced in Russia expired. It is to be reminded that while the duty is imposed on the entire import from the EU, motor vehicles produced in Russia, Kazakhstan and Belarus are exempted from it. So, the utilization duty creates advantages for car makers from the Customs Union, which situation contradicts the WTO norms.

According to the data of the Federal Treasury of the Russian Federation, from the day the utilization duty was introduced in September 2012 the federal budget revenues from that tax amounted to Rb 55.4bn.

The bilateral consultations carried out on July 29–30, 2013 failed to eliminate differences. On October 10, 2013 the EU turned to the authority which resolves the WTO disputes with a proposal to convene a panel of arbitrators which will consider the issue of legitimacy of such a duty.

On October 22, 2013, the WTO Committee on Resolution of Disputes was held in Geneva where the Russian representative opposed the EU's request to the

WTO to convene a panel of arbitrators to consider the issue of the existing utilization duty mechanism in Russia as a possibility of an amicable settlement of the dispute was not yet exhausted. If the EU raises the issue again at the next meeting, Russia has not right to block it for the second time.

In such a case, before the end of the year the WTO group of arbitration is to be formed and it will have within six months to determine if the EU's claims are justified or Russia's actions are in conflict with the WTO rules. After that, Russia will be granted 30 days to inform how it is going to fulfill the decision of the arbitration group. If the claims are found justified and Russia does not abolish discriminatory measures, the EU will be granted the right to introduce countervailing measures in respect of Russian goods. The EU will manage to increase duties to make up for the damage caused by European manufacturers. The sum of the damage is to be calculated by the arbitration group.

In combination with other factors, the utilization duty would have an effect on the volumes of import duties in Russia. So, in January–August 2013 the import of trucks into Russia in physical terms was 33.5% lower than in January–August 2012. The import of light vehicles dropped dramatically as well: during the eight months of 2013 their import was 21.6% lower than during the eight months of 2012. However, it is difficult to evaluate a decrease in supplies of cars from the EU due to the effect of the utilization duty as the Russian auto market shrinks under the effect of many factors.

The claim filed by the EU's authorities to the WTO court in July 2013 made the Russian authorities to reconsider its position. On October 21, 2013, Vladimir Putin, President of the Russian Federation signed such amendments to the Law on Production and Consumer Waste as make conditions of an utilization payment equal both to Russian and foreign car makers. Under the new law which becomes effective from January 1, 2014, the utilization duty will be charged not only from transport vehicles imported from abroad, but also from those manufactured in the territory of the Customs Union. An exception is made only in respect of vehicles owned by compatriots who move to live in Russia on a permanent basis in accordance with a special program and diplomatic and consular missions. In addition to the above, rare vintage cars manufactured at least 30 years ago are exempted from that duty.

Despite the fact that Russia has fulfilled the requirements of the European Union as regards making conditions of payment of the utilization duty equal both to importers and domestic manufacturers, Brussels still expects "further information and explanations". The EU has claims as regards the methods of calculation of the utilization duty. In particular, the EU believes that the duty should not depend on the engine volume of a car and that the method of calculation allows for a big difference between the amount of the duty on new cars and that on used ones. ●

## ABEYANT STATE LANDS: PROBLEMS AND WAYS OF THEIR SOLUTION

V.Uzun

*At the beginning of 1990s land reform was carried out in Russia. After long and very heated debates private ownership of land was permitted giving start to its privatization. Mainly lands of agricultural destination and lands of settlements were transferred to private ownership. As of January 1, 2012 lands of agricultural destination accounted for 128.6m hectares out of 133.1m hectares of privatized lands, lands of settlements – for 4.3m hectares thereof (Table 1). The rest of lands (1576.7m hectares) remained in the state and municipal ownership.*

The problems of privatized land use are being scrutinized by the authorities, mass media and scientists. Far less attention is being paid to the management and use of lands that remain in the state ownership. Russian statistical records lack data allowing to calculate the comparative use efficiency of private and state lands of agricultural destination. Special studies revealed that corporate farms instituted by the state and municipal authorities and situated on the state and municipal lands lag far behind other corporate farms by the rate of profitability<sup>1</sup>.

According to the Land Code, the land that remained state-owned should have been divided and transferred to the ownership of either the Russian Federation, a constituent member of the Russian Federation, a municipal area or a rural municipality. The need to split state land ownership into the federal, regional and municipal components was declared back in 2001. Soon afterwards the procedure of such delineation was defined. However, as yet the most part of state land areas remain non-delineated. The owners of these plots are not established and lands remain “no-ones”.

As evidenced by *Table 1*, over one half of state-owned lands in Russia are “no-ones”. The biggest advance is made in delineating forest lands: 2/3 of them have already been registered as federal property. The remaining areas raise no concern as well – according to the law they belong to the Federation even in case delineation and registration procedures have not been completed. The situation is far more complicated with other categories of lands: they can be owned by the Russian Federation, constituent members of the Federation or municipalities but over 90% of their areas have not been delineated as yet.

How can one use state lands if it is not clear whose property they are? The Law on enacting the Land Code

of the Russian Federation envisages that “the tenure of non-delineated state land plots lies within the jurisdiction of local administrations of municipal areas and urban districts...” (Article 3, Paragraph 10).

After acquiring such right, municipal areas should have become the owners of all non-delineated state lands and manage them at their own discretion. However, the analysis of Rosreestr statistics shows that it never happened. Only 3.9m hectares of land are in municipal ownership although as of January 1, 2012 the total area of non-delineated lands amounted to 831.3m hectares. Despite the granted title to dispose of all non-delineated lands, municipal administrations actually cannot dispose of non-delineated forest areas since these lands are *a-priori* federally-owned.

The non-delineation of state lands has the decisive impact on the development of agriculture and rural areas.

### Rural municipalities are deprived of forests

In Tsarist Russia rural communities in forest and forest-steppe zones had their own woods that were used both for the construction of wooden dwellings and household outbuildings and for the procurement of firewood. Villagers took care of their wood and preserved it since they understood its importance for the living and future generations. In the times of New Economic Policy rural communities also obtained operating control over former landlords’ forests. Probably, this is the key to explaining the building boom that was observed then in rural areas.

After the collectivization rural woods became the property of collective farms. Rural communities’ rights to dispose of forests were curtailed but villagers still continued to use them. In the post-reform period corporate farms became private. The titles to some rural forests were withdrawn while a part of them was transferred for use to private entities. Rural communities were completely deprived of actually all titles to forests except for the right to visit them and pick mushrooms and berries.

1 V. Ya. Uzun, E.A. Gataulina, V.A. Saraykin et al. Tendentsii razvitiya i mekhanizmy vzaimodeystviya krupnogo i malogo biznesa v agropromyshlennom komplekse. [Developments trends and mechanisms of interaction between large and small business in the agro-industrial sector]. Moscow, ERD, 2009, p.160.



Table 1

**RUSSIAN FEDERATION: DISTRIBUTION OF LANDS BETWEEN OWNERS AS OF JANUARY 1, 2012,  
MILLION HECTARES**

	Total area	including						
		Private ownership	State ownership	Owned by				
				RF	RF constituent members	municipalities	Non-delineated	Non-delineated areas as % of state-owned lands
Land area	1709.8	133.1	1576.7	745.4	8.8	3.9	831.3	52.7
including:								
Lands of agricultural destination	389.0	128.6	260.4	8.3	7.7	3.4	241.0	92.5
of them:								
lands of re-distribution fund	46.0	-	46.0	0.5	1.1	0.2	44.2	96.1
Lands of forest fund	1120.9	-	1120.9	698.6	0.3*	0.006*	422.0	37.6
Lands of settlements	19.7	4.3	15.4	0.7	0.2	0.3	14.2	92.2
Reserve lands	98.8	-	98.8	0.06	0.001	0.07	98.7	99.9

\* According to the law lands of forest fund are owned by the Russian Federation. The Rosreestr staff must have made a mistake when collecting or processing data.

Source: Land fund of the Russian Federation as of January 1, 2012. Moscow, Rosreestr, 2012.

The program for sustainable development of rural areas for 2014–2017 and the period till 2020 envisages allocation of over Rb 170bn to the improvement of living conditions in rural areas and complex compact development of rural settlements. There are plans to commission (acquire) 5.4m square meters of living space (or on the average 0.2 square meters per one rural resident).

The effect can be much greater if forests are returned to rural municipalities<sup>1</sup>. This would help to improve their economic performance, to raise budget receipts, to provide rural population with construction materials and fuel, to get assistance of rural community in fighting forest fires, etc. Such a solution would encourage much faster development of construction in rural areas.

The transfer of forests to the ownership of rural municipalities can involve both the lands of forest fund and the forest areas situated close to rural settlements and currently controlled by private enterprises. Municipalities and rural communities are interested in and have more opportunities for the rational utilization and preservation of their forests as compared with federal authorities residing in the faraway capital. Private entrepreneurs use forests pursuing their own commercial interests. Meantime, rural municipalities can provide for their utilization in accordance with the public interests.

There is a threat that in case rural communities are passive, corrupted local officials will abuse

their powers, strip and kill out forests. But, first, the scopes of abuse by higher ranking officials are far more outreaching as the latter are less controllable by civil society. Second, this threat can be diminished by means of thoroughly elaborated legislative rules of rural woods use and the control over their observation.

#### **Constituent members of the Russian Federation are barred from the disposal of forest fund lands**

In the course of discussing patterns of forest fund lands ownership the idea of their privatization was rejected although in many countries including our neighbors (e.g. Finland) forests are privately owned. It helps to retain population in villages situated in forest regions, improves sustainability of rural development and ensures additional personal incomes.

But when adopting the RF Forest Code it was decided to concentrate the lands of forest fund in the federal ownership. The concentration of control over these lands in the federal center inhibits regional authorities from fully exploiting their opportunities for the improvement of utilization and protection of forests situated on their territory<sup>2</sup>. There is concern that the partial transfer of powers to constituent members of the Russian Federation may result in bigger corruption and abuse. This problem can be tackled by means of control over regional officials on the part of civil society and federal authorities.

<sup>1</sup> As of January 1, 2013 there were 18,722 rural municipalities and 1,817 municipal areas in Russia. According to the effective legislation rural municipal units are parts of municipal areas.

<sup>2</sup> Lands of forest fund comprise 1,120.9m hectares of land which is almost 2/3 of the country's territory. Federal ownership of this land seriously limits the autonomy of Federation's constituent members as component parts of the federal state.

### Lands of agricultural destination

As of January 1, 2012 there were 389m hectares of lands of agricultural destination in Russia. 1/3 of this area (128.6m hectares) was privately owned by legal bodies and individuals while 2/3 (260.4m hectares) were in state ownership. Only 7.5% of state lands (19.4m hectares) were delineated. The Federation owned 8.3m hectares of lands of agricultural destination, its constituent members – 7.7m hectares, municipalities – 3.8m hectares. These are largely the lands of state unitary agricultural enterprises instituted by the governing bodies of the Russian Federation and its members and those of municipal enterprises.

241m hectares of lands of agricultural destination remained non-delineated. Local municipalities transferred most part of them to farm producers for permanent (perpetual) use or lease. Nearly 30m hectares of farmlands have not been transferred to agricultural producers and are not used according to their destination.

Although state lands of agricultural destination are situated on the territory of rural administrations, rural municipal bodies have no powers of disposal thereof. Even if arable land is not used for decades and gets covered with shrubs, rural municipalities can but view this process without any right to interfere and alter the situation.

With the purpose to allot land to individual private farms, the land re-distribution fund was set in the period of reforms. First of all, it is intended for allotting land to beginning farmers. As of January 1, 2012 there were 46m hectares of lands of agricultural destination in this fund. However, almost all this area is not delineated; rural municipal bodies have not registered property rights to these lands and therefore cannot allot them to farmers.

In order to get land a beginning farmer should apply to municipal authorities. They do not have any titles to lands from the re-distribution fund either but are entrusted with the powers to dispose of non-delineated state lands. In this situation local government bodies of a municipal area will suggest that an applicant should parcel out the selected plot and register it as a property of the municipal area at his own expense.

After the farmer has spent a lot of money on parceling out the plot, he will get a suggestion to lease it or buy it out. According to the law, both lease and buying out of a state-owned plot requires holding a tender. There is no other way. Since the farmer who has parceled out the plot can lose this tender, measures are taken to make it a mock auction, to prevent participation of other real bidders, etc.

This entire scheme is non-transparent and corrupt from the beginning to the end. And the cause of it is

the non-delineation of state lands, the lack of funds in the budgets of all levels for the registration of land plots and preparation of them for lease or sale. Being short of small money for registering plots, budgets lose big money due to the non-use of land.

The same is true for the reserve lands. A large part of them are farmlands that are neither delineated nor registered. Due to that such plots are lingering on in reserve for years as it's hard to find users who will agree to spend large amounts of money on parceling out and registration of plots in the situation when the risk of losing the following tender is not ruled out. And indeed, who is to search for such users: federal authorities, constituent members of the Federation, regional administrations or rural municipalities? It's not clear as the land is not delineated.

The situation is aggravated by the fact that not a single institution in the country is charged with the mission to carry out this work; thus, there will be no discernible progress even if budgets of all levels find the funds for delineating and registering land plots. Roskomzem that used to be in charge of management of the country's land resources and had a net of local divisions was closed down 6 years ago. At the moment no one is responsible for land in the country. There are only institutions that gather statistics, register plots and transactions therewith, exercise control and impose penalties, but none of them is ready to take up the difficult and cost-consuming work of delineating state lands between the Federation, its constituent members, area and rural administrations.

An even more meticulous work is to be done after the delineation: each plot should be prepared for lease or sale as no one will take it if there is no road infrastructure, no electricity network, etc.<sup>1</sup> In addition to preparing the plot, the search for potential users should be launched and in case there are no local applicants, terms for inviting outsiders from other regions and even countries should be elaborated. Only a special institution whose main mission is to dispose of land for the public good can cope with this set of complicated tasks. It's at least naive to believe that a small team of officials sitting in their Moscow offices of the Federal Agency for State Property Management is able to take care of billions of hectares of land.

The above analysis leads to the following conclusion: to date the system of managing state lands has not been formed in Russia. They turned out to be abeyant. Due to that budgets of all levels suffer great losses in the amount of received taxes (no one pays taxes for land with non-documented use titles; taxes for a large part

<sup>1</sup> In the times of Stolypin's reform the state treasury bore the expenses on registering plots, building roads, digging dwells, etc. before allotting land to peasants.

of documented but non-used lands are not paid either), lease payments (only land tax is imposed on lands transferred for permanent (perpetual) use) while in case of leasing them out at market prices budget receipts could be much higher), revenues from the selling of land.

The establishment of the system of state land management should start with the delineation of titles to this land and the forming of land plots to be owned by the Russian Federation, its constituent members, area and rural municipalities. Depending on the area of lands at each level (conditioned by local specifics)

agencies, institutions and organizations capable to ensure the rational utilization of available lands should be formed.

In case state and municipal bodies are unable to manage lands under their jurisdiction, the latter should be gradually privatized. Each piece of land should have a particular owner (physical or legal body, rural municipality, governing bodies of an area, a constituent member of the Federation or the Russian Federation at large) responsible for its maintenance and development. ●

## THE PROSPECTS FOR SELF-REGULATION OF FINANCIAL MARKETS: THE STATE REGULATOR'S INFLUENCE IN ON THE INCREASE

N. Polezhaeva

*A comparative analysis of the existing model of financial market regulation and the model put forth by the Bank of Russia within the framework of the Draft Federal Law 'On Self-Regulating Organizations in the Field of Financial Markets' indicates that the Bank of Russia is creating a new system of regulating the activity of self-regulating organizations operating in Russia's financial markets, which significantly increases the powers of the state regulator. According to the Draft Law, the state regulator is to become free to unilaterally determine the scope of its own participation in the regulatory process. The unfettered discretion given to the state regulator may significantly undermine the interests of self-regulating organizations and their members, because the Draft Law fails to put forth any formal guarantees that the Bank of Russia should indeed permit such organizations to adequately participate in the process of setting standards and guidelines, or in monitoring the compliance therewith.*

On 1 September 2013, the Federal Law 'On the Introduction of Alterations to Some Legislative Acts of the Russian Federation in Connection with the Transfer to the RF CB of the Authority to Regulate, Control and Supervise Financial Markets'<sup>1</sup> came into effect. On that day, the powers formerly vested in one federal body, the Federal Financial Markets Service, were transferred to another such body, the Bank of Russia.

Even before the Federal Law came into force, the Bank of Russia had increased the scale of its interference in the activity of self-regulating organizations comprising financial institutions<sup>2</sup>, clearly aiming at boosting its role as state regulator. It should be noted in this connection that any substantial rise in the powers of state regulator *vis-à-vis* self-regulating organizations can have a negative effect on the activity of such organizations if they are deprived of any of the main components of self-regulation. These components are as follows: the right to set standards and guidelines for professional (or entrepreneurial) activity, and the right to monitor compliance with the said standards and guidelines<sup>3</sup>.

Similar trends can be detected in the Draft Federal Law 'On Self-Regulating Organizations in the Field of Financial Markets'<sup>4</sup> developed by the Bank of Russia

and submitted to the RF Government for consideration in 2013<sup>5</sup>.

Similarly to the framework law on self-regulating organizations adopted in 2007<sup>6</sup>, the CB's draft law sets some purely general principles of self-regulation in financial markets, irrespective of the type of one or other self-regulating organization.

It should be noted that, initially, the framework law on self-regulating had been developed exclusively as a law on self-regulating organizations operating in financial markets. However, as the framework law's developers had failed to coordinate it with the Bank of Russia and the Federal Financial Markets Service, some of Russia's financial markets were excluded from the sphere of application of that law<sup>7</sup>.

One of the Draft Law's key ideas, which actually puts at risk the freedom of activity of self-regulating organizations, is expressed in its provisions that the function of setting standards and guidelines for self-regulating organizations should be subject to increased legislative regulation, and that the state regulator's authority with regard to these matters should be expanded (Articles 9 and 10).

The Draft Law submitted by the Bank of Russia requires that self-regulating organizations operating in financial markets will have to develop and approve

1 Federal Law of 23 July 2013, No 251-FZ 'On the Introduction of Alterations to Some Legislative Acts of the Russian Federation in Connection with the Transfer to the Central Bank of the Russian Federation of the Authority to Regulate, Control and Supervise Financial Markets' // *Sobranie zakonodatel'stva Rossiiskoi Federatsii* [Collection of Legislation of the Russian Federation], 29 July 2013, No 30 (Part I), p. 4084.

2 Non-credit financial institutions and credit institutions operating in the securities market.

3 See item 1, article 2 of the Federal Law of 1 December 2007, No 315-FZ 'On Self-Regulating Organizations' // *Sobranie zakonodatel'stva Rossiiskoi Federatsii* [Collection of Legislation of the Russian Federation], 3 December 2007, No 49, p. 6076.

4 See: <http://www.nfa.ru/docs/zpsro.pdf>.

5 See N. A. Polezhaeva, *Pravovoye regulirovanie deiatel'nosty smoreguliruemyykh organizatsii professional'nykh uchastnikov rynka tsennykh bumag* [Legal regulation of the activity of the self-regulating organizations of professional security market participants] // *Zakon i pravo* [Law and Justice], 2013, No 8, pp. 50—52.

6 Federal Law of 1 December 2007, No 315-FZ 'On Self-Regulating Organizations'.

7 See V. S. Pleskachevsky's presentation delivered on 19 March 2013 at the Third All-Russian Forum of Self-Regulating Organizations 'Self-Regulation in Russia: The Experience and Prospects of Development' held within the framework of the Russian Business Week 2013 (under the aegis of the Russian Union of Industrialists and Entrepreneurs).

mandatory internal standards for self-regulating organizations, and also to develop, approve and coordinate with the Bank of Russia a set of mandatory basic standards uniform for all self-regulating organizations of the same type.

In order to be granted the status of self-regulating organization, a not-for-profit organization will be obliged to conform to the basic standards previously coordinated with the Bank of Russia. Also, such standards can become mandatory for all corresponding type financial institutions irrespective of whether or not they are members of the self-regulating organization.

The Bank of Russia intends to establish the list of internal and basic standards that a self-regulating organization will be obliged to develop and approve, and to determine the volume, the content and the form of the social relationships to be regulated.

The afore-mentioned standards should conform to both Russian legislation and the Bank of Russia's normative acts, the provisions of which are as yet unknown.

As a rule, existing financial legislation<sup>1</sup> is silent on the issue of the state regulator's participation in the process of developing and setting the afore-mentioned standards and guidelines, thus leaving these processes to the discretion of the organizations themselves.

It should be said that those participants in self-regulation that take part in the development of at least some of the standards and guidelines follow them more willingly than the standards and guidelines imposed on them from above.

Thus, for example, the model of self-regulation that operated in the US securities market prior to 2007 was characterized by the co-existence of two major self-regulating organizations: the New York Stock Exchange

(NYSE) and the National Association of Securities Dealers, Inc. (NASD).

The NYSE was established at market participants' own initiative. They also set standards and guidelines for their own activities. As NYSE members cared about the reputation of their organization, their services were in greater demand among securities owners and other clients than those provided by the NASD.

By contrast, the NASD was created with the active participation of the State (the Maloney Act of 1938), and its members did not take part in the development of standards and guidelines. Standards and rules, usually referring to the normative acts of the state regulator, were mutually agreed upon by the management of the self-regulating organization and the state regulator. Thus, the NASD was deprived of one of the most important advantages of self-regulation – participation in the development of standards and guidelines, so helpful in getting to a higher level of observance with those standards and guidelines.

If the above provisions of the Bank of Russia's Draft Law should indeed come into force, self-regulating organizations may easily find themselves in a situation similar to that of the NASD, which then will further be aggravated by the fact that the state regulator will apparently have the right to decide whether or not the candidacy of a person nominated to head one or other self-regulating organization should be accepted (this is discussed in more detail later in our overview).

The second idea of the Bank of Russia's Draft Law that can harm the interests of self-regulating organizations operating in financial markets and, correspondingly, the interests of their members, is the idea that the supervisory function of those organizations should be curbed.

Apart from the two afore-mentioned components of self-regulation (the function of setting of standards and guidelines for self-regulating organizations and the function of supervision over the observance thereof<sup>2</sup>), the Bank of Russia has established a third component – supervision over the observance of the federal laws which regulate financial market activities, normative legal acts of the Russian Federation, and normative legal acts issued by the Bank of Russia (Articles 6 and 7).

It should be noted that, at present, the constituent documents of some self-regulating organizations specify that one of their powers is to supervise the activity of their members<sup>3</sup>.

1 Federal Law of 22 April 1996, No 39-FZ 'On the Securities Market' // *Sobranie zakonodatel'stva Rossiiskoi Federatsii* [Collection of Legislation of the Russian Federation], No 17, 22 April 1996, p. 1918; Federal Law of 29 November 2001 'On Investment Funds' // *Sobranie zakonodatel'stva Rossiiskoi Federatsii* [Collection of Legislation of the Russian Federation], 3 December 2001, No 49, p. 4562; Federal Law of 7 May 1988, No 75-FZ 'On Non-Governmental Pension Funds' // *Sobranie zakonodatel'stva Rossiiskoi Federatsii* [Collection of Legislation of the Russian Federation], No 19, 11 May 1998, p. 2071; RF Law of 27 November 1992, No 4015-1 'On the Organization of Insurance Affairs in the Russian Federation' // *Rossiiskaia Gazeta* [The Russian Gazette], No 6, 12 January 1993; Federal Law of 30 December 2004, No 215-FZ 'On Housing Savings Cooperatives' // *Sobranie zakonodatel'stva Rossiiskoi Federatsii* [Collection of Legislation of the Russian Federation], 3 January 2005, No 1 (Part 1), p. 41; Federal Law of 18 July 2009, No 190-FZ 'On Credit Cooperation' // *Sobranie zakonodatel'stva Rossiiskoi Federatsii* [Collection of Legislation of the Russian Federation], 20 July 2009, No 29, p. 3627; Federal Law of 2 July 2010, No 151-FZ 'On Micro-Financial Activity and Micro-Financial Institutions' // *Sobranie zakonodatel'stva Rossiiskoi Federatsii* [Collection of Legislation of the Russian Federation], 5 July 2010, No 27, p. 3435.

2 In the draft federal law submitted by the Bank of Russia, this component is referred to as monitoring the observance of standards, guidelines and the Federal Law 'On Self-Regulating Organizations in the Field of Financial Markets'.

3 See, for example, sub-item 'e' of item 2.1 of the *Charter of the National Association of Stock Market Participants* and paragraph 4, item 2.2 of the *Charter of Registrars, Transfer Agents and Depositories*.



However, while proposing to legislatively establish this additional component of self-regulation, the Bank of Russia at the same time stipulates that a self-regulating organization should have the right to supervise the activity of its members only if the corresponding powers have been delegated to it by the Bank of Russia. The procedure for delegating the afore-said powers, as well as the reasons and the procedure for their cancellation, is to be established by the Bank of Russia on an individual basis for each of the types of self-regulating organizations (the powers delegated to same-type organizations should be absolutely equal). The fact of the supervisory powers being delegated to self-regulating organizations should not imply that the Bank of Russia itself has lost such powers.

In the event when the Bank of Russia has delegated to a self-regulating organization the powers to receive accounting and other reports from its members; to conduct personnel certification with regard to its CEOs, members and personnel; and to participate – via its representatives – in the supervision of the activity of its members, carried out by the Bank of Russia and state authorities, these functions should also be performed by the afore-said self-regulating organization.

Thus the Bank of Russia intends to create a new system for regulating the activity of self-regulating organizations in the field of financial markets, the upshot of which will be a significantly increased role of the state regulator. According to the Draft Law, the state regulator will then be free to unilaterally determine the scope of its own participation in the regulatory process. The unfettered discretion given to the state regulator may significantly undermine the interests of self-regulating organizations and their members, because the Draft Law lacks any formal guarantee that the Bank of Russia should permit such organizations to adequately participate in the process of setting standards and guidelines or in monitoring compliance therewith.

Unlike the existing model of self-regulation in the field of financial markets, which implies that self-regulating organizations should be voluntary associations, the Draft Law submitted by the Bank of Russia stipulates that membership in such organizations should be mandatory (Article 11).

At the same time, the Draft Law does not eliminate the licensing of activity, although the licensing of activity makes sense only when membership in a self-regulating organization is voluntary.

According to Article 4 of the Draft Law, the following types of self-regulating organizations can be created in the field of financial markets: (1) SROs of brokers; (2) SROs of dealers; (3) SROs of managers; (4) SROs of depositories; (5) SROs of registrars; (6) SROs of joint-stock investment funds, mutual funds, investment

funds' asset managers and non-governmental pension funds; (7) SROs of specialized depositories; (8) SROs of non-governmental pension funds; (9) SROs of the following insurance subjects: insurance organizations, insurance brokers, mutual insurance societies; (10) SROs of micro-financial organizations; (11) SROs of credit cooperatives; (12) SROs of housing savings cooperatives; (13) SROs of credit history bureaus<sup>1</sup>.

At present, mandatory membership is established only for credit cooperatives, with the exception of second-level cooperatives<sup>2</sup>.

Maybe, the Bank of Russia's proposal to the effect that membership in self-regulating organizations operating in the field of financial markets should be made mandatory was motivated by the Bank's desire to safeguard the interests of securities owners and other clients of financial institutions, because this measure is designed to make it possible to establish additional control over the activity of such organizations. However, past experience indicates that sometimes such mandatory double control (licensing and self-regulation), if introduced in conjunction with the extended powers of the state regulator, may not necessarily be in the best interests of financial institution clients.

It goes without saying that financial institution clients are interested not only in the security of their interests, but also – and primarily – in obtaining some profit. The simultaneous presence of several voluntary self-regulating organizations promotes competition and is conducive to establishing better standards and guidelines, intended to be more attractive to potential clients. In such a situation, potential clients are able to pick and choose among the differing financial institutions – members of one or other self-regulating organization.

The Draft Law also stipulates that, in order to get registered, a self-regulating organization uniting financial institutions of the same type should comprise at least 30% of the total number of financial institutions engaged in that type of activity, not counting its associated members<sup>3</sup>.

1 Federal Law of 30 December 2004, No 218-FZ 'On Credit Histories' (see *Sobranie zakonodatel'stva Rossiiskoi Federatsii* [Collection of Legislation of the Russian Federation], 3 January 2005, No 1 (Part 1), p. 44) does not envisage the establishment of self-regulating organizations of credit history bureaus. However, this does not imply that such organizations may not be established in accordance with the 2007 framework Law 'On Self-Regulating Organizations.

2 Item 1 of Article 35 of Federal Law of 18 July 2009, No 190-FZ 'On Credit Cooperation' // *Sobranie zakonodatel'stva Rossiiskoi Federatsii* [Collection of Legislation of the Russian Federation], 20 July 2009, No 29, p. 3627.

3 On associated membership, see Article 15 of the Bank of Russia's Draft Law.

According to the Draft Law, a financial institution should be endowed with the right to be a member of only one self-regulating organization of one or other specific type. If a financial institution is engaged in different types of activity, it should have the right to become a member of several self-regulating organizations of different types, or of a self-regulating organization comprising several self-regulating organizations of different types. In the latter case, a self-regulating organization can be established, provided that it will comprise no less than 30% of the total number of financial institutions engaged in each type of activity.

Therefore, this provision of the Draft Law effectively means that the number of same-type self-regulating organization should be limited to three.

At present, the existing framework rule stipulates that, in order to be granted the status of self-regulating organization, a not-for-profit organization should comprise no less than one hundred subjects of specific professional activity (or no less than twenty-five subjects of entrepreneurial activity), unless otherwise provided by federal legislation<sup>1</sup>. The laws regulating the activity of those self-regulating organizations in the field of financial markets, to which the 2007 framework Law on Self-Regulating Organizations does not apply (SROs of pension funds and the organizations contracted by them to manage pension accounts; SROs of asset managers; SROs of housing savings cooperatives), do not specify the minimum required number of members for a self-regulating organization to be registered. The only exception is represented by self-regulating organizations of professional securities market participants (the minimum required number of members is ten). Thus, at present the number of same-type self-regulating organizations is not limited by law.

Also, the Bank of Russia intends to introduce a procedure whereby it will have the right to decide whether or not the head of a self-regulating organization meets the established professional qualification requirements. Furthermore, the Draft Law stipulates that the Bank of Russia should have the right to decide whether or not the candidacy of a person nominated

to become head one or other self-regulating organization should be accepted (Article 29).

At present, the issue of appointing and dismissing the head of a self-regulating organization belongs to the competence of the corresponding body of that organization.

The Draft Law establishes that the heads of self-regulating organizations (or other persons representing their interests) and the council of self-regulating organizations (in the person of its chairperson), which they have the right to create, selecting it from the ranks of their CEOs, should be entitled to represent, on a consultative basis, the interests of the said self-regulating organizations to the Bank of Russia.

However, according to the Draft Law, all the rights and duties of the afore-said representatives to the Bank of Russia, including issues pertaining to the subject of activity of the self-regulating organizations whose interests they represent, should be determined by the Bank of Russia (Article 35).

Representation of its members interests *vis-à-vis* the RF federal authorities, bodies of state authority of Russian Federation subjects and local self-government bodies is one of the main functions of any self-regulating organization. Therefore, the state regulator's participation in appointing representatives of the interests of the organizations supervised by the said regulator, in this case the heads of self-regulating organizations, may turn out to be harmful to the interests of such organizations.

As far as the current situation of self-regulating enterprises is concerned, the following observations may be offered. One can say that, so far, the appointment of a new state regulator has had no effect on the procedure for regulating the activity of self-regulating organizations in the field of financial markets. Financial market participants continue to enjoy significant independence in regulating their own activity.

However, if the Bank of Russia's Draft Law 'On Self-Regulating Organizations in the Field of Financial Markets' is enacted into law, the influence of the state regulator and the load on financial market participants (financial institutions) will sharply increase. Moreover, it is not impossible that the very essence of self-regulating organizations will disappear into thin air, in spite of the preservation of their formal status. ●

<sup>1</sup> Sub-item 1, Item 3 of Article 3 of Federal Law of 1 December 2007, No 315-FZ 'On Self-Regulating Organizations'.

## MAIN TRENDS IN THE RUSSIAN EXPORT OF DIRECT INVESTMENT

A.Pakhomov

*Despite uncertainty in the global economy and domestic problems of the Russian economy, the export of direct investments from Russia keeps growing. Generally, a large-scale withdrawal of the enterprise capital from the country has a contradictory – both positive and negative – effect on national reproduction processes and is ambiguously assessed by Russian scientific and research community so it requires an in-depth analysis.*

In the beginning of the last decade, in Russia explosive growth in export of direct investments was registered, while at present large-scale business activities by public and private companies have become typical of the Russian economy. At the current stage of globalization, efficient development of the national economy is impossible without a real export of the enterprise capital which ensures an optimal way of securing resources which are in short supply, production factors, as well as materialization of potential advantages of domestic companies and the economy as a whole. Implementation of the above conditions creates prerequisites for raising a competitiveness edge on the corporate, sectorial and national levels.

Though a large-scale and sustained withdrawal of the enterprise capital from the country started only in the mid of the last decade (that is, less than 10 years ago) (Table 1), as regards the total volume of the export of direct foreign investments (DFI) in 2012 the Russian Federation was rated the 8<sup>th</sup> in the world (in accordance with the updated data of the UNCTAD), while its unit weight in the global flow of direct investments amounted to 3.7% as compared to the 27<sup>th</sup> position and the share of 0.3% in 2000<sup>1</sup>.

As a result, after the 2008–2009 crisis, Russia has consolidated its position among the world's ten largest producers of direct foreign investments (DFI), while from 2009 it has become a net exporter of the enterprise capital. In the three quarters of 2013, the record-high export of direct foreign investments (\$89bn) was registered though the above index is a general one

which includes, in particular, a diversified deal on purchase by Rosneft of the TNK-BP's assets<sup>2</sup>.

Generally, the extent of Russia's involvement in the trans-border capital movement in the post-crisis period is well ahead of other indices of the country's positioning in the international exchange (the export of goods, services and technologies). The above situation points to strengthening of the investment component of Russia's participation in globalization processes. (Table 2).

It is to be noted that business activities by Russian companies abroad have an ambiguous effect on the country's economic growth. For that reason, an in-depth analysis of the causal effect of the export of direct investments and such Russian business's activities abroad as are related to DFI, as well as their effect on reproduction processes in individual industries and sectors of the Russian economy is required.

The activities of the Russian business abroad have the specifics of their own (reasons for export of DFI, methods and spheres of application of the capital abroad and the specifics of relations with state) and differ from incentive motives of trans-border deals and projects carried out by companies from developed countries and states with a dynamically developing economy.

It is to be noted that one should take into account that there are virtually no "attractive" opportunities for making investments in Russia; among exporters of DFI energy and primary sector companies which determine the main lines and areas of investments by Russian multinational corporations on the global level prevail and decisions on

1 Calculated by the author on the basis of the data of the World Investment Report 2013. Global Value Chains: Investment and Trade for Development, UNCTAD, Geneva, 2013, p. 218–220.

2 The operating data of the Central Bank of the Russian Federation.

Table 1

### DYNAMICS OF DIRECT INVESTMENTS FROM RUSSIA AND THE ACCUMULATED INVESTMENTS ABROAD IN THE 1992–2012 PERIOD (BILLION USD)

	1992	1995	2000	2005	2008	2009	2010	2011	2012
Export of DFI	1,566	0,606	3,177	12,767	55,540	43,632	51,697	67,283	51,058
Accumulated DFI road	2,301	3,346	20,141	146,679	370,129	302,542	366,301	362,101	387,217

Source: the data of the Central bank of Russia and the UNCTADstat for the respective year.

Table 2

**THE POSITION OF THE RUSSIAN FEDERATION IN THE INTERNATIONAL EXCHANGE OF GOODS,  
SERVICES AND DFI FLOW IN THE 2000–2012 PERIOD**

Index	2000	2005	2007	2008	2009	2010	2011	2012
GDP volume	17 / 0.8	12 / 2.1	10 / 1.3	8 / 2.8	12 / 2.1	11 / 2.4	10 / 2.8	9 / 2.8
Export of goods	17 / 1.7	13 / 2.4	12 / 2.5	9 / 2.9	13 / 2.4	12 / 2.6	9 / 2.9	9 / 2.8
Import of goods	29 / 0.7	19 / 1.2	16 / 1.6	16 / 1.8	17 / 1.5	18 / 1.6	17 / 1.8	16 / 1.8
Export of services	31 / 0.7	26 / 1.1	25 / 1.2	22 / 1.3	22 / 1.3	23 / 1.2	22 / 1.3	22 / 1.3
Import of services	22 / 1.2	17 / 1.6	16 / 1.9	16 / 2.2	16 / 1.9	16 / 2.0	15 / 2.3	14 / 2.3
Export of DFI	27 / 0.3	17 / 1.4	14 / 2.0	12 / 2.8	7 / 4.2	8 / 3.8	7 / 4.0	8 / 3.7
DFI accumulated abroad	28 / 0.3	15 / 1.1	13 / 1.9	15 / 1.3	15 / 1.3	13 / 1.8	14 / 1.7	17 / 1.8
Import of DFI	37 / 0.2	15 / 1.2	10 / 1.8	5 / 4.1	6 / 3.8	8 / 3.3	9 / 3.5	9 / 3.4
DFI accumulated in the country	27 / 0.4	17 / 1.6	10 / 2.7	18 / 1.4	18 / 1.4	15 / 2.5	15 / 2.2	16 / 2.2

Note. The first figure means the place in the international rating, while the second one, the world share (%) as regards the concrete index.

Source: the author's calculations on the basis of the data of the IMF, the WTO and the UNCTAD for the respective year.

expansion abroad made by owners of large Russian companies are of a subjective nature (Table 3)<sup>1</sup>.

The large-scale and sustained export of direct investments is a relative advantage of Russia on the world market. The effect of that factor is to be taken into account in development of a state policy strategy and transformed into the country's new competitive advantage on foreign markets.

At the current stage, under the effect of the rapidly changing situation on global commodity and financial markets, as well as the economic situation in Russia the following new trends both in export of direct in-

vestments from Russia and multi-field activities of Russian business abroad are being formed:

- Strengthening of the role of state corporations and companies (Gasprom, Rosneft, RusHydro, Gasprom Neft, Rosatom, RZhD and other) in purchasing of assets and implementation of new projects abroad;
- Reorganization of assets and modification of the corporate strategy of large private multinational corporations (Severstal, Lukoil, Evraz and other);
- Stepping up of activities by state-owned banks in different segments of financial markets of the CIS (the VTB and the Bank for Foreign Economic Affairs) and far abroad (Sberbank);

<sup>1</sup> For more details see: A.A. Pakhomov. The Export of Direct Investments from Russia: Essays on Theory and Practice – Moscow. The Gaidar Institute, Delo, 2012. p. 368

Table 3

**REPRESENTATION OF RUSSIAN COMPANIES IN THE 100 TOP LIST OF NON-FINANCIAL MULTINATIONAL CORPORATIONS FROM DEVELOPING ECONOMIES AS REGARDS THE VOLUME OF FOREIGN ASSETS IN 2011**

Company	Sector	Position in the rating		Performance abroad (million USD)			TNI* (%)
		As regards the volume of foreign assets	As regard the TNI level*	assets	sales	Number of the employed (persons)	
Vypelcom	Telecommunications	9	53	29 829	11 280	34 479	54
Lukoil	Oil and gas	11	67	29 159	108 976	18 144	43
Gasprom	Oil and gas	28	85	15 789	91 434	25 900	22
Evraz	Metallurgy	55	65	8 281	9 766	24 640	43
Severstal	Metallurgy	57	84	7 638	1 630	11 557	23
Mechel	Metallurgy	65	80	6 363	6 817	11 983	33
AFK Sistema	Telecommunications	74	95	5 223	2 512	19 663	11
RUSAL	Metallurgy	78	76	4 610	9 706	7 100	36

\* TNI is the index of trans-nationality calculated as the average of the following three indices: the ratio of the cost of foreign assets to the total assets, the ratio of foreign sales to the aggregate sales and the ratio of the number of workers employed at branches abroad to the total number of the corporation's employees. The TNI index points to the extent of importance of the company's foreign operations and that of operations by foreign branches on foreign markets to a multinational corporation. The higher the index, the higher importance of activities of foreign branches to the company.

Source: UNCTAD World investment Report 2013. Geneva, Country Fact Sheet: Russian Federation, Presence in the top-100 non-financial TNCs from developing countries, ranked by foreign assets, 2011, p. 2.

- Diversification of activities of the “second echelon” of Russian multinational companies (Summa Group, Inter RAO, Tatneft and other), private investment funds, individuals, as well as mid-sized companies and companies beyond the primary sector;
- Utilization of mixed forms of investment (asset swap, nonmonetary deals, strategic partnership and other);
- Growth in the number of purchases in energy and mining industries and the innovation sector and sales of foreign assets in metallurgy;
- Growth in the role of prestigious jurisdictions in DFI movement abroad.

It would seem that strengthening of positions of Russian investors on the global level will be determined by sectorial and geographic diversification of their activities beyond the limits of traditional areas which are less dependent on the effect of external pricing factors and entry by the “second echelon” of Russian corporations, primarily, non-primary sector companies and financial sector companies, as well as innovation companies which represent mid-sized business to the global DFI market.

It is to be noted that investment expansion of the Russian business abroad will have a growing effect on the economic development of Russia and its foreign economic relations. The scale of the accumulated Russian investments (industrial and financial resources) abroad have reached the extent when those investments are transformed into a foreign segment of the Russian economy (about \$400bn) where the factors of forward effect on the sphere of national reproduction and formation of a new model of Russia’s participation in the globalizing economy are created.

The above trends point to strengthening of the investment aspect of Russia’s deeper integration into the global economy. Due to the above, it is important

to ensure coordination of the Russian investment policy on the international and national levels, as well as its inter- subordination to the internal development strategy and the policy pursued in other areas (foreign economic, social and innovation spheres).

With a consistent government policy pursued, the export of direct investments may become an important component in implementation of Russia’s foreign economic strategy and a new factor of development of investment processes in the country. It is to be noted that the following key issues as raising of efficiency of management of foreign assets on the corporate level in a situation of growing global competition and strengthening of the feedback of the above foreign segment with the domestic economy are to be solved.

In the past few years, the research community is in search of a new economic growth model as the existing model aimed, in particular, at development of the primary sector’s export has virtually exhausted its potential. Due to worsening of the situation in the economy, it is the issue of how to ensure a 4% growth that is on the top of the agenda, rather than the prospect of achievement of annual growth of 5-6%<sup>1</sup>.

A particular attention is to be paid to the foreign economic component of economic development which accounted for 2.0%-2.5% of GDP growth in the pre-crisis period against less than 1% at present. Due to the above, it appears that the export of direct investments from the country may become an important factor behind implementation of the foreign economic policy of the Russian Federation and give a new impetus to the domestic economy. ●

<sup>1</sup> See, for example, the Forecast of the Long-Term Social and Economic Development of the Russian Federation till 2030 (the Ministry of Economic Development of the Russian Federation) approved on March 25, 2013.



## THE SPECIAL OF STRUCTURAL REFORMS IN RUSSIAN SCIENCE

I. Dezhina

*In Summer–Autumn, the period of structural reforms in Russian science began, that is, establishment of a new Federal Agency of Research Institutions, reforming of the system of three state academies and development of a new Russian Research Fund. The lines of the reforms are not brought in harmony with one another and a number of serious aspects which have a long-term effect on the state of science was not elaborated. Approaches to structural reforms point to a deep crisis in state management of science.*

Late in June 2013, the process of reforming of the country's research complex began; the above complex was probably the most substantial one since the beginning of the 1990s when after the collapse of the USSR new institutes in the sphere of science were established. In July–October, several large-scale developments took place: a merger of three state academies – the Russian Academy of Sciences (RAS), the Russian Academy of Medical Sciences (RAMS) and the Russian Academy of Agricultural Sciences (RAAS)<sup>1</sup> – with simultaneous deprivation of their control over research institutes which were subordinate them, establishment of a new Federal Agency of Research Institutions and development of the criteria and mechanism of evaluation of academic institutes. The project to establish the Russian Research Fund was made public. At the same time, the work on appraisal of performance of national research universities (NRU) – the cycle of budget funding of a portion of the above NRU was completed in 2013 – was carried out. The above developments should be analyzed together, though no connection between them is explicit at the first glance.

Draft law No. 305828-6 on The Russian Academy of Sciences, Reorganization of State Academies of Sciences and Amendment of Individual Statutory Acts of the Russian Federation emerged unexpectedly even to the administration of the Academy, so, it was received negatively by a larger part of the research community. Indignation was caused not only by the content of the draft law, but also the method which was selected for carrying out of the reform. In violation of the existing legislation in accordance with which public hearings are to be conducted, the draft law was introduced directly to the State Duma. The profile ministry – the Ministry of Education and Science of the Russian Federation (MES) – declared that it was not the architect of that draft law and the mystery about the authorship

still prevails which very fact is noteworthy. After two readings of the draft law, the administration of the RAS suggested that five principal amendments should be introduced:

- 1) Reorganize the RAS by means of a merger with the RAMS and the RAAS, rather than liquidate it.
- 2) Formulate the main goal of the RAS as carrying out of fundamental and applied research.
- 3) divide the authorities between the RAS and the Agency (later called the Federal Agency of Research Institutions (FARI)) so that the FARI was entrusted with the single function, that is, management of the RAS property.
- 4) return the status of a legal entity to RAS regional branches.
- 5) preserve a two-step system of ranks (a corresponding member and an academician) and reserve with the RAS the right to decide how and when to elect its new members.

The list of amendments explicitly reflects the extent of the government's intentions. It is to be noted that the draft law was negligently prepared and included discrepancies even after two readings in the State Duma.

On the basis of three readings, the RAS succeeded in defending most amendments, including those as regards reorganization by means of a merger of three academies, preservation of the function of the RAS to carry out fundamental and applied research, as well as coordination of research at higher educational establishments (HEE), reestablishment of regional branches as independent legal entities and preservation with the Academy of the status of the main administrator of budget funds on research, including maintenance of activities of regional branches. Finally, the rank of a corresponding member of the RAS was preserved. However, the RAS was deprived of its authorities to act as the owner of federal property which was vested in research institutions under its jurisdiction. As a result, the situation of research institutions has become the most uncertain one.

<sup>1</sup> RAS – the Russian Academy of Sciences, RAMS – the Russian Academy of Medical Sciences and RAAS – the Russian Academy of Agricultural Sciences.

The law was approved on September 27<sup>1</sup> and on the same day the Decree of the President of the Russian Federation on the Federal Agency of Research Institutions<sup>2</sup> was issued. Only after the Decree had been issued the work on development of guidelines for activities of the FARI and its authorities began. Actually, a new ministry of science emerged and it was assigned research institutions which were under jurisdiction of state academies. As the above developments will inevitably result in changes in the existing portion of the research complex which has been the most efficient one up till now (as regards the number of publications and their quoting), the Commission on Non-Government Supervision over the Reform of the Academy of Sciences was established (on October 8). The situation prompted consolidation of the civil society movement in science: ten non governmental entities of science and education joined the above Commission<sup>3</sup>. Such a consolidation can be regarded as a positive indirect effect of the poorly devised reform of the academic sector of science.

The Commission which existed only for a week focused on introduction of amendments into the statutes on the FARI as in the document which was developed in the government the role of the Agency was changed from a soft regulator to a tough centralized manager. In particular, in the first version the function of a coordinator of activities of research institutions, expertise and scientific methods was reserved with the RAS, but later it was deprived of that function<sup>4</sup>.

Debates on the draft law were to last till October 26, however, on October 16 the draft law was submitted to the government<sup>5</sup>. The fate of amendments which were still in the process of development remained unclear.

The draft statutes of October 18 on the FARI – the latest version available for the public analysis – suggests that all the key issues related to financing, property of the research institutions, the social sphere and purchase of the equipment and chemical agents are the prerogative of the Agency. In the text, the RAS was

referred to only twice. The first mention of the RAS was as follows: The proposals of the RAS are expected to be taken into account only in approving by research institutions of state assignments on fulfillment of fundamental and applied research. The second mention of the RAS: The RAS participates in formation of the scientific and coordination council by nominating candidatures of their representatives. It is to be noted that the role of the Council is not that great. A limited range of issues is expected to be handled with approval of the council; such issues include assessment of research institutions, as well as a proposal on establishment, reorganization and liquidation of research institutions which are under the jurisdiction of the FARI.

The work on development of the draft statutes on evaluation of efficiency of research institutions was less in the highlight<sup>6</sup>, though, logically, such an evaluation should be the basis of audit of academic institutions which are assigned to the jurisdiction of the FARI.

As seen from the text of the draft law, evaluation will be of an extradepartmental nature and it is carried out on the basis of comparison of reference groups of institutes.

The extradepartmental nature of evaluation is expected to be ensured by means of establishment of the Interdepartmental Commission on Evaluation of Efficiency of Research Institutions. The above Commission is entrusted with handling quite a lot of issues, including determination of the minimum values of the indices which situation is very important and predetermines to a great extent the outputs of evaluation. However, in the text the guidelines for formation of such a commission and personnel selection criteria are not specified.

Another aspect is reference groups and general evaluation principles. The latter can be understood only after reading an explanatory note to the draft law – according to the above explanatory note the expert community may be engaged in that work, but proceeding from the context there will be exceptionally quantitative evaluation on the basis of a set of 25–30 indices. In this connection, it remains unclear if the qualitative and quantitative evaluations correlate? If the qualitative evaluation is envisaged, it remains unclear which one: at the stage of making up of reference groups or somewhere else? It is to be noted that formation of reference groups requires a thorough expert approach as it is rather complicated to compare the areas of expertise with taking into account the specifics of the work and, in case of need, “sources and mecha-

1 №253, 27.09.2013 <http://graph.document.kremlin.ru/page.aspx?1;3586986>

2 №735 27.09.2013 <http://graph.document.kremlin.ru/page.aspx?1;3587023>

3 Scientist established a Commission on Non-Government Supervision over the Reform of the Academy of Sciences. [http://www.polit.ru/news/2013/10/08/public\\_control\\_in\\_science/](http://www.polit.ru/news/2013/10/08/public_control_in_science/) October 8, 2013.

4 S.Samokhina, N.Gorodetskaya, A.Chernykh and Kh. Aminov. The Complex Situation // Kommersant No.184, October 9, 2013 <http://www.kommersant.ru/doc/2315297>

5 P.Kotlyar. Nothing Will be Left Either to the Academy or Scientists. The Statutes on the New Agency will be Submitted to the Government without Debates. [http://www.gazeta.ru/science/2013/10/15\\_a\\_5709173.shtml](http://www.gazeta.ru/science/2013/10/15_a_5709173.shtml) 15.10.2013.

6 The draft resolution of the Government of the Russian Federation on Amendment of Resolution No. 312 of April 8, 2009 on Evaluation of the Efficiency of Activities of Research Institutions Engaged in R&D.

nisms of funding, as well as the form of incorporation of research institutions. So, the criteria of selection of experts need to be specified, as well, there is no mention of the word “expert” and its derivatives in the text of the draft resolution.

It is unclear how the evaluation of the RAS institutes will be related – if related – with the government’s intentions to develop academic research, including by way of support of NRUs and allocation of substantial funding to 15 higher educational establishments of which at least five universities are to be included in the world’s 100 top universities by 2020. For a NRU, a closer cooperation up to a take-over of academic research groups could be advantageous. Assessment of the performance of NRU in 2013 showed that they lag behind as regards scientific and technological activities: publication activities and, particularly, quoting and patenting<sup>1</sup>.

Finally, another related line of reforms is the project of establishment of the Russian Research Fund which may dramatically change the composition of institutes of support of academic research. Draft Law No.308179-6 on the Russian Research Fund was approved in the second reading on September 18, 2013. The need of expansion of grant financing of science was discussed for quite a long time as well as the need to have a variety of funds. However, judging by the position of the new fund among other institutes and instruments it seems it will sooner be a substitution of the existing organizations, rather than a complementary one.

The range of the Fund’s authority is defined rather broadly: it will deal with all those issues which are currently handled by research funds (the Russian Fund of Fundamental Studies and the Russian Humanitarian Research Fund): also a number of projects funded within the frameworks of federal purpose programs (for example, measures aimed at support of research

and educational centers, groups led by representatives of diasporas and mega-grants) may be assigned to the Fund. The Fund will allocate grants in the amount of Rb 5m – Rb 29m on research on the competitive basis to support projects for the term of 3–7 years. The range of the types of the projects is a broad one: from development of the mega-science policy to strengthening of the personnel potential of research and educational institutions. It is unclear whether the authorities between the existing entities and the new fund are going to be divided or a partial overlap is envisaged.

In addition to the above, the Fund may engage in entrepreneurial activities and found economic entities, that is, to be a surprising hybrid of anything possible; the above specifics is not normally utilized in other funds which are not incorporated as a “fund”, though such a possibility for research funds has been discussed since 2001. Probably, emergence of a new fund is related among other things to reforming of the academic sector, but the principles of networking between the RAS, the Federal Agency of Research Institutions, the MON and the Fund are not specified.

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In the mid-term prospect, the possible consequences of the reform of the academic sector of science can be assessed as negative. Reduction of the number of institutes will be accompanied by a partial loss of the personnel (due to, among other things, an outflow to abroad). Consequently, efficiency of research in the country will decrease at least for some time (years). If the property is administered without taking into account the specifics and the value of the research, damage may be caused to collections, museums and archives.

The decision-making methods in restructuring of the research complex, lack of harmony between measures which are developed concurrently and have an effect on science and the low level of development of the above measures point to a deep crisis of state regulation of science. ●

<sup>1</sup> T.Kondrakova. With Other Non-Equal. NRU were Estimated Without Discount as Regards the Difference in Potentials // Poisk, No.41, October 11, 2013, p.6.

## PARALLEL REALITY OF STATE DEFENCE ORDER

### V.Zatsepin

*The State Defense Order 2012 was implemented nearly 80%. Being limited in labor force, Russia's defense plants are facing problems related to drastically increased the State Defense Order 2013. President Putin's requirements to create a transparent military economy, establish order in terms of administration in the military-industrial complex and its pricing have encountered serious difficulties.*

A final conclusion of the Accounts Chamber of the Russian Federation on a draft Federal Law "On the Implementation of the Federal Budget for 2012" was posted on the State Duma's official website on September 17, 2013. The conclusion shed light on certain considerations related to the implementation of the State Defense Order (SDO) in 2012<sup>1</sup>.

The fact of further cut offs in the SDO 2012 adopted in the Russian Government's Executive Order dd. October 22, 2012 No. 1076-21 and December 22, 2012 No. 1385-31 "with regard to the procurement of weaponry, military and special equipment (WMSE), including the 10 tasks which are considered as top-priority"<sup>2</sup> was finally confirmed. The Accounts Chamber of the Russian Federation pointed out that "products for the procurement and repair of WMSE were short-delivered under 121 concluded public contracts, including 65 contracts on the procurement of WMSE, 56 contracts on the repair of WMSE". Eighteen of the defense-related R&Ds failed to be completed in due time in the previous year, of which 35 were fully paid and 26 implemented over a period of 20 years and beyond. Yet, as is known, it didn't stop those in charge to report the 99% implementation of the SDO at the very beginning of 2013<sup>3</sup>.

The Accounts Chamber's data confirms the statement made in June 2013 by Head of the Military Rep-

resentative Office under the Ministry of Defense of the Russian Federation O. Stepanov that the Russian defense industry short-delivered "nearly 20% of military (defense) products" to the Russia's Armed Forces in 2012<sup>4</sup>. It is particularly remarkable that a relative value of the last-year short-delivery under the SDO corresponded well with a 19.6% nominal growth in the federal budget expenditures under the 'National Defense' line in 2012. Judging by this, our defense industry can't be equal to the Government's task of reaching the 15% annual growth in the output of military (defense) products<sup>5</sup>, and drastic increase in the SDO financing provided for by the ongoing State Armament Program for 2011–2020 (SAP) set apparently impossible tasks for the industrial sector and discouraged it to enhance its effectiveness.

The developing situation has been soberly evaluated by the Military-Industrial Commission under the Government of the Russian Federation and at the Ministry of Defense of the Russian Federation. For instance, Military-Industrial Commission Deputy Chairman O. Bochkarev stated in August 2013 that certain enterprises' order volume almost doubled and growth rates stood at 25–40% in general at enterprises of the military-industrial complex (MIC), and that "it is a hardship for our colleagues in the industry to achieve such values"<sup>6</sup>. In addition, Deputy Minister of Defense for Armament Y. Borisov confirmed during his visit to the Primorye Territory in October 2013 that "many-fold increase in the volume of works on the side of Minis-

1 Заключение Счетной палаты Российской Федерации на отчет об исполнении федерального бюджета за 2012 г. (утверждено Коллегией Счетной палаты Российской Федерации, протокол от 30 августа 2013 г. № 35К (926). № ЗСП-19/15-10. М., 2013. 491 с. [The Accounts Chamber of the Russian Federation Report on the implementation of the Federal Budget for 2012. (Approved by the Board of the Accounts Chamber of the Russian Federation, Protocol dated August 30, 2013, No. 35K (926). No. ZSP-19/15-10. М., 2013. P.491] URL: [http://asozd2.duma.gov.ru/main.nsf/\(ViewDoc\)?OpenAgent&work/dz.nsf/ByID&597281A07886E03D43257BDA004C1BB8](http://asozd2.duma.gov.ru/main.nsf/(ViewDoc)?OpenAgent&work/dz.nsf/ByID&597281A07886E03D43257BDA004C1BB8) (access date: 28.10.2013).

2 Ibid. С. 215.

3 Дмитрий Rogozin дал интервью телеканалу «Вести» по итогам селекторного совещания о гособоронзаказе. Стенограмма. М., 21 января 2013. [Dmitri Rogozin gave interview to Vesti TV channel on the results of a telephone conference on the State Defense Order. Shorthand report. М., January 21, 2013] URL: [http://government.ru/vice\\_news/296](http://government.ru/vice_news/296) (access date: 28.10.2013).

4 «Оборонка» недопоставила Вооруженным силам в 2012 г. 20% продукции // INTERFAX.RU. 2013. 25 июня. [ // INTERFAX.RU. June 25, 2013 ] URL: <http://www.interfax.ru/print.asp?sec=1448&id=314761> (access date: 28.10.2013).

5 Рабочая встреча с Заместителем Председателя Правительства Дмитрием Rogozиным. Ново-Огарево, 21 марта 2013. [A working meeting with Deputy Prime Minister of Russia Dmitri Rogozin. Novo-Ogarevo, March 21, 2013.] URL: <http://www.kremlin.ru/news/17719> (access date: 29.10.2013).

6 Деятельность Военно-промышленной комиссии и гособоронзаказ // Эхо Москвы. 2013. 12 августа. [The Military-Industrial Commission and the State Defense Order // Echo of Moscow. August 13, 2013.] URL: <http://echo.msk.ru/programs/arsenal/1132844-echo/> (access date: 28.10.2013).



try of Defense of the Russian Federation constitutes a common problem” and “qualified personnel training is our heel of Achilles”<sup>1</sup>.

It is pointless to dispute the fact that labor force has become the key factor constraining MIC output growth. According to Member of the State Duma Defense Commission A. Zhuravlev, today the Russian MIC enterprises have almost 900,000 employees (at an average age of 46) and about 440,000 are employed at research institutions (at an average age of 48), running short of engineer technologists (17%), designing engineers (22%), and blue-collar personnel (40%)<sup>2</sup>.

In spite of that, as early as June 2013 Deputy Minister of Economic Development A. Klepatch estimated approximately a 19% growth in MIC output in 2013 and a 15% annual average growth in the period between 2014 and 2016, although he admitted that “we have a huge military-industrial complex which earns very little”<sup>3</sup>. He also said that the share of the MIC “is too big indeed, accounting for as little as 5% of the industrial sector and almost one third of the machine building industry”<sup>4</sup>. It should be noted that with regard to the latter A. Klepatch totally disagreed with Deputy Prime Minister of the Russia D. Rogozin who noted some time ago that our defense sector or ‘defense segment’, as he put it, “is huge and much bigger than the rest of non-defense economy”<sup>5</sup>. Perhaps, this is why D. Rogozin defends so easily an unbridled build-up of military expenditures in the federal budget, considering the MIC the goose “that lays the golden eggs”<sup>6</sup>. According to Rogozin, “various industries show 12–14% of growth in production output, in particular

in the aircraft and shipbuilding industries, and electronics industry. Now it goes behind nothing but wage increase, but in general its increase “in the defense industry” ranged within a significant figure of 23% and 25% annually”<sup>7</sup>.

In August 2013 the Rosstat (Federal State Statistics Service) published itemized statistical data on the production account and gross value added deflators for 2011 and 2012. Though the data, of course, neither deny nor confirm the Deputy Prime Minister’s words, it allow one to assume that defense industry’s output growth within the first two years of the SAP for 2011–2020 is at least compensated by a decline in output of non-defense products in the MIC basic industries, and the aforementioned wage increase is not linked with labor productivity. Furthermore, a visible effect of termination of so called ‘price wars’ with the Ministry of Defense of the Russian Federation in the shipbuilding industry in 2012 should be highlighted.

Early in October 2013 an information leaked to mass media about likely changes to the current federal budget, in particular with regard to a Rb 35,3bn cut off in arms procurement of the Ministry of Defense of Russia and Rb 21,6bn of military pay costs, with the saved resources being allocated to capital construction related to the state armament program (Rb 43,6bn) and compensation for growth in tariffs of natural monopolies<sup>8</sup>. However, a Rb 58,6bn cut off in classified budget allocations to the Ministry of Defense of the Russian Federation in the draft Federal Law of October 22, 2013<sup>9</sup> is indicative of that the Ministry of Defense’s arms procurement will be cut off to a far greater degree than it was expected just a month ago, thereby resembling a lot the aforementioned situation with amendments to the SDO in 2012.

Both the manner in which Prime Minister D. Medvedev admitted the bias “towards financing of expenditures on the military-related component” at a meeting with members of the Board of the Council of Federation in September 2013<sup>10</sup> and the measures the Government and the Military-Industrial Commission

1 Борисов: проблема завода «Звезда» в Приморье – недостаток кадров // РИА Новости. 2013. 10 октября. [Borisov: Zvezda Plant, in the Primorye Territory, faces the issue of personnel shortage // RIANOVOSTI. October 10, 2013.] URL: <http://ria.ru/vl/20131010/968929045.html> (access date: 28.10.2013).

2 Законодательная поддержка оборонно-промышленного комплекса // Эхо Москвы. 2013. 26 августа. [Legislative support of the Military-Industrial Complex // Echo of Moscow. August 26, 2013.] URL: <http://echo.msk.ru/programs/arsenal/1142000-echo/> (access date: 28.10.2013).

3 Оборонные гарантии России // Красная звезда. 2013. 29 июня (№ 112). [Defense guarantees of Russia // Krasnaya Zvezda. June 29, 2013. (No. 112) ] URL: <http://www.redstar.ru/index.php/newspaper/item/9939-oboronnye-garanti> (access date: 28.10.2013).

4 Ibid.

5 Эксклюзивное интервью итоговой программе «Сегодня» (38’00”) // Канал НТВ. 2012. 25 ноября. [An exclusive interview to the Segodnya TV program (38’00”) // NTV Channel. November 25, 2012.] URL: <http://www.ntv.ru/novosti/372478/> (access date: 28.10.2013).

6 ОПК России: 20 лет спустя... // Военно-промышленный курьер. 2013. 9 октября (№ 39). [The Russian MIC: 20 years on... // Voенно-promyshlenny Kuryer. October 9, 2013. (No. 39). ] URL: <http://www.vpk-news.ru/articles/17722> (access date: 28.10.2013).

7 Ibid.

8 На чем сэкономит и на чем экономит новая версия бюджета-2013 // Коммерсантъ. 2013. 7 октября. [What the new version of the 2013 federal budget will save and saves on // Kommersant. October 7, 2013. ] URL: <http://www.kommersant.ru/doc/2313985> (access date: 28.10.2013).

9 Законопроект № 365264-6 «О внесении изменений в Федеральный закон “О федеральном бюджете на 2013 год и плановый период 2014 и 2015 годов”». [Draft Federal Law No. 365264-6 “On the Amendments to the Federal Law “On the Federal Budget for 2013 and the Planning Period of 2014 and 2015” ] URL: <http://asozd2.duma.gov.ru/main.nsf/%28SpravkaNew%29?OpenAgent&RN=365264-6&02> (access date: 28.10.2013).

10 Дмитрий Медведев встретился с членами Совета палаты Совета Федерации. Стенограмма. М., 23 сентября 2012. [Dmitri



proposed during this year for improving the situation with the SDO implementation (the Military-Industrial Commission Operation Headquarters (which holds weekly meetings), a SDO task team under the public prosecutor's office, an increase in legislative pressure upon those who commit violations), as well as expectations of a new version of the SDO law<sup>1</sup> to enter into force in January 2014 after the adoption of eight additional Executive Orders by the Russian Government could do nothing but create the impression of unbreakable deadlock for Russia.

Medvedev met with the members of ] URL: <http://government.ru/news/5990> (access date: 28.10.2012).

1 О государственном оборонном заказе: федер. закон Рос. Федерации от 29 декабря 2012 г. № 275-ФЗ: принят Гос. Думой Федер. Собр. Рос. Федерации 19 дек. 2012 г.: одобр. Советом Федерации Федер. Собр. Рос. Федерации 26 дек. 2012 г. // Рос. газ. — 2012. — 31 декабря. [On the State Defense Order: the Federal Law dd. December 29, 2012, No. 275-FZ: adopted by the State Duma of the Russian Federation on December 19, 2012: approved by the Council of the Federal Assembly of the Russian Federation on December 26, 2012 // Ros. Gaz. — December 31, 2012].

Therefore, the recent Military-Industrial Commission Deputy Chairman O. Bochkarev's statement about likely establishment of an auditing framework to control pricing in the Russian MIC<sup>2</sup> should be viewed with a certain hope. Perhaps, this is the chance for the Russian government authorities to finally manage to implement the idea of monitoring prices of products by their studying which was formulated in 1916 by then Ministry of Finance L. Bark, almost 100 years ago<sup>3</sup>.

2 Военно-промышленная комиссия задумалась об аудиторах цен в «оборонке» // РИА Новости. 2013. 23 октября. [The Military-Industrial Commission thinks about price auditors in the defense industry // RIANOVOSTI. October 23, 2013.] URL: [http://ria.ru/defense\\_safety/20131023/972113639.html](http://ria.ru/defense_safety/20131023/972113639.html) (access date: 28.10.2013).

3 *Воронкова С.В.* Материалы Особого совещания по обороне государства. Источниковедческое исследование. М.: Издательство МГУ, 1975. С. 162. [*Voronkova S. V.* The materials of a special national defense meeting. Historiographic study. М.: MSU Publishing House, 1975. P. 162].

## ASSESSMENT OF THE BUSINESS CLIMATE IN RUSSIA

### V.Starodubrovsky

*The Global Competitiveness Report 2013-2014 has been published. Its findings are virtually the same as in the report for the previous year which was analyzed in the Gaidar Institute's August Review. In the business climate, the most difficult situation for more than a single year has prevailed in such lines as weak protection of ownership rights, lack of independence of courts and corruption at courts, excessive state regulation burden, ineffective security of an individual, low level of corporate culture, weak competition, preservation of administrative barriers and high tax burden and inconsistent taxation. In other words, all the factors which make business feel insecure about the future and determine an underlying motive to withdraw capital abroad rather than invest in development of business in Russia still remain in place. A favorable situation is registered in macroeconomics (as long as prices on hydrocarbons do not fall) and quite a good one in the infrastructure (unless the situation with motor roads is considered a failure), secondary and higher education and retraining. Generally, Russia moved from the 67<sup>th</sup> place to the 64<sup>th</sup> place (the 63<sup>rd</sup> place in 2010 and the 51<sup>st</sup> place in 2008). It is to be noted that improvement also took place in the most painful aspects of the business climate though there were no explicit progress factors. The higher rating place can be explained by both expectations, including those not to change taxes and a certain lag of published materials from the statistical data and some information events in 2013. The Report fairly represents the realities of 2012 and, partially, till the middle of 2013.*

The recently published Global Competitiveness Report 2013–2014 includes the updated data on **The Global Competitiveness Index**<sup>1</sup>. The above research provides the most comprehensive evaluation of various aspects of the business climate. The latest Report covers 148 countries against 144 countries last year.

The analysis of the institutional environment with utilization of different ratings was provided in the August 2013 review by the Gaidar Institute<sup>2</sup>. The main conclusion consists in the fact that in the present situation the private business is not confident in its future, primarily, due to unsatisfactory protection of ownership rights, lack of independence of courts and abuse

of power by the judicial system and pervasive corruption. The above factors cause mistrust of the authorities and apprehension to make large investments and prompt the business to withdraw its capital from the country. Also, the inhibiting factor is a weak competition, considerable administrative barriers faced by businessmen and inconsistent rules of regulation of the economy.

In the latest Global Competitiveness Report, the situation in Russia is assessed somewhat better than in the previous one though all the problems still prevail. Russia moved three positions upward from the 67<sup>th</sup> place to the 64<sup>th</sup> place. That rating is better than in 2011<sup>3</sup> (the 66<sup>th</sup> place), but worse than in 2010 (the 63<sup>rd</sup> place). The level of the index itself rose insignificantly, too, from 4.2 to 4.25 (with the maximum value of 7, the highest value (5.67) was achieved by Switzerland). Switzerland was followed by Finland (5.54), Germany (5.51) and the US (5.48). At the bottom of the index, there are Sierra Leone (3.01), Yemen (2.98) and Guinea (2.91). Russia's best index level was registered before the crisis of 2008 when it occupied the 51<sup>st</sup> place.

Dynamics of the index of competitiveness and places occupied by Russia by the main blocks and groups of factors are shown in *Table 1*. As seen from the table, the most explicit advance took place (no matter how strange it might be) as regards the block which includes the factors of innovation and the quality level of doing business: from the 108<sup>th</sup> place to the 99<sup>th</sup> place

1 The Global Competitiveness Report 2013-2014. Full Data Edition. [http://www3.weforum.org/docs/WEF\\_GlobalCompetitivenessReport\\_2013-14.pdf](http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2013-14.pdf) The Global Competitiveness Index is developed under the auspices of the World Economic Forum (WEF) on the basis of both the statistical data and the global survey of managers of enterprises with assistance of 150 partner-entities. The index deals with 114 aspects of competitiveness which are united into 12 major groups of factors (benchmarks) which are divided in their turn into three blocks: baseline conditions, efficiency factors, innovation and the quality of performance. About two-thirds of the aspects of competitiveness are determined on the basis of surveys. The index is determined in absolute terms and varies from 1 to 7 (from the low level of competitiveness to the highest one; the respondents in different countries are normally asked to use the above scale to evaluate each aspect of competitiveness and the obtained outputs are subsequently weighted in accordance with the adopted methods to determine the aggregate index) and the country rating is specified as its line number.

2 See. V. Starodubrovsky. The State of the Business Climate in the Country. The Economic Development of Russia. No. 9, 2013, pp. 55–62.

3 The first year – from among those specified in the reports – which the collected information actually refers to will be used.

which is nowhere near the place of honor, but, nonetheless, was an advance nine positions upward. It is to be noted that prior to 2012 Russia occupied higher places in the index. The index improved somewhat as well (from 3.2 to 3.3), but it remains rather low. The unit weight of that block of factors which determines the influence on the general competitiveness index amounts in accordance with the adopted methods to 23.1%. Baseline conditions – the 47<sup>th</sup> place against the 53<sup>rd</sup> place in the previous year with a great dispersion of estimates of the groups of factors inside that block – were evaluated somewhat higher, too. It is to be noted that that place was the best one for the years specified in the table.

The block's unit weight amounts to 26.9%. The block of efficiency factors whose unit weight amounts to 50% advanced three positions upward from the 54<sup>th</sup> place to the 51<sup>st</sup> place, though before the crisis its positions were better. Within the block, the difference in estimates of individual groups of factors is rather high, too.

Also, the table provides an idea of the dynamics of more favorable and backward spheres of the economy which competitiveness depends on. If the explicit advantage in the scale of the market is put aside – which advantage among other things is an attractive factor for foreign investments and makes many Western companies be ready to invest in the Russian economy should other conditions improve – the **macroeconomic environment** is worth paying attention to (as regards macroeconomic environment Russia is rated the 19<sup>th</sup> and has the highest index (5.9) among all the groups of factors). The estimate is entirely based on the official data and not on the surveys. The main advantages are related to the low level of the state debt in relation to GDP where Russia is rated the 10<sup>th</sup> (though in 2012 and 2011 it held the 9<sup>th</sup> place and the 7<sup>th</sup> place, respectively) and has quite a favorable balance of the state budget (the 23<sup>rd</sup> place against the 20<sup>th</sup> place in 2012). At the same time, the above example illustrates vulnerability of mechanical utilization of the statistical data as in conditions of dependence on hydrocarbons the soundness of the budget system is not quite reliable and actually remains rather strained. The above is pointed to by a reduction of expenditures – that reduction is planned in the 2014–2016 budget – which measure though a delayed one is still very important. As regards the credit rating, Russia is rated the 39<sup>th</sup> though before the crisis it was rated the 10<sup>th</sup>. When exiting the crisis, Russia moved downwards to the 49<sup>th</sup> place. The worst thing in that group – evaluation of the rate of inflation – was the 91<sup>st</sup> place; it is to be noted that in 2012 the inflation rate (December on December) was par-

ticularly low and amounted to 5.1%. In 2011, Russia held the 111<sup>th</sup> place, while in 2010, the 125<sup>th</sup> place.

The next one in the group of factors is **infrastructure** where Russia is rated the 45<sup>th</sup> though it is the best result in the years under review. Russia's standing in that group suffers due to a poor quality of motor roads: the 136<sup>th</sup> place and the worst index (2.5) from among the entire 114 factors of competitiveness. The quality of the railway infrastructure is rated better – the 31<sup>st</sup> place – however, as regards infrastructure of ports and airline service it is rated the 88<sup>th</sup> and 102<sup>nd</sup>, respectively. So, as regards the general quality of infrastructure Russia is rated 93<sup>rd</sup> with a low index of 3.8. However, in the past three years the situation was even worse. The entire group is propelled to a higher level thanks to the extent of density of mobile phones (the 6<sup>th</sup> place) and seat capacity of airline service (the 11<sup>th</sup> place).

**The secondary and higher education and retraining** is rated 47<sup>th</sup> with the index of 4.7. The above position is primarily ensured by a large number of students at higher education establishments (the 14<sup>th</sup> place), availability of the Internet at schools (the 54<sup>th</sup> place) and the quality of mathematical and science education. As regards other factors of that group, Russia's positions are worse than generally in the Global Competitiveness Index. It is to be noted that as regards retraining of personnel and the quality of management schools Russia is rated the 88<sup>th</sup> and even the 113<sup>th</sup>, respectively. Interestingly, as regards the **education and primary education** group of factors Russia's index is much higher (5.7) than that of the secondary and higher education and retraining, however the 71<sup>st</sup> place is the worst one in the years under review. It means that a larger number of countries is more successful and quick at making progress in that area. However, in that group evaluations of specific aspects of competitiveness are almost entirely based on the statistics data and the zero incidence rate of malaria – which permits to share the first place as regards that factor with a number of other countries – plays a particular role. However, as regards child mortality, the TB incidence rate and life expectancy Russia is rated the 58<sup>th</sup>, the 94<sup>th</sup> and the 101<sup>st</sup>, respectively. The quality of primary education is evaluated on the basis of surveys and Russia is rated the 61<sup>st</sup> with the index of 4.1, that is, lower on average than that as regards the secondary and higher education and retraining.

Now, let us discuss factors related directly to the institutional environment and the business climate. The parameters of individual aspects of that environment are included in different groups of factors. Let us begin from those which are included in evaluations of the **efficiency of the commodity market**. As regards the above criterion, Russia is rated the 126<sup>th</sup> of all the

Table 1

## CHANGES IN THE GLOBAL COMPETITIVENESS INDEX AND THE MAIN GROUPS OF ITS FACTORS FROM 2007 TO 2013

	2007–2008 (131)*		2008–2009 (134)		2009–2010 (133)		2010–2011 (133)		2011–2012 (142)		2012–13 (144)		2013–14 (148)	
	Place	Index	Place	Index	Place	Index	Place	Index	Place	Index	Place	Index	Place	Index
Global Competitiveness Index	58	4.19	51	4.31	63	4.15	63	4.24	66	4.21	67	4.2	64	4.25
Baseline conditions	68	4.4	56	4.5	64	4.4	65	4.5	63	4.6	53	4.8	47	4.9
Institutes	116	3.1	110	3.3	114	3.2	118	3.2	128	3.1	133	3.1	121	3.3
Infrastructure	65	3.5	59	3.7	71	3.6	47	4.5	48	4.5	47	4.5	45	4.6
Macroeconomic environment	37	5.4	29	5.6	36	5.2	79	4.5	44	5.2	22	5.8	19	5.9
Healthcare, education and primary education	60	5.5	59	5.6	51	5.6	53	5.9	68	5.7	65	5.7	71	5.7
Efficiency factors	48	4.2	50	4.3	52	4.2	53	4.2	55	4.2	54	4.3	51	4.3
Secondary and higher education and retraining	45	4.3	46	4.4	51	4.3	50	4.6	52	4.5	52	4.6	47	4.7
Commodity market efficiency	84	3.9	99	3.9	108	3.7	123	3.6	128	3.6	134	3.6	126	3.8
Labor market efficiency	33	4.7	27	4.7	43	4.7	57	4.5	65	4.4	84	4.2	72	4.3
The extent of development of the financial market	106	3.6	112	3.6	119	3.3	125	3.2	127	3.2	130	3.2	121	3.4
Technological efficiency	72	3.0	67	3.4	74	3.4	69	3.6	68	3.7	57	4.1	59	4
Market scale	9	5.5	8	5.7	7	5.8	8	5.7	8	5.7	7	5.8	7	5.8
Factors of innovation and quality of doing business	77	3.5	73	3.6	73	3.5	80	3.4	97	3.2	108	3.2	99	3.3
Quality of doing business	88	3.7	91	3.7	95	3.6	101	3.5	114	3.3	119	3.3	107	3.6
Innovations	57	3.3	48	3.4	51	3.4	57	3.2	71	3.1	85	3	78	3.1

\* The number of countries researched is specified in brackets.

Source: <http://www.weforum.org/>

groups of factors (with the index of 3.8). The above low position is determined primarily by institutional conditions. **The level of competitiveness.** As regards the extent of competitiveness on the domestic market, Russia is rated the 113<sup>th</sup> with a fairly good index of 4.5 against the 124<sup>th</sup> place in 2012 and 2011 and the 106<sup>th</sup> place in 2009, as regards the extend of domination on the market, it is rated the 93<sup>rd</sup> with the index of 3.5 though a year before it was rated the 107<sup>th</sup>, as regards the efficiency of anti-trust policy it was rated the 116<sup>th</sup> (the index of 3.5) against the 124<sup>th</sup> place and the 111<sup>th</sup> place in 2012 and 2011, respectively. Despite the occasionally favorable dynamics, the level of competitiveness is still estimated at a very low level. **Taxation.** As regards the effect of taxes on motivation of investments, Russia is rated the 125<sup>th</sup> (the index of 3), while as regards the general level of taxation in relation to profit Russia backtracks to the 124<sup>th</sup> place against the 105<sup>th</sup> place and the 88<sup>th</sup> place in 2012 and 2009, respectively. **Barriers faced by the business.** The situation with a start-up of business is somewhat better, though it is still far away from being favorable. As regards the number of procedures required for starting business, Russia holds the 88<sup>th</sup> place against the 97<sup>th</sup> in 2012, though it was rated the 27<sup>th</sup> in 2007. As regards the number of days spent on execution of documents, it is rated the 78<sup>th</sup> against the 104<sup>th</sup> place and the 57<sup>th</sup> place in 2012 and 2007, respectively. As regards the extent of foreign trade barriers it is rated the 124<sup>th</sup> against the 132<sup>nd</sup> place in 2012, as regards the level of customs tariffs – the 103<sup>rd</sup> place against the 106<sup>th</sup> place in 2012 and as regards the burden of customs procedures, the 124<sup>th</sup> place against the 132<sup>nd</sup> place in 2012. Even some improvements in the foreign economic regulation related, probably, with Russia's accession to the WTO do not ensure progress which can be assessed as normalization of the situation. As regards the extent of foreign property, Russia occupies the 132<sup>nd</sup> place against the 133<sup>rd</sup> in 2012.

In the group of factors related to the **labor market efficiency**, the estimate of the effect of taxation on labor motivation was introduced. As regards that criterion, Russia is rated the 122<sup>nd</sup> with the index of 3, that is, the worst value from the entire group of factors. Not surprisingly, if the situation with insurance contributions, including those for individual entrepreneurs is taken into account.

The group of factors related to **development of the financial market.** As regards availability of financial services Russia moved upwards from the 117<sup>th</sup> place in 2012 and the 119<sup>th</sup> place in 2011 to the 91<sup>st</sup> place in 2013. As regards availability of loans, it shifted from the 86<sup>th</sup> place to the 68<sup>th</sup> place (the 91<sup>st</sup> place in 2011 and the 107<sup>th</sup> place in 2010). However, as regards, reli-

ability of banks Russia is rated the 124<sup>th</sup> with the index of 4, which is better than the 132<sup>nd</sup> place with the index of 3.8 in 2012 and the 129<sup>th</sup> place in 2011 and 2010, but still regrettable.

And, finally, the group of factors related to **institutes.** As regards **protection of ownership rights**, as in 2012 Russia is still at the disappointing 133<sup>rd</sup> place with the lowest index which rose, however, a bit from 2.8 to 3, while as regards protection of intellectual property Russia moved from the 125<sup>th</sup> place to the 113<sup>th</sup> place with the index of 2.9. As regards **independence of courts**, the country moved from the 122<sup>nd</sup> place to the 119<sup>th</sup> place with the index of the mere 2.7. As regards **corruption**, particularly, illegal payments and grafts, the thing which one can hardly call the progress is expressed in Russia's advance from the 120<sup>th</sup> place to the 109<sup>th</sup> place (the index of 3.2), while as regards siphoning-off of state funds, an advance from the 126<sup>th</sup> place to the 113<sup>th</sup> place (the index of 2.5 is the lowest in that group of factors). **The state and state regulation of the economy.** As regards people's confidence in politicians, Russia is rated the 84<sup>th</sup> (the index of 2.7), while a year earlier – the 86<sup>th</sup> place; as regards, favoritism in decisions of government officials – the 111<sup>th</sup> place (2.6) against the 127<sup>th</sup> place earlier, as regards squandering of state funds – the 99<sup>th</sup> place (2.8) against the 103<sup>rd</sup> place; as regards transparency of the state policy – the 101<sup>st</sup> place (3.8) against the 124<sup>th</sup> place in the previous year (the 101<sup>st</sup> place is the best place in the years under review); as regards efficiency of the debate support system the 118<sup>th</sup> place (3) against the 124<sup>th</sup> place and as regards the burden of state regulation – the 120<sup>th</sup> place (2.9) against the 130<sup>th</sup> place. All the above aspects point to the fact that the situation has improved, but remains sensitive which factor reflects high but not critical mistrust of the authorities on the part of the business. **Protection of an individual.** As regards business's losses from crimes and violence: the 80<sup>th</sup> place with the index of 4.5 against the 90<sup>th</sup> place in the previous year, as regards business's losses from terrorism – the 112<sup>th</sup> place, 4.7 and the 119<sup>th</sup> place, respectively; as regards organized crime – the 111<sup>th</sup> place, 4.2 and the 114<sup>th</sup> place and as regards reliability of police services – the 122<sup>nd</sup>, 3 and the 133<sup>rd</sup> place. In accordance with the same scheme – parameters of the **level of corporate relations:** as regards companies' ethic behavior – the 101<sup>st</sup> place, 3.7 and the 119<sup>th</sup> place, as regards the level of standards of reporting and audit – the 107<sup>th</sup> place, 4 and the 123<sup>rd</sup> place, as regards efficiency of boards of directors – the 98<sup>th</sup> place, 4.3 and the 124<sup>th</sup> place, as regards protection of minority shareholders – the 132<sup>nd</sup> place, 3.3 and the 140<sup>th</sup> place and as regards protection of the interests of investors – the 100<sup>th</sup> place,



4.7 and the 94<sup>th</sup> place. Estimates of efficiency of boards of directors improved, while estimates of protection of investors' interests became worse.

As a result, it can be repeated that the most acute problems related to the business climate still remain the same for more than a single year: weak protection of ownership rights, lack of independence of courts and corruption at courts; corruption, excessive burden of state regulation, inefficient protection of an individual, low level of corporate culture, weak competition, maintenance of administrative barriers and high and inconsistent taxation. In other words, all those factors which make business feel unsecured about its future and determine the dominating motive to withdraw the capital abroad, rather than invest it in Russia are still in place.

The estimates of the main factors which impede doing business have changed a little. In all the years under review (from 2008), corruption was on the top of the list. In 2012, it accounted for 20.5% of the answers of managers of enterprises (it is to be noted that only one factor was asked to be named). It is followed by inefficiency of state bureaucracy (half as many answers) – 11.9%, availability of funding (10%) and the level of taxation (9.3%). In 2013, corruption accounted for 19.1%. It was followed by the level of taxation (13%), tax regulation (10.7%) and inefficiency of state bureaucracy (9.8). So, the business has started to experience more dramatically tax-related problems which situation is not surprising due to a short-sighted and inconsistent policy as regards insurance contributions.

Though the estimates of the main aspects of the business climate are quite disappointing, there is a question what factors were behind the explicit improvement of those estimates despite the fact that they are still far from those Russia used to receive in the recent past. The outputs of surveys of managers of enterprises used in formation of the index provide an idea about the opinion of those managers, but not the factors that opinion is justified with. So far, there is no explicit evidence of improvement in the institutional environment. One may suggest the effect of a number of factors. It is primarily hopes and expectations which play an important role in the economy. For example, an authoritative statement was made that the tax system was not going to be changed in the foreseeable future. The above statement is important not only in connection with explicit growth in a devastating tax burden on business, but also in broad terms: it is believed that business may adapt to any conditions provided that they are stable. Some hopes may be related to identification of large-scale corruption crimes (though investigations of those cases sooner raise more questions than provide answers) and the work

on road maps aimed at reduction of barriers which impede doing business.

However, discussion of the work on road maps at the government meeting on September 23 showed that the progress was far from being satisfactory. Only 83 measures (less than a half) out of 173 measures in respect of which the deadline took place were carried out, 37 measures were still in progress, while 52 measures (about one-third) failed to be fulfilled<sup>1</sup>. The above road maps are aimed at upgrading of procedures which are reflected in the rating of the World Bank and *Doing Business*, an international financial corporation. As was shown in the previous report, though making of those procedures simpler is of utmost importance they do not cover the most painful aspects of the business climate related to protection of property, the state of the judicial system, corruption and other, so, even a breakthrough in that sphere may not be sufficient enough to have an effect on the situation.

Surveys on competitiveness were carried out earlier than important developments of the recent past took place: a verdict to A. Navalny was regarded by many as another abuse of power by the judicial system which situation resulted in a huge spontaneous meeting in the center of Moscow, election results of the Mayor of Moscow and the low voting turnout in regions where elections were held. The above developments reflect the extent of the risk of explosion of the sociopolitical situation in the country which situation cannot but affect the business climate. But the above developments were left beyond the frameworks of the Report in question. However, rational processes such as reduction of expenditures of the state budget and limitation of growth in prices of natural monopolies take place simultaneously.

With an insignificant number of managers of enterprises surveyed in Russia – about 100 – the dynamics of estimates can be influenced both by a relatively small change in their composition or a change in the opinion of a relatively small number of those managers.

Finally, though it is announced that in global competitiveness reports a year following the year of publication is analyzed, they actually reflect the reality with a delay. For example, if the 2013-2014 report came out in 2013 there was no statistical data available for that year, so the 2012 statistical data was utilized. That delay is explicitly shown in *Table 1*. The year 2009 was the most difficult crisis year in Russia, but apparent worsening of such aspects of competitiveness as the macroeconomic environment, the state of institutes and efficiency of the main markets started in 2010. So, the realities of 2013 can be adequately judged after the next report is published in 2014. ●

1 <http://government.ru/news/5951>

## THE REVIEW OF THE MEETINGS OF THE GOVERNMENT OF THE RF IN OCTOBER 2013

M.Goldin

*In October, at the meetings of the Government of the Russian Federation the following issues were discussed among other things: a draft law introducing the requirements for gradual transformation of participants in the market of nongovernment pension funds into joint-stock companies; a draft law setting a limitation on the amount of a severance benefit of managers (chief accountants) of public sector entities.*

**On October 10**, the draft law on Amendment of the Federal Law on Nongovernment Pension Funds and Individual Statutory Acts of the Russian Federation was considered. The draft law is actually meant to carry out a forced transformation of most nongovernment pension funds (hereinafter – NPF) which are non-profit organizations as of that day into joint-stock companies.

The above goal will be attained by the following means. Firstly, from January 1, 2014 a ban will be introduced by the federal law (if approved) on establishment of new nongovernment pension funds in the form of non-profit organizations. Secondly, reorganization of the existing non-profit NPF will be limited to mergers and affiliations. From July 1, 2014, NPF will be able to carry out restructuring only by means of transformation into joint-stock companies. In addition to the above, until January 1, 2016 NPF which are non-profit organizations and carry out activities as an insurer of the mandatory pension insurance are subject to transformation into joint-stock companies or in accordance with the federal law into another form of a profit-making organization or be liquidated. As the activities in the capacity of insurer of the mandatory pension insurance are the most important ones, it means that there will be virtually no nonprofit NPF left.

The fact that the existing NPF are non-profit entities of unitary nature entails a number of unsolvable problems starting from the issue of realization by actual beneficiaries of NPF of control over the activities of NPF to the problems related to determination of sources of funding of an actuarial deficit. Transformation of NPF in joint-stock companies is meant to solve the above problems.

The draft law was approved and submitted to the State Suma of the Russian Federation.

**On October 25**, draft federal law on Amendment of the Labor Code of the Russian Federation as Regards Setting of the Amount of Compensations and Sever-

ance Benefits Due to Termination of a Labor Contract to Individual Categories of Workers of State-Run Corporations, State-Owned Companies, State Unitary Companies and Economic Entities in Which Over 50% of Equities (Interests) in the Charter (Pooled) Capital is Owned by the State was discussed at the meeting of the Government of the Russian Federation.

The draft law was developed and submitted to meeting of the Government of the Russian Federation by the Ministry of Labor and Social Protection of the Russian Federation.

If approved the draft law provides for limitation of the amount of compensations and severance benefits paid to chief executives, deputy chief executives, chief accountants and members of entities' collegiate executive bodies.

The draft law is meant to introduce such amendments into the Labor Code of the Russian Federation (hereinafter – the LC of the RF) as set limitations on the amount of the compensations and severance benefits to chief executives, deputy chief executives, chief accountants and members of the collegiate executive body of state-run corporations, state-owned companies, state unitary enterprises and economic entities in which over 50% of equities (interests) in the charter (pooled) capital is owned by the state.

Payments are limited by the amount which is no less than a threefold average monthly pay and no more than a sixfold one.

Payment of compensations and severance benefits to the above categories of individuals is provided for in the following cases: due to a change of the owner of the entity's property (Article 81 (1), (4) of the LC of the RF);

Due to taking of a decision by the company's authorized body or owner of its property or a person (body) authorized by the owner on early termination of the labor contract (Article 278 (2) of the LC of the RF). ●

## REVIEW OF TAXATION REGULATORY DOCUMENTS ISSUED IN THE PERIOD OF SEPTEMBER THRU OCTOBER 2013

L.Anisimova

*Although the latest period saw failure in coping with economic stagnation in Russia, it should be noted that Russian's economy demonstrated a good stress resistance. In our opinion, this can be indicative of its gradual adaptation to the market. The 'budget rule' has proved efficient – the fiscal relations system didn't collapse due to high water in the area of Amur River; Pushkino Bank's (the Moscow Oblast (Region)) sudden bankruptcy required no extra infusion of public funds and was localized with the resources allocated by the Deposit Insurance Agency. This is all indicative of that protection mechanisms of public finances were actuated in a proper manner in emergency, there was no need to increase tax burden or resort to unscheduled emergency-related fundraising. The key topic of discussion in the period under review a new pension formula and proposal to use its funded component to finance pay-as-you-go system in 2014. Furthermore, certain tax initiatives which needs to be polished were discussed in the economic process.*

The pension reform decision whose principal target is mitigate the deficit in the Pension Fund of the Russian Federation (PFR) by reallocation of the funded component of a pension is intended to ensure sustainability of the budget system and undercut the inflation effect of the funded component. In our opinion, it was the only good decision that could be accepted under the current circumstances<sup>1</sup>. At the same time,

<sup>1</sup> For reference: Rb 12,8 trillion federal budget revenues in 2012 (Federal Law No. 254-FZ dd. 30.09.2013) included Rb 2,8 trillion of inter-budget transfers to the PFR's budget. Total PFR's revenues (Rb 5,9 trillion) included Rb 3 trillion of social insurance contributions payable to the PFR (Federal Law No. 255-FZ dd. 30.09.2013), i.e., 22% of federal budget revenues were allocated to finance the PFR, accounting for 47.5% of total PFR's revenues. It will be recalled that the funded component (6%) transferred to the banking system accounts for about 1/3 of social insurance contributions to the PFR. The gap in funding current expenditures is additionally covered with budget transfers, thereby setting up the tax pressure. Some disagree with the pension innovations offered by the Russian Government – see, Е. Гонтмахер, «Народ, деньги есть? А если найду?», сайт МК.ru от 6.10.2013 [Е. Gontmaher, "People, do you have money? What if I say you do? МК.ru dd. 6.10.2013] МК.ru/free-theme/article/2013/10/06/926187.

In our opinion, there is one thing that the ongoing discussion on pension ignores – the social insurance contributions rate which accounts for 30% of the payroll – marginal acceptable rate which ensures neutrality in allocation of a brand new product (save for profit) among the three generations for the purpose of simple reproduction: the middle age generation have to pay from their salary to maintain themselves, the younger generation, and the older generation. Should the resources accrued according to this proportion are insufficient to maintain the older generation, the increase in such resources would 'merely' result in reduction of the resources of younger generations, being similar to self destruction of the society. This is why, in spite of all the reproaches regarding non-expediency of the refusal in 2014 to transfer the funded component under individuals' control, we believe that it is only the balance between current contributions to and payments from the Fund, with a marginal limit on the social insurance contribution rate (30% of the payroll), that can be the initial point of the pension reform.

restoration of the balance between the PFR's current revenues and expenditures makes it possible to launch a discussion about whether it is reasonable or not to replace the source of insurance contributions by carrying such contributions from corporate costs over to employees' salary and emoluments and other personal incomes. This could resolve many issues and, above all, optimize the amount of such contributions, discontinue unjustified benefits for certain categories of employees, release ungrounded tax pressure upon the cost of goods (works, services), ensure predictability of investment-related costs incurred by manufacturers. Changes to the source of insurance contributions will definitely have to be explained to the effect that it would have no adverse impact upon real wages (because in nominal terms the latter will simply be raised by the amount of insurance contributions), as well as require addressing the issue of nondiscrimination of migrants and subsequent creation (under certain circumstances) of pension liabilities to migrants. Increase in both the retirement age and pensionable amount of compulsory seniority, as recommended by the IMF, could seriously mitigate the issue.

In our opinion, changes to the source of contributions payable to public social insurance extra-budgetary funds could be the most significant precondition for restoring congenial investment climate in the Russian Federation.

The PFR's share in social insurance contributions is 22% / 30% = 73.3%. The marginal amount that can be mobilized in the PFR = 75 million of employed x 30,000 average monthly salary x 12 months. X 30% x 73.3% = Rb 5,9 trillion. This amount exactly corresponds to the PFR's revenues in 2012, i.e., much as they would like to retain the funded component, under the current circumstances it 'breaks through' a 30% marginal restrictive rate on social charges, because of the need to provide additional compensation with budget funds for the uncovered current expenditures to pay pensions.

Special attention should be focused on a few other issues that received coverage in economic publications.

A proposal to exempt from taxation capital gains with regard to government bonds<sup>1</sup> was made once again, 17 years on after the crisis in 1998. It will be recalled that at that time tax exemption of the income generated from the GKO (Government Short-Term Commitments) bid-offer spread<sup>2</sup> in the secondary market facilitated a higher-than-anticipated growth in the demand for these government bonds<sup>3</sup> and eventually resulted in insolvency of the state. This is why, in our opinion, an exemption from capital gains tax with regard to bonds would be quite a hasty measure. Should the bid-offer spread be subject to tax exemption, the budget might be exposed to a specific risk, in which case profit tax allowance would be unlimited in terms of volume. Tax allowance on the income (interest/discount) predetermined (preset) during securities issue is confined to the amount of such income (interest rate/discount), IPO price or stated interest limits, and has no such devastating effect as the exemption from capital gains tax with regard to securities<sup>4</sup>.

1 «Минфин освободит от налогов доходы от государственных облигаций», сайт lenta.ru от 9.10.2013. «...Сейчас российские компании платят 15 процентов с купонного дохода и 20 процентов от прироста стоимости облигаций. В то же время иностранные инвесторы от этого налога освобождены». [“Minfin will provide tax exemption on the government bond income”, lenta.ru website dd. 9.10.2013. “...Russian companies currently pay 15 percent from the coupon yield and 20 percent from capital gain on bonds. However, foreign investors are exempted from this tax”.]

2 Issued according to the Council of Ministers’ Order, the Russian Government dd. 8.02.1993, No. 107.

3 See p. 4, the Letters issued by the State Tax Service of Russia (hereinafter referred to as the STC RF) No. NP-6-01/362 dd. 23.09.1994; the Ministry of Finance of Russia No. 130 dd. 21.09.1994; registered with the Ministry of Justice of Russia on November 3, 1994, No. 719 (as amended in 1995): “...имеются льготы по следующим доходам (полностью освобождаются от налогообложения): ...сумма дисконта (положительная разница между балансовой стоимостью и ценой реализации (погашения) государственных краткосрочных бескупонных облигаций), включая их реализацию на вторичном рынке...” [“...there are tax allowances on the following types of income (totally exempted from taxation): ... the discount amount (positive difference between the book value and the redemption price of the government short-term zero coupon bonds), including their realization in the secondary market...”].

4 Qualifying interest for allowance means nothing but economically unreasonable refusal of the state to receive the taxes due to the state, in particular on Eurobonds – interest recipients are not exempted from taxation at their place of fiscal residence. With regard to the bid-offer spread tax exemption, securities constitute movable property, and under double taxation conventions the movable property is subject to taxation at the place of fiscal residence of the owner (seller) of such movable property. In other words, it is a simple application of double taxation conventions rather than a special privileged taxation regime established in Russia for foreign nationals, as presented by the authors of some publications.

The issue of (at least partly) reallocation of income related to personal income tax<sup>5</sup> withheld by the employer at the employee’s work place and payable to the budget at the employee’s place of residence has sharpened again. A draft law introducing changes to the personal income tax payment scheme was submitted to the State Duma of the Russian Federation for consideration. Members of the Murmansk Regional Duma (the region is facing labor migration outflow) proposed that contributions be payable at the individuals’ place of residence rather than the place of registration of the entity in which they are employed. Not surprisingly, the initiative encountered stubborn opposition on the side of the Ministry of Finance of Russia and a few members of the State Duma Budget Commission (in particular, Dmitrieva O. G.). Those who oppose the initiative have the same old arguments they provided before – the initiative is technically difficult, costly, and unreasonable.

As a matter of fact, the feasibility issue refers to economic issues. Obviously, there is no direct economic contradiction in paying a most secure and conflict-free tax to the budget at the individual’s or his/her family’s<sup>6</sup> place of residence, quite the opposite, it is economically unreasonable not to do that. In our opinion, designing a fiscal system should be based on the prevalence of the principle of equity, and personal income tax should be at least allotted among the budget at the place of employment and residence of the individual. Such arguments as technical complexity and high cost are vicious in the era of advanced Internet. The technical complexity that will be shown below can be surmounted, and the individual will neither have to personally visit the tax office to file his/her tax return nor transfer the tax to his/her regional budget.

To technically resolve the issue, a few steps should be taken, as follows:

1) Since TIN (Taxpayer Identification Number) may be assigned only once and cancelled upon taxpayer’s death, it should be complemented with two additional

5 Т. Ширманова, «Депутаты предлагают платить подоходный налог по месту жительства. Идея, которая подверглась критике министерств, опять представлена на рассмотрение Госдумы», сайт izvestia.ru от 7.10.2013 г. [T. Shirmanova, “MPs suggest income tax be paid at the taxpayer’s place of residence. The idea which faced criticism of ministries has again been submitted to the State Duma for consideration”, izvestia.ru website dd. 7.10.2013.]

6 All the more so, introduction of the real property tax was postponed for at least a year, because of the difference between abutting real property owners’ income and unmatched data of the Russian State Register and the Federal Tax Service of Russia (hereinafter – the FTS RF).

See also: Д. Ивашкина, «Минфин на год отложил введение налога на недвижимость», сайт kp.ru от 18.10.2013 [D. Ivashkina, “Minfin postpones the real property tax for a year”, kp.ru website, dd. 18.10.2013]



TRRCs (Tax Registration Reason Code) for individuals – at the place of permanent residence (permanent registration, registered domicile) and for each place of employment (by the way, every individual already has more than one TRRCs – at the place of registration of immovable property and motor vehicles)<sup>1</sup>;

2) include a certificate issued by the local tax inspectorate on the submission of the TRRC application at the new place of permanent residence (registered domicile or permanent registration) into the list of documents to be submitted to the Resident Registration Office for the purpose of domicile registration (registration at the permanent place of residence);

3) the individual must provide the accounting office at every place of employment with a certificate bearing the TRRC number at the permanent place of residence (registered domicile or permanent registration) issued by tax authorities;

4) post information on the nalog.ru website about all TRRCs linked to the taxpayer's (physical body's) TIN.

This is for a reason that we only refer to the personal income taxpayer's place of permanent residence (registered domicile or permanent residence): if the individual hires an apartment or a room to be able to live as close as possible to his/her place of employment, he/she pays a rent to the owner of the apartment (room), and the latter as separate taxpayer is to pay the rent income tax to the budget at the place of his/her residence. This is why, in our opinion, no confusion or difficulties whatsoever can be encountered in allocating the personal income tax charged by the employer and its partial redirection to the budget according to the TRRC at the employee's place of permanent residence.

Following are the documents that came into force in the period under review and play an important role in the regulation of taxation and are worth describing.

1. The Federal Law dd. 30.09.2013, No. 260 "On the Amendments to Part 3 of the Civil Code of the Russian Federation". This Federal Law plays a special role in determining the rules for selecting a legislation in resolving the issues concerning the commencement, execution and transfer of ownership rights, exercise the title and property right, contractual right in the course of operation of foreign legal entities on the territory of the Russian Federation, settlement of property disputes which may arise.

In particular, the Federal Law establishes that if a foreign legal entity operates predominantly on the

territory of the Russian Federation, liability under the commitments assumed by its founders (interest holders) and other persons authorized to give binding orders are subject to the Russian law or, as the creditor may choose, the personal law of such legal entity (Article 1202, Paragraph 2, Subparagraph 9 thereof).

Articles 1205–1207 specify the concept of, the property covered by, and the procedure for exercising the property right. In particular, it is established that commencement and termination of ownership rights and other rights to a property shall be determined under the law of the country where the property was located at the moment when the action or any other fact took place, giving rise to the commencement or termination of ownership rights and other property rights, unless otherwise stipulated by the law. In other words, foreign legal entities may not sell a real property situated on the territory of the Russian Federation under laws other than the law of the Russian Federation, because such a deed is simply declared null and void under the law of the Russian Federation.

Article 1210 establishes that imperative norms of law prevail, and in the conclusion of an agreement the parties thereto may not discretionary choose for the conclusion of the agreement and settlement of disputes the norms of law of a country whose territory is extraneous to all the facts related to the subject matter of relations between the parties thereto.

Articles 1222, 1222.1 establish the law of the state to govern liabilities arising due to unfair competition, restriction of competition, liabilities arising due to unfair conduct of negotiations on the conclusion of an agreement, etc.

2. The Federal Law dd. 30.09.2013 No. 267-FZ makes amendments to the Tax Code of the Russian Federation (hereinafter referred to as the TC RF) with regard to the specifics of taxation of regional investment projects implemented in the Far Eastern District, the Zabaikalye Territory, the Irkutsk Region, and the Buryat Republic.

The concept of 'regional investment project participant' was introduced. The taxpayer may be entitled to tax allowances if the taxpayer is recognized as a participant of such a project and the project is not designed to produce (process) crude carbohydrates, manufacture excisable goods (save for motor cars and motor bikes). Project's lifespan and payoff period depends on the volume of capital investments: six years of project's lifespan are established if capital investments of Rb 50–499m are made within three years, and 10 years of project's lifespan are established if capital investments of more than Rb 500m are made within five years. Taxpayers who obtain the status of investment

1 The Order of the Ministry of Finance of Russia and the FTS RF dd. 29.07.2012, No. MMV-7-6/435 "On the Establishment of the Procedure and Terms for the Assignment, Application as well as Modification of the Taxpayer Identification Number" (Registered in the Ministry of Justice of Russia on August 14, 2012, No. 25183).



projects' participants are entitled to a 0% profit tax rate with regard to the amount credited to the federal budget, and the profit tax rate credited to the budget of a constituent territory of the Russian Federation within the first half of project's lifespan may not exceed 10%, and may not be less than 10% in the second half of project's lifespan. The project participant is eligible for a reduced interest rate if revenues earned from sales of goods manufactured as part of the project account for at least 90% of total booked income. A decreasing coefficient of the mineral extraction tax rate, depending on the location of a field (increasing from 0 to 1 within 24 fiscal periods on the mineral extraction tax), was introduced.

The taxpayer may obtain the status of regional investment project participant 1) if capital investments result in the construction of manufacturing facilities exclusively on the territory of the Far Eastern District, the Zabaikalye Territory, the Irkutsk Region, and the Buryat Republic; 2) if the taxpayer isn't integrated into consolidated groups; 3) if the land parcels where the project will be implemented are not owned by other legal persons and physical bodies (save for certain types of infrastructural objects); 4) if the taxpayer individually implements the project, isn't entitled to tax allowances and special regimes with regard to the activity conducted as part of the project; 5) if the taxpayer is registered on the territory of the Far Eastern District, the Zabaikalye Territory, the Irkutsk Region, and the Buryat Republic and has no ringfenced entities outside the foregoing territories and some other restrictions.

In addition, from January 1, 2014, if at least one of the parties to a deal participates in a regional investment project subject to a zero rate of the profit tax credited to the federal budget and/or reduced rate on the profit tax credited to the budget of a constituent territory of the Russian Federation, the deal is recognized as being regulated according to Article 105.14 of the TC RF.

3. Under the Federal Law dated 30.09.2013, No. 268-FZ, organizations engaged in the production of hydrocarbons in offshore green fields and offshore areas of green fields are subject to tax allowances. To be eligible for tax allowances, the taxpayer must be granted the status of 'offshore hydrocarbon field operator'. An organization can be recognized as such operator as long as it meets a series of requirements, namely the organization itself or its participant (founder) who also has an indirect interest in the organization must have a license for the development of a respective subsurface mineral estate; the organization is individually or with the help of subcontractors is engaged in at least one type of activity related to mineral extraction in

the field; the organization and license holder has an agreement on mineral extraction on a fee basis. The license holder is entitled to enter into agreement with no more than one extraction operator at the mineral estate.

The territory of the Russian Federation is recognized as place of realization of commodities made of offshore crude hydrocarbons, as well as products of their technological conversion (stable condensate, liquefied natural gas, broad fraction of light hydrocarbons) if the commodities are located (or were located at the time of shipping) on the Russia's continental shelf and/or the exclusive economic zone of Russia or the Russia's part (Russia's sector) of the Caspian Sea floor. No provision is made for granting VAT allowance with regard to realization of hydrocarbons on the territory of the Russian Federation.

International shipping services are subject to VAT allowance. International shipping services are referred to works (services) on transportation and/or shipping of hydrocarbons from the departure point located on the continental shelf, the exclusive economic zone or Russia or the Russia's part of the Caspian Sea floor to the destination point outside the Russia's territory and other territories being under its jurisdiction. According to Article 164 of the TC RF, international shipping services are subject to a 0% VAT rate.

Paragraph 3, Article 259 thereof defines straight line depreciation as mandatory method of depreciation of fixed assets used for the production of hydrocarbons in an offshore green field of hydrocarbons (irrespective of the method provided for by the taxpayer's accounting policy).

Article 261 thereof establishes the procedure for booking natural resources development costs incurred during activities related to prospecting, appraisal and/or exploration of offshore green hydrocarbon fields to taxpayer's expenses. Furthermore, it provides for possible deduction of costs on mineral estates which are planned to shutdown due to economic ineffectiveness, lack of geological prospects or for other reasons. Costs on the mineral estate recognized as unpromising may be 'booked' to other mineral estates in the field, provided that no more than 1/3 of the such costs is booked to each mineral estate.

The voluntary insurance payable under the Russia's legislation to finance measures provided for by the oil-spill response plan (Article 263 thereof) has been allowed to be charged to operating costs.

The TC RF introduces a transfer mechanism for accrued expenses on longstanding hydrocarbon production projects during license transfer. In particular, allowance is made of a build-up mechanism for provisions (Article 267.4 thereof) for future costs related to

termination of the production of crude hydrocarbons in an offshore crude hydrocarbon green field, whose build-up starts as soon as the level of reserve depletion in the green field reaches 70%. Should the mineral extraction license be transferred to a new licensee holder at this stage, the previous license holder must rebuild the accrued provisions as part of the tax base (Paragraph 7, Part 2, Article 250 thereof) and the new license holder is entitled to charge the provisions to the reduction of the profit tax base. Decommissioning costs don't include short-accrued depreciation. Therefore, taxation excludes potential overcosting at the stage of 'easy oil' production by using the abnormal depreciation mechanism and makes the production entity focus on the maximum possible development of hydrocarbon resources at the field.

Article 275.2 thereof establishes the specifics of determining the profit tax base for green fields. The taxpayer as license holder is allowed to book costs incurred at mineral estates which are recognized as inefficient to the costs on other mineral estates of the field. At the same time, the green field is regarded as stand-alone project. Neither other fields' losses, nor losses from other types of activity may decrease green field's profit (see Paragraph 4 thereof), whereas green field's losses may be charged to organization's overall performance and reduce the total tax base.

The green field's profit is subject to a 20% rate.

Articles 299.3 and 299.4 of the TC RF establish specifics of income generation and costing of taxpayers as license holders and operators. Taxpayers of the mineral extraction tax are recognized as organizations engaged in offshore hydrocarbon production. Article 338 of the TC RF establishes specifics of mineral extraction tax base formation.

Article 340.1 thereof establishes a mechanism of pricing per unit of hydrocarbons produced in the accounting period in an offshore green field on the basis of the average price in global markets and the average RUB/USD exchange rate in the accounting period. Minimum marginal price per unit of flammable natural gas or associated gas produced in an offshore green field is determined as the average weighted price – by volume of supplies to the domestic market and for export – of natural gas in the fiscal period, which is very important for equalizing the terms and conditions of gas supplies to the domestic market and for export.

Paragraph 2.1, Article 342 establishes mineral extraction tax rates applicable to the base determined in accordance with Article 338 thereof. The rates are differentiated by region in which offshore fields are located, and varying within a range of 30 to 4.5% for hydrocarbons (save for natural gas) and 1 to 1.3% for natural gas.

Transport tax allowances are granted with regard to offshore stationary and floating platforms, mobile rigs and drilling vessels, as well as property tax allowances with regard to the property located in the inland sea waters, territorial waters, continental shelf, the Russia's exclusive economic zone or in the Russia's part (Russian sector) of the Caspian Sea floor, which is used in carrying out the activity related to the development of offshore hydrocarbon fields, including geological survey, survey, mineral estate preparation works.

Exempted from customs duties are crude oil (including oil, gas and condensate produced due to technological specifics of shipment of crude oil and stable gas condensate via pipelines), gas condensate, liquefied natural gas and natural gas, broad fraction of light hydrocarbons which are produced at and moved from offshore green hydrocarbon fields, as well as the same products produced in the fields located in the southern part of the Sea of Okhotsk (brown-fields).

4. The Federal Law dd. 30.09.2013, No. 269-FZ makes amendments to the excise duties payment procedure for taxpayers.

The computation scheme for excise duties on manufacturers of alcohols and alcohol-containing products is updated. Transfer of excisable toll-manufactured products to the owner or, as instructed by the owner, to other persons if the foregoing products are sold outside the territory of the Russian Federation according to the customs export procedure, with due regard to losses (within the limits of the norms of natural loss), are exempted (Paragraph 1 Article 183 of the TC RF) from excise duties. In this case, for the purpose of being extracted from excise duty the taxpayer shall provide the tax authority with a bank guarantee not later than the 25<sup>th</sup> date of the month of tax return submission. The bank guarantee must provide for the bank's obligation to pay in full the excise duty if the taxpayer fails to provide the documents and pay the tax. The bank guarantee must be valid within at least 10 months upon a date set for the payment of the excise duty. The validity period of the bank guarantee provided by the taxpayer for the purpose of simultaneous exemption from upfront payment of the excise duty on alcoholic and/or excisable alcohol-containing products and payment of the excise duty assessed for the foregoing products exported outside the Russian Federation according to the customs export procedure must be at least 12 months following the fiscal period in which ethyl alcohol was purchased. Not later than the date following the date of bank guarantee, the bank must notify the tax authority at the taxpayer's place of registration of the fact of bank guarantee issue.

Excise duty rates on alcohol-containing and alcoholic products for 2016 are indexed (indexation will account for 10% of the 2015a level). Where manufacturers of alcoholic and/or excisable alcohol-containing products buy raw ethyl alcohol in the Customs Union member-countries (hereinafter referred to as the CU), the manufacturers must pay excise duty upfront (Paragraph 8 Article 194 of the TC RF) or provide a bank guarantee covering the corresponding amount. Perhaps, this measure could help somehow restrain the flow of counterfeit alcohol which flooded into Russia in response to a drastic increase in the alcohol excise duty vs. excise duties established in other CU member-countries.

Amendments have been made to the payment procedure for excise duties on tobacco products. Under the TC RF, at least 10 calendar days prior to the beginning of fiscal period (calendar month) the taxpayer must provide the tax authority with a notification specifying a ceiling price applicable to tobacco products. The ceiling retail price of tobacco products is referred to the ceiling (not higher) price at which the pack unit may be sold to consumers. The taxpayer shall individually set this price per retail pack unit of tobacco products separately for each trade mark (each brand name) of tobacco products (Paragraph 2, Article 187.1 of the TC RF). Since January 1, 2014 the foregoing notification must specify minimum retail prices too.

Additional adjustment was made to tax rates on the 4- and 5-grade motor gasoline, as it was provided for by the *Tax Policy Guidelines for 2014–2016*. The 4-grade gasoline excise duty rate will increase up to Rb 9916 (against Rb 9416 as previously planned) in 2014, Rb 10858 (instead of Rb 10358) per ton in 2015, while the 5-grade gasoline excise duty will increase up to Rb 6450 (against Rb 5750 as previously planned) in 2014, Rb 7750 (instead of Rb 6223) per ton in 2015. (Paragraph 1, Article 193 of the TC RF).

Taxpayers as holders of a no-alcohol containing products manufacturing certificate are allowed to deduct the amount of excise duty assessed during the purchase of industrial alcohol used for the production of no-alcohol containing products (Paragraph 11, Article 200 of the TC RF). To this effect, taxpayers as holders of the industrial alcohol manufacturing certificate must issue registers of invoices to buyers who manufacture no-alcohol containing products. The buyer shall provide the registers to the tax authority at the place of buyer's tax registration in order to receive the mark indicating that the buyer may deduct (credit for tax) the paid excise duty on the purchased alcohol (Paragraph 11, Article 201 thereof).

The same procedure (Paragraph 13, Article 201 thereof) for making marks by the tax authority at the

buyer's premises is established with regard to registers of invoices issued by the taxpayer as supplier holding a certificate for the production of straight-run gasoline to the taxpayer-buyer holding a certificate for the refinement of straight-run gasoline (i.e., the buyer of straight-run gasoline).

5. The Federal Law dd. 30.09.2013, No. 263-FZ makes amendments to the computation procedure for mineral extraction tax and the Law of the Russian Federation "On the Customs Tariffs" (Article 3.1. thereof). The long and short of the amendments is that the export tariff declines (according to the terms of accession to the WTO) as the mineral extraction tax included into the cost increases.

The Federal Law makes changes to mineral extraction tax rates per ton of produced crude oil, gas condensate and natural gas. The mineral extraction tax rate on crude oil will amount to Rb 493 per ton in 2014, with an increase of 4.9% against 2013 (Rb 470), in 2015 the rate will increase up to Rb 530 per ton of crude oil, and Rb 559 in 2016. Crude oil export tariffs will decline respectively: an overrun of more than \$182,5 per ton in the price of Urals crude oil in the global markets is subject to a base tariff of \$29 which is subsequently to be adjusted in 2014 by an amount equal to 59% of the overrun amount of the average price over \$182,5, 57% in 2015, 55% in 2016.

Besides growth in mineral extraction tax rates on crude oil, the Federal Law is distinguished by making an attempt to introduce for owners and external users of gas transmission networks universal calculation formulas (Article 342.4 thereof) for mineral extraction tax on gas within (natural gas, gas condensate) the fields. In particular, the rate on mineral extraction tax for a field will be multiplied by the base value of the unit of fuel equivalent and the coefficient representing the degree of extraction difficulty in the field. The resulted rate should be adjusted by hydrocarbon shipping costs. And ultimate price of natural gas (gas condensate) will be determined as average weighted of the shares shipped for export and to the domestic market.

The formula is quite complex, multiple-factor, and its actual effectiveness can be evaluated in practice.

6. The Russian Government's Order dd. 26.09.2013, No. 846 approves the Rules for the establishment and application of special calculation formulas for crude oil export customs duties according to Subparagraph 2, Paragraph 5, Article 3.1. of the Federal Law "On the Customs Tariff".

The Russian Government is authorized to establish special calculation formulas for rates of export customs duties on crude oil with special physical and

chemical characteristics produced in the oil fields located on subsoil plots which are fully or partly located within the boundaries of the Republic of Sakha Yakutia, the Irkutsk Region, the Krasnoyarsk Territory, the Nenets Autonomous Area, northward of 65 degrees of latitude north of the equator fully or partly within the boundaries of the Yamalo-Nenets Autonomous District; within the Russia's part (Russian sector) of the Caspian Sea floor; within the Russia's inland sea waters floor; within the Russia's territorial waters floor; within the Russia's continental shelf.

The Order established a procedure for the submission of proposals, documents and calculations for the introduction of such special tariffs. A special formula is computed in such a way as to achieve a 16.3% internal rate of return of the field development program (Paragraph 7 thereof).

7. Given a special emphasis that has recently been placed upon the issues concerning the counteraction of the legitimization of proceeds of crime, the Ministry of Finance of Russia issued the Letter dd. October 2, 2013, No. 07-02-05/40858 which contains an extended explanation addressed to accountants and auditors. It is the first detailed analysis of the law enforcement practice which also covers explanations about measures to be taken upon discovery that an organization is engaged in financial operations with customers registered in states and territories of preferential tax treatment, organizations which fail to observe the FATF's requirements, etc.

8. The Letter of the Ministry of Finance and the FTS RF dd. September 30, 2013, No. PA-4-6/17542 as part of the implementation of the Federal Law dd. 28.06.2013, No. 134-FZ "On the Introduction of Amendments to Certain Legislative Acts of the Russian Federation With a View to Counteracting Illegal Financial Operations" contains a sensitization campaign plan and explanations with regard to further interaction between taxpayers and tax authorities.

In particular, from 1.01.2014 all VAT taxpayers (including those who are fiscal agents) will be obliged to file only electronic VAT returns via telecommunications channels through the electronic document management operator.

From January 1, 2014, electronic tax returns only may be filed through the electronic document management operator.

According to the TC RF, documents submitted to a tax authority, including invoices, must bear an enhanced encrypted and certified signature. The FTS RF noted that until the end of 2013 all electronic digital signature (EDS) certificates which taxpayers are cur-

rently using must be replaced with electronic signature (ES) certified certificates. To do so, one should apply to his special purpose communications service provider.

Lists of electronic document management operators for every constituent territory of the Russian Federation are available on information stands at the territorial tax authorities and official websites of the FTS RF's Departments by constituent territory of the Russian Federation.

9. To reduce the number of tax litigations and harmonize approaches towards resolving tax issues, the Ministry of Finance of Russia and the FTS RF issued a Letter dd. October 2, 2013 No. CA-4-7/17648 which contains information about the practice of settlement of tax issues by concluding amicable agreements between taxpayers and tax authorities. Amicable agreements are subject to approval by courts of arbitration. The FTS RF instructed its subordinated authorities to take account of this court practice in their work. Furthermore, draft amicable agreements must be submitted to the Legal Department of the FTS RF for approval.

10. Russian organizations have recently been looking forward to moving their manufacturing facilities outside the Russian Federation. It is private enterprises that may move their screwdriver facilities to other countries.

In our opinion, an extreme caution should be addressed to certain public corporations'<sup>1</sup> intentions to move their screwdriver most sophisticated technology facilities to the territory of other states, alleging as the reason that foreign labor force is cheaper. Public corporations' activity in external markets is considered as moving profit-making activities of the state itself to foreign territories. We already repeatedly stated that public corporations' products may be regarded as state-subsidized, in which case subsidies will be calculated and surcharged in favor of the organizations and budgets of countries which are likely to lose their market share with the emergence of public corporations as new market players. Eventually, public corporations' products manufactured in third countries may happen to encounter lack of the demand, because they may

1 О. Самофалова, «Есть на чем сэкономить. Российские самолеты гораздо дешевле производить в Индии» [О. Samofalova, "There is something to save on. Manufacturing costs of Russian aircrafts are cheaper in India"], website [vz.ru/economy/2013/10/4/653471.html](http://vz.ru/economy/2013/10/4/653471.html) от 4.10.2013. "Sukhoi Superjet-100 and MC-21 can be assembled in India. This will reduce the price by 40%. It appears that India can offer a complete package of terms and conditions enhancing cost-effectiveness of manufacturing, which is not just labor costs which are lower than in Russia. According to experts, Russia will eventually benefit from it."

lose competitive advantages as a result of forced increase in their value up to the level of independent manufacturers. Perhaps, they would have to be repurchased with Russia's federal budget resources for the reason of low liquidity. Finally, the federal budget of Russia would have to finance both construction of

manufacturing facilities on a foreign territory (which may become the matter of commercial disputes on violations of free competition, like in the case with pipelines to the EU) and wages of 'cheaper' foreign labor force engaged in assembling works, instead of paying wages to Russian workers. ●



## REVIEW OF RUSSIA'S ECONOMIC LEGISLATION IN OCTOBER 2013<sup>1</sup>

I.Tolmacheva, Yu.Grunina

*In October, the following amendments were introduced into the legislation: such new as well as updated norms of the Civil Code of the Russian Federation as regulate the civil institute of the international private law will become effective from November 2013; the annual quota on education of foreign nationals and stateless persons at the expense of allocations from the federal budget does not exceed 15,000 persons.*

### Federal Law of the Russian Federation

Federal Law No.260-FZ of September 30, 2013 on AMENDMENT OF PART III OF THE CIVIL CODE OF THE RUSSIAN FEDERATION

The Section – the International Private Law – of the Civil Code of the Russian Federation is supplemented with norms regulating, in particular, the following:

- responsibility of founders of a legal entity founded abroad as regards its obligations (so, if a legal entity founded abroad carries out its business activities mainly in the territory of the Russian Federation, the Russian law or, at discretion of the creditor, the personal law of such a legal entity is applied to claims as regards liabilities<sup>2</sup>);
- the domain of the law subject to application of proprietary rights (in particular, it includes: types of legal objects of proprietary rights, including real property and movable things; transferability of object proprietary rights; types of proprietary rights; scope of proprietary rights; creation and termination of proprietary rights including a transfer of proprietary rights; execution of proprietary rights and protection of proprietary rights);
- the right of parties to reach an agreement on creation and termination of such rights of ownership and other proprietary rights to moveable property as are subject to application to their deal without prejudice to third persons;
- the law applied in respect of agreements on commercial concession, alienation of the exclusive right to outputs of intellectual activities and license agreements (revised Article 1211 which determines that in case of absence of agreement between the parties on which law is to be applied to the agreement, the law of the country where the place of domicile or the place of the main business of the party carrying out performance which is of crucial significance to the scope of the agreement is applied);
- the law which is subject to application to assignment of the rights of a creditor to another person on the basis of the law (new Article 1216.1. was introduced. So, in meeting by a third person of the creditor's claims to the debtor (a new creditor), an assignment of the creditor's rights on the basis of the law to such a third person (a new creditor) is determined in accordance with the law which is subject to application to relations between the initial creditor and the new creditor unless otherwise is specified in the law or stems from the aggregate of facts and circumstances of the case);
- representation which is based on the agreement: in such a case the relations between the represented party and the representative are determined in accordance with the law of the country where on the day of entering into agreement the place of domicile or the main place of business activities of the party which carries out performance is situated (new Article 1217.1 was introduced);
- termination of a liability by means of a set-off. It is established that termination is determined in accordance with the law of the country subject to application to relations from which the claim arose against which the set-off of a counterclaim is declared. Termination of a liability by means of a set-off carried out by agreement between the parties is determined by rules of the law which is subject to application to the agreement;
- claim for damage: it can be made by the affected party directly to the insurer if it is permitted by the law applied to the obligation which arose as a result of the inflicted damage or that applied to the insurance agreement (Article 1220.1 was introduced);
- determination of the law which is subject to be applied to obligations which arose due to the fact that negotiations on conclusion of the agreement were carried out not in good faith. Article 1222.1 was introduced; it reads that in respect

<sup>1</sup> The Review was prepared with assistance of the Konsultant-Plus Legal System.

<sup>2</sup> The personal law of a legal entity is the law of the state in which territory the legal entity was registered.

of obligations which arose due to unscrupulous negotiations on conclusion of the agreement the law which is subject to application to the agreement is used, while in case the agreement was not concluded the law that would be applied to the agreement if it was concluded is used.

- selection by the parties to the agreement of the law which is subject to application to an obligation which arose as a result of the inflicted damage or unjustified enrichment if on the day of carrying out of actions or emergence of another factor which inflicted damage or caused unjustified enrichment all the circumstances related to the subject matter of the relations between the parties are related only to one country, selection by the parties of the law of another country cannot affect mandatory norms of the law of the country which all the circumstances of the relations are related to.

#### **Resolution of the Government of the Russian Federation**

Resolution on ESTABLISHMENT OF THE QUOTA ON EDUCATION OF FOREIGN NATIONALS AND STATELESS PERSONS IN THE RUSSIAN FEDERATION

In accordance with the Federal law on Education in the Russian Federation, foreign nationals have the right to receive the secondary vocational education, higher education and additional vocational training at the expense of allocations from the federal budget, budgets of constituent entities of the Russian Federation or local budgets in accordance with international agreements of the Russian Federation, federal laws or quotas on education of foreign nationals established by the Government of the Russian Federation, as well as at the expense of funds of individuals and legal entities in accordance with agreements on rendering of paid education services.

According to the Resolution of the Government of the Russian Federation, the annual quota on education in the Russian Federation (at educational establishments on vocational programs of the secondary vocational education, higher education and additional vocational training at the expense of allocations from the federal budget) of foreign nationals and stateless persons, including compatriots living abroad does not exceed 15,000 persons.

Resolution No.638 of August 25, 2008 on Cooperation with Foreign Countries in the Sphere of Education is recognized as null and void. ●

## CHANGES IN THE REGULATORY BASE OF THE BUDGETARY PROCESS IN OCTOBER 2013 M.Goldin

*In October, the following documents were approved: the procedure for provision of budget investments to legal entities which are neither state or municipal entities, nor state or municipal unitary enterprises; guidelines for application of methods of determination of the initial (maximum) contract price and the price of the contract concluded with a single supplier.*

By **Resolution No.941 of October 24, 2013 of the Government of the Russian Federation** on Approval of the Rules of Taking of Decisions on Provision of Budget Investments to Legal Entities which are Neither State or Municipal Entities Nor State or Municipal Unitary Enterprises in Capital Construction Projects at the Expense of Funds of the Federal Budget (hereinafter – the Rules of Provision of Budget Investments), a procedure was approved for taking of decisions on provision to nongovernment legal entities (hereinafter—bidders) of budget investments in capital construction projects at the expense of the federal budget funds on implementation of investment projects on building (reconstruction, including restoration and re-equipment) of capital construction projects and (or) purchasing of real property projects.

It is specified by the Rules of Provision of Budget Investments that the regulatory act in question is not applied to the following:

- Investment projects included in federal purpose programs funded by means of budget investments;
- Investment projects funded by means of federal budget funds at the expense of budget allocations from the Investment Fund of the Russian Federation (including investment projects where the above allocations are granted for development of project documentation);
- Investment projects whose funding by means of the federal budget funds was started prior to January 1, 2014.

A decision on allocation of budget investments to bidders is initiated by the main administrator of budget funds (the federal state authority which is in charge of implementation of measures of a state program on building (reconstruction) or management of the real property project) and agreed upon by the Ministry of Economic Development of the Russian Federation. The final decision is taken by the Government of the Russian Federation as the decision on allocation of budget investments is to be executed in the form of a regulatory act of the Government of the Russian Federation.

Provision of budget investments is carried out on condition that the above investments cannot be channeled to legal entities for funding of the following work:

- a) development of the project documentation on capital construction projects and carrying out of engineering surveys for preparation of project documentation;
- b) purchasing of land plots for building;
- c) carrying out of a technological and pricing audit of investment projects on building (reconstruction and technical re-equipment) of capital construction projects in cases established by the legislation of the Russian Federation;
- d) carrying out of state due diligence of the project documentation and outputs of engineering surveys required for preparation of such project documentation;
- e) checking adequacy of the estimated cost of capital construction projects (reconstruction, including restoration and technical re-equipment) which are funded with federal budget funds.

By **Order No.567 of October 2, 2013 of the Ministry of Economic Development of the Russian Federation**, the guidelines were approved for application of methods of determination of the initial (maximum) contract price and the price of contract concluded with a single supplier (contractor, performer).

The guidelines were approved in accordance with Article 22 (20) of Federal Law No. 44-FZ of April 5, 2013 on the Contract System in Procurement of Goods, Jobs and Services for State and Municipal Needs.

The guidelines were developed for rendering of methodical assistance to state customers by authorized bodies and entities in determination and justification of the initial (maximum) contract price (IMCP) in carrying out of procurement with utilization of competitive methods of determination of suppliers, as well as the price of the contract concluded with a single supplier.

Determination of IMCP is carried out in formation of the schedule of purchases and preparation of a notification and documentation on a purchase. The result of determination of IMCP is shown in the above documents.

The guidelines are mainly dedicated to explanation of the methods of determination and justification of IMCP as well as specification of determination of such

criteria of evaluation of a bid as calculation of the cost of the life cycle of goods and projects created as a result of fulfillment of work. ●