



RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES 02'2010

MONTHLY BULLETIN:

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RUSSIAN ECONOMY IN FEBRUARY 2010: TENTATIVE INDICATORS AND MAJOR TRENDS

In February the most notable events of the political background were the protest actions that took place in several Russian cities (there were more than 10 thousand participants in the largest rally in Kaliningrad). The major topics of speeches were both, economic demands (protest against increased tax on vehicles and housing utilities tariffs) and dissatisfaction with the federal government policy in appointing Heads of the executive authorities of the Regions (Kaliningrad, Khanty-Mansi Autonomous Region). It is worth noting, that according to the sociological surveys, the subjective assessments of the economic situation got worsened: as per Public Opinion Foundation (POF) February survey, the number of respondents, negatively estimating the economic situation, for the first time since April 2009 once again exceeded the number of “neutral” assessments (“neither good, nor bad”).

Appointment to the position of Dagestan President of Magomedislam Magomedov, the son of Magomedali Magomedov, the Ex-President, on whose departure Moscow insisted in 2006, confirms the assumption that the policy of the Federal Center in regard to the Caucasian republics has changed : instead of limiting the influence of “traditional” local clans, Moscow is trying to move to a policy of incorporation thereof in the federal elite. The statement of A. Khloponin, the President’s Representative in the Region about the possibility of creating special economic zones in the Caucasus, which will be granted tax benefits, should be understood in the same vein. However, the policy of the Federal Center in regard to the North Caucasus is in a way moving in a circle: the experience of creating special economic zone in Ingushetia in early 1990-s was later assessed as negative.

Macroeconomic dynamics to a large extent was based on the situation in the global markets. Oil prices have reached the post-crisis peaks in early January (USD 81.91 per barrel for Brent), which have declined in early February and even fell down below USD 70 per barrel, but later resumed the growth. Absolutely similar dynamics was demonstrated by prices for aluminum and copper, while as opposed to that, nickel prices showed an impressive growth in February (growth by 25%), against the background of their stability within preceding months. Volatile fluctuation of commodity prices was traditionally affecting the dynamics of the Russian stock market quotations. Optimism of early January, when the indices reached the post-crisis highs: the MICEX index has exceeded the level of 1,400 points and the RTS index has exceeded 1500 points and then varied within the range of those indicators, in early February started to decline for the remainder of the month the indices were varying at the level of 1300-1360 (MICEX) and 1360-1420 (RTS) points. However, the “rollback” of stock indices was observed in the majority of the global stock exchanges. According to the Central Bank estimates, in January there was a net outflow of capital amounting to USD 13 billion, but in February it should come to zero or be replaced by some inflow.

Foreign currency reserves of the Central Bank continued to decline slightly in February: On 19.02 their volume was 432.4 billion dollars (as compared with 437.1 billion dollars on 29.01.10), we would like to remind that the growth in reserves, which began in the second half of March 2009, was suspended by early December after reaching the post-crisis maximum (USD 451.2 billion); the decline against this level in the second half of February 2010 amounted to 4.2%.

Nominal value of dollar in February showed much less volatility than in December-January and got stabilized near the value of RUR 30/USD 1 (+1.6%), while Euro continued to weaken against ruble under the impact of negative news from the Euro zone and amounted to Rb 28.02-40.80 against Rb 4246 a of 30.01 (strengthening of ruble made 4.06%). As a result, the value of the two-currency basket continued to decline, amounting on February 28 to Rb 34.83 (-2.9%; In January strengthening of the real effective ruble rate amounted to 2.5%). The volume of the Central Bank net purchases in the domestic market in the first three weeks of February amounted to nearly USD 2 billion.

After tangible acceleration of inflation in the first weeks of January, based on an increased tariffs, the growth of prices in late January-February has significantly slowed down and in the period from

February 1 to 24 made 0.7%. In annual terms, inflation as of February results has dropped to the level of 8.1%, and the Central Bank predicts its further reduction to the level of 7%. These expectations and the current dynamics allowed the Bank of Russia once again to reduce the refinancing rate to the level of 8.5% per annum from 24 February 2010.

The situation in the real sector is still characterized by conflicting indicators and assessments. According to the Federal State Statistics Service, the growth of industrial production in January 2010 amounted to 7.8% against the same period of the last year. The RF Ministry of Economic Development has assessed the indicator of production growth in January against December 2009 at 0.7% (with regard to seasonal factor).

The dynamics of retail trade turnover, demonstrating a slower decline in the preceding months (against the relevant period of the last year), in January 2010 reached positive values and amounted to 100.3%. The consumer spending growth was achieved through the growth of population real incomes by 7.1% and wages by 2.6% against January 2009. However, compared with January 2009, the turnover of food products increased by 3.8%, while the turnover of non-food items reduced by 3.0%. The latter figures indicate that the recovery in the consumer sector is very limited.

A marked growth of unemployment rate can be regarded an important indicator of the economic situation in January: unemployment (estimated in accordance with methodology of the Ministry of Economic Development and Trade) increased to 6.841 million people against 6.173 million in December 2009, or 9.2% of the economically active population. The increase in unemployment at the beginning of the year is a seasonal phenomenon, but one should bear in mind that the unemployment rate was growing throughout the last months of 2009. As a result, in January 2010 an increase in the number of unemployed versus the relevant level of September 2009 amounted to 17.2% (from 5.8 to 6.8 million of people).

In February 2010 the companies, according to IET industries surveys, continued to show some optimism with regard to the dynamics in demand and production. Thus, for the first time during the current crisis, the share of enterprises whose sales increased was larger than the enterprises with reduced sales (however, there is an effect of seasonal factor). The most intensive growth of sales (i.e., the growth adjusted for seasonal factors) was registered in food and light industries. Assessments of production growth (adjusted for seasonal factors) remained virtually unchanged since September 2009 and demonstrated a moderate increase in output. Here the most intensive growth is observed in food and light industries, positive growth indicators in output were registered also in the construction industry. Positive expectations in regard to demand and production allowed the companies to move to a policy of increasing prices for the supplied products. Estimates of price growth for the second consecutive month, remain at the highest level for the last 18 months. However, those expectations are pushing companies to change HR policy: the ratio of hiring against firing, according to February surveys, virtually reached zero balance, and plans for changes in employment policy were regarded as positive.

In general, the positive impacts on the domestic market look quite weak, and stabilization, or even some growth in demand are not supported by the changes in investment trend. ●

THE POLITICO-ECONOMIC RESULTS OF FEBRUARY

S.Zhavoronkov

In February, the United Russia party and the existing one-and-a-half-party regime were subjected to public criticism by a number of top political figures close to Vladimir Putin. These included the Speaker of the RF Council of the Federation, S. Mironov and the Minister of Finance, Aleksey Kudrin, which indicates that there indeed exists some discontent among the ruling group. Criticism was confined to the demands that the so-called administrative resource should be used on a smaller scale, while the scale of political competition, on the contrary, should be broadened. Several governors were appointed, and it was noticed by experts that none of them was from Dmitry Medvedev's circle. President Medvedev announced the forthcoming dismissal of the officials responsible for the poor performance of Russian sportsmen at the 2010 Vancouver Winter Olympic Games. The dismissal has not materialized as yet. It was announced that the launch of the giant Shtockman natural gas deposit would be delayed at least by three years, until 2016.

Although not very prominent from the point of view of major political events and institutional decisions, February 2010 witnessed, nevertheless, some interesting political discussions. In early February, there was a loud scandal triggered by an interview on Vladimir Posner's Channel One talk show. The guest of the program, Speaker of the RF Council of the Federation and Chairman of *Fair Russia* S. Mironov, subjected the *United Russia* party and its leader V. Putin to rather mild criticism. In particular, he said: *'For example, at the time of the 2004 election, when Vladimir Putin was not the leader of United Russia, I really used to say that I supported Vladimir Putin. And I can say that in terms of foreign policy and some domestic policies we, our party, support him. But, for example, we categorically disagree with the budget introduced by Vladimir Putin, and so we voted against it. We do not agree with the anti-crisis measures suggested by Vladimir Putin, and so we put forth our own anti-crisis plan. Therefore it is to say that we - and myself in particular - totally support Vladimir Putin in the present circumstances'*. Thus, the long-lasting ban on criticism of Vladimir Putin, especially on TV, was breached at last. The man who did this was Mr. Putin's creature who had never been engaged in any criticism of his patron.

Members of the *United Russia* faction (formally holding a majority of seats in the RF Council of the Federation) demanded that Sergey Mironov should be dismissed from his post of Speaker, and political analysts began speculating on the causes of Mironov's utterances. Some of them suggested that the Speaker had acted in somebody's interests (for instance, President Medvedev's), while other experts believed that Mironov's interview was yet another sign of his deficiency in intellect. The scandal ended peacefully, with Mironov and *United Russia* having signed a special agreement stipulating the Speaker's right to have his own point of view (a natural right in a normal society!). Sergey Mironov reformulated his statements to the effect that he supported most of Vladimir Putin's actions and disagreed only with some of them. Mr. Mironov has retained his post.

A week later *United Russia* once again came under criticism, this time voiced by Vice Prime Minister and Minister of Finance A. Kudrin coincidentally on the same TV program hosted by Vladimir Posner. *'...At present, I have disagreements with United Russia... Recently, the RF President has deplored the fact that an excessive administrative resource is used for these purposes, and that we need true inter-party competition. I fully agree with these words. I think that people in United Russia have got carried away with these things ... Somehow, policy development in the true meaning of the word is still carried out by the government, and the fact is that it is only due to Vladimir Putin that we manage to materialize many ideas. On the whole, United Russia proves to be left of center, not right of center. This does not completely correspond to my preferences'*, said Kudrin, answering a question on whether he was going to join the party of power or not. In response, the head of *United Russia*, Speaker of the RF State Duma Boris Gryzlov said that nobody had ever invited Kudrin to

become a member of his party, and that the administrative resource was needed to block incorrect initiatives of the Ministry of Finance (by way of example, he cited a draft law on increasing the transport tax). No practical conclusions to base any action on have been made so far by V. Putin.

Thus, in February we saw some curious manifestations of a political philosophy which had never been especially popular among the officials close to V. Putin. This philosophy was typical of a number of liberal experts who called on the authorities to conduct reforms. Apparently, there are several reasons for the officials to utter such views. Firstly, the physical persons who are in charge of certain governmental departments are irritated by *United Russia's* undisguised claims to political leadership. In their view, the *United Russia* party is nothing more than an instrument of politics (which is true of their departments as well), while real power – as it has been justly pointed out by Kudrin – resides in the hands of V. Putin. Secondly, all the criticism addressed to the political system as a whole is actually addressed to *United Russia*, because the pseudo-competition-based one-and-a-half-party mechanism headed by *United Russia*, which makes any direct criticism of the authorities impossible, is really one of the most dubious and eye-catching elements of this system. As far as the ‘systemic parties’ are concerned, the severe restrictions imposed on their activities, including the actual ban on criticism of not only the federal authorities but even of governors, seriously undermine their electoral base, and the ever increasing number of citizens with oppositional political views simply boycott the polls. Thirdly, we are witnessing the phenomenon of circlism, resembling the pre-revolutionary circles of top bureaucrats and members of the Tsar’s family who tried to convince the Monarch that it was indeed possible to carry out liberal reforms without the risk of losing power. It is highly unlikely that Vladimir Putin is now ready to carry out any radical liberalization of the regime. But the demands for it, coming even from the people close to Mr. Putin, are forming a certain elite consensus that could become a rather useful resource in the future.

In February, for the first time in many months (the previous large protest had taken place during the peak of the crisis, in winter 2008-09), a number of Russian regions saw a wave of protest actions. The most noteworthy of them was the mass-meeting in the city of Kaliningrad, attended by more than 10 thousand persons. Other protest actions with many thousands participants were held in Samara, Irkutsk and Archangelsk. The causes of those protests were different – from Kaliningrad residents’ discontent with the toughening of the tax regime and the imposition of duties on imported cars to indignation at the re-launch of the Baikal cellulose plant (which had been severely criticized by ecologists), and even to the plans to close down the Samara *Wings of the Soviets* sports club. The meetings were heavily influenced by the participation of the ‘non-systemic’ opposition, and protesters called on Vladimir Putin to retire. In Kaliningrad, the protests were apparently heated up by the strong opposition to the current governor on the part of the oblast elite who were eager to demonstrate to the Kremlin Georgy Boos’ inability to control the situation. Whether or not this upsurge of opposition in Kaliningrad is to continue will become evident in March, particularly by the scope of the spring meeting which will be important, for psychological reasons, for both the authorities and the opposition.

February was a month of multiple gubernatorial appointments and the many surprises associated with these appointments. One of the most noticeable surprises was that none of the candidates linked to Dmitry Medvedev either by a shared past or good relations at present (A. Filipenko, I. Fedorov, M. Abdulaev) was appointed to any of the available gubernatorial posts, which clearly indicates that D. Medvedev is not the only one who controls gubernatorial appointments, even if he indeed has a say in such matters.

The only appointments that actually happened in accordance with expectations were those to the governorship of Krasnoyarsk Krai, which was given to former Vice Governor L. Kuznetsov, who is known to have been transacting business in recent years and to be a veteran comrade-in-arms of A. Khloponin; and to the governorship of the Jewish Autonomous Oblast, which was given to the Mayor of Birobidjan, A. Vinnikov (the successor of the former head of this region, N. Volkov). A. Mikhailov was reappointed as Governor of Kursk Oblast, although he had had numerous conflicts with local businessmen and the Kursk Oblast under his leadership had shown some disappointing economic results.

The heads of Khanty-Mansi and Yamalo-Nenets autonomous okrugs were replaced. A. Filipenko and Yu. Neelov, who had been very popular governors of these two regions since the early

1990s, could not actually be presented with any specific charges¹; however, the posts of heads of these immensely rich regions were too lucrative from the point of view of opportunities for redistribution. Filippenko could not even be saved by his reputation of a person close to *Surgutneftegaz* and D. Medvedev's entourage, and Yu. Neelov – by his connections with *Gazprom*. However, it should be noted that the two persons whose candidacies had been most dreaded in the two regions – Tiumen Vice Governor S. Sarychev (in Khanty-Mansi Autonomous Okrug) and D. Medvedev's fellow student I. Fedorov (in Yamalo-Nenets Autonomous Okrug) – were not appointed governors. Instead, the governorship of Khanty-Mansi Autonomous Okrug was given to the head of the State Duma Committee for Natural Resources and Nature Management, N. Komarova, while that of the Yamalo-Nenets Autonomous Okrug – to the head of Pur Raion of the same okrug, D. Kobylkin. Both appointees share one common feature – experts believe that they owe their promotion to the *Novatek* corporation which has its roots in Yamal. In Yamal, it is believed that the new governor has come from the 'reserve cadres' of the previous one, and therefore everybody is sure that the succession will be smooth. The situation in Khanty - Mansi Autonomous Okrug is different – the region has already seen its first in twenty years protest actions against the appointment, and the new governor will certainly face some problems in establishing her hold on the region.

Unexpectedly, the post of President of the Republic of Dagestan was given to Magometsalam Magomedov, son of Magomedali Magomedov who had headed Dagestan in 1991 – 2006. Apart from the populous Dargin people, he is said to be supported by billionaire S. Kerimov who has his roots in Dagestan. Although once thought to be the favorite, Vice Prime Minister of Dagestan Magomed Abdullaev, a representative of another populous Daghestani people, the Avars, and a former post-graduate student of Dmitry Medvedev, got the consolation post of Prime Minister of Dagestan. It should be remembered that in the early 2000s, under Magomedov, Sr., who is, by the way, still alive and healthy today, the situation in Dagestan drastically deteriorated: alongside the criminal conflicts and rampant corruption traditional for that region, there emerged a new factor of instability: the active and belligerent Islamist underground who are now waging a virtual war against the power structures. It cannot be said, though, that the situation had greatly improved under the previous head of the region, Avarian Mukhu Aliev – rather, it stabilized, while the problems of the region began to be spoken about more honestly and frankly (Mukhu Aliev himself had begun his leadership with making public the price-list of bribes paid in Dagestan for being appointed to one or other position). The personnel decision of the Kremlin has caused a lot of perplexity in the republic because it looks like a 'return to the 1990s', which official propaganda swears to prevent from happening.

In February, the Plenipotentiary Representative of the RF President in the North Caucasus Federal District, Alexander Khloponin, announced that he was going to create 'special economic zones' with a beneficial tax regime, where tax benefits, including on federal taxes, would be granted to businesses for the purpose of attracting investments and solving the outstanding problems of the region. Whether or not such zones are to be created will be decided by the leadership of the country, because their establishment would require the introduction of major amendments into federal legislation. So far, Mr. Khloponin's initiative has caused a lot of questions, bearing in mind the well-known experiment with the establishment, in the 1990s, of a special economic zone in Ingushetia, which had not significantly improved the situation in the republic – except for the fact that its head, Mikhail Gutseriev, later became known as a dollar billionaire. However, there is some information that the zone being planned will not be a simple off-shore entity, but a special economic zone of the tourism-recreation type. Nevertheless, this idea might seem a bit preposterous because of the terrorist threat which has still not been eradicated from the region. Meanwhile, A. Khloponin, in addition to his post of Vice Prime Minister of the Russian Federation, has been entrusted with a couple of other tasks: that of coordinate the distribution of financial aid from the federal budget, and if supervising the state investment projects and objects of infrastructure in the North Caucasus Federal District (more than 120 bn rubles for 2010). This means that Mr. Khloponin is now vested with the powers that have not been given to the other plenipotentiary representatives of the RF President in the federal districts.

1 It is noteworthy that Yu. Neelov, despite his forthcoming dismissal, headed the United Russia party list for the March 2010 elections to the Yamalo - Nenets Okrug Duma – his popularity was and is needed by the party of power.

In February, the RF Government became the scene of one replacement which, while not being very important, turned out to be quite scandalous. Prime Minister Putin dismissed Nikolai Yurgel from the post of head of the Federal Service for Supervision in the Sphere of Health Care and Social Development (Roszdravnadzor) 'for violating the Law on Civil Service'. According to the explanations rendered by the RF Government Press Service, the case in point was N. Yurgel's expressed attitude to the draft law 'On the Turnover of Pharmaceuticals', which differed from the views of the RF Ministry of Health Care and Social Development. Vladimir Putin announced that '*... the Ministry has defined its position, the Government has approved it, and any deviation from this position will be stopped, including by the adoption of personnel decisions*'. It should be said that the contentious draft law establishes new demands to the safety and quality of pharmaceuticals. The draft law's proponents believe that it will lower administrative barriers, while its opponents see it as a ploy to redistribute the market.

The end of February was likewise marked with dismissals and retirements. They were promised by Dmitry Medvedev in connection with the obvious failure of Russian sportsmen at the Vancouver Winter Olympic Games. '*If they do not take the decision themselves, we will help them ...*', said the President and then *apropos* mentioned the futilely spent considerable funds. However, RF Minister of Sports Vitaly Mutko had the pluck to start a polemic, saying that he was ready to retire but was not sure whether it would benefit Russian sports. It is to be hoped that Mr. Medvedev's promise will be fulfilled and become one of the extremely useful examples of personal responsibility, which are still not very frequent in Russia.

As far as the economic sphere is concerned, February brought the noteworthy news of the serious problems with regard to the implementation of the Shtockman natural gas deposit project. The operator of the project, Shtokman Development AG (the controlling shareholder – *Gazprom*; 25 % - French *Total*, 24 % - Norwegian *StatoilHydro*) announced that the launch of the Shtockman deposit would be delayed by three years (initially planned for 2013, it is now postponed until 2016). For almost a decade, this project has been heralded as a key to resolving the problems existing in the sphere of natural gas extraction, which were mainly caused by the depletion of old deposits. Its importance from the economic and PR points of view can hardly be overestimated. ●

INFLATION AND CREDIT AND MONETARY POLICY

N.Luksha

In January 2010, inflation has traditionally been accelerated, however CPI for the month was by one-third lower than in 2009 (1.6 per cent against 2.4 per cent). In February inflation rate slowed down considerably, accounting to 07 per cent over three weeks of the month. Thus, the increase in consumer prices since the beginning of the year until mid-February amounted to 2.1 per cent. After the December weakening real effective exchange rate of the ruble began to strengthen again: in January the upgrading made 2.5 per cent. In January and the first three weeks of February foreign currency and gold reserves of Russia decreased again: their volume on February 19 was 432.4 billion dollars. In January, capital outflow from the country was continued, reaching, according to preliminary estimates, about 14 billion dollars. The Bank of Russia continued the policy of mitigating interest rate: from February 24, the refinancing rate has been reduced to 8.5 per cent per annum.

In January consumer price index made 1.6 per cent at the end of the month (see Fig. 1). The fastest growth in January was traditionally observed in prices for commercial services (+3.9 per cent). This includes prices for services of housing utilities services increased by 10.1 per cent, pre-school education - by 2.9 per cent. Reduction in prices was the reviewed types of services was noted only in foreign tours (-2.1 per cent).

In January, there was a fast growth for food products (+1.4 per cent). In particular, prices have grown for sugar (+8.3 per cent), fruit and vegetable products (+7.2 per cent). Continued reduction was in prices for pasta (-0.3 per cent), cereals and beans (-0.1 per cent). Prices started to grow again for sunflower oil (0.3 per cent), fish and seafood, meat and poultry (by 0.2 per cent).

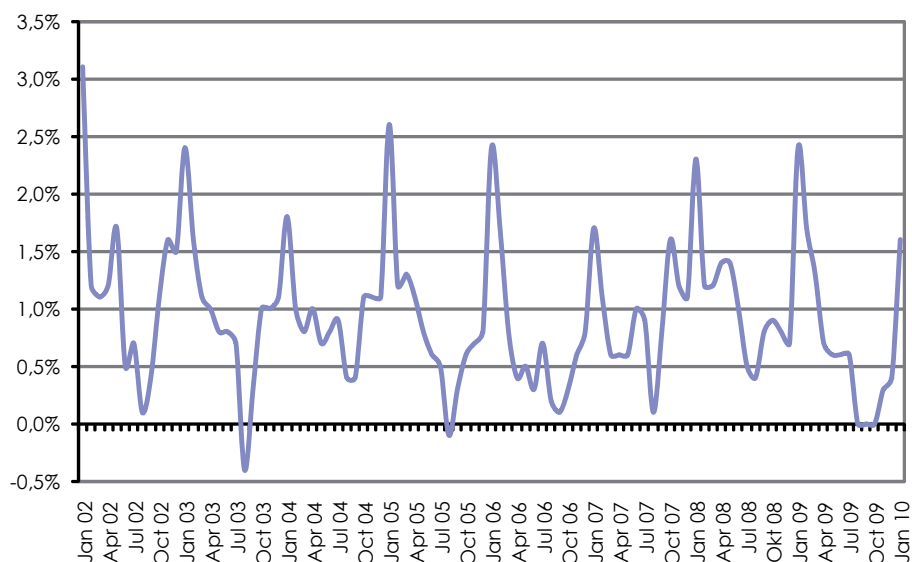
The increase in prices for non-food products in January was unchanged as compared with the previous month and amounted to 0.2 per cent. In this category of products, the utmost growth was demonstrated by tobacco (+1.4 per cent). Prices for medicines ceased grow and even reduced and amounted to 0.2 per cent. Decline in prices for gasoline was continued (-1.5 per cent).

Thus, in January, consumer prices growth amounted to two thirds of the relevant period of the last year. However, comparison of the indicators of the current and preceding month demonstrates that inflation accelerated in January, having grown from 0.6 per cent in monthly terms in December to 1.6 per cent (which is the highest in the last 10 months). This increase was based on the growth of administered prices, as well as on the seasonal growth of food prices.

In February, inflation rate was slowed down. During the first two weeks of February prices rose by 0.4 per cent. The slowdown in inflation rate was the result of a significant slowdown in the sector of commercial services, where a month before prices rose sharply for housing and utilities services. During the third week of the month consumer price index growth accelerated to 0.3 per cent. However, according to A.G. Ulyukayev, First Deputy Chairman of the Central Bank, in February, in general, the inflation in Russia will slow down to about 0.8 per cent¹. Restraining factors of inflation will be based, as in the past months, on the dynamics of monetary supply and low consumer demand. Stable prices in the wholesale network will also contribute to moderate growth of consumer prices. For example, in January producer price index in industrial sector has fell down by 1 per cent. However, the decline was largely due to export industries (primarily in oil and gas industry). But even in sectors oriented to domestic demand, the price growth was lower than retail inflation (1.1 per cent in manufacturing industries). One can assume that until mid-year inflation is likely to be lower than the last year indicators.

1 RBC News (<http://rian.ru/economy/20100218/209838747.html>), 18.02.2010.

This will be contributed by low dynamics in the lending market, low domestic demand, as well as the excessive production capacities. However, in the second half of 2010 there may be observed higher rate of inflation due to increased growth of monetary supply in late 2009, urged by the expected growth in domestic demand. Factors related to ruble strengthening will also be of importance. Thus, according to the statement of A. Ulyukaev, the First Deputy Chairman of the RF Central Bank in the first two months of this year, the Bank of Russia has purchased in the market about 8 billion dollars for the supporting the national currency within a narrow range of 35-38 rubles against the two-currency basket¹. Within the term of 3-6 months control theover the nominal exchange rate can provoke the growth of prices.



Source: RF Statistical Service.

Fig. 1. The Growth Rate of the CPI in 2002 – 2010 (% per month)

The basic CPI of consumer price index² in January 2010 has made 0.5 per cent (versus 1.3 per cent in the relevant period of 2009).

As of January results, the monetary base (in broad definition) has decreased by 10.5 per cent and amounted to RUR 5785.7 bn, which is a traditional seasonal decline. Cash in circulation with regard to the fund balances in credit organizations on February 1 has reached RUR 4.3 trillion (-6.9 per cent as compared with December), correspondent accounts of credit organizations in the Bank of Russia made RUR 526.1 billion (decreased by 3.4 per cent), mandatory reserves made RUR 151.4 billion (remained unchanged since November), banks' deposits with the Bank of Russia made RUR 526,1 billion (declined times 1.5), the value of shares of the Bank of Russia with credit organizations made RUR 451.7 billion (increased by 1.6 times).

In January, the excessive reserves of commercial banks³ have decreased again, amounting as a result of the month to RUR 1325.2 billion. Therefore, the reduction made RUR 367.8 billion, or 22 per cent. Nevertheless, excessive liquidity is still observed in the banking system.

In January, the situation in the sphere of bank crediting has not improved. According to A.G. Simanovsky, Director of the Department of Banking Regulation and Supervision of the Central Bank, in the last month crediting volume continued to decline to companies and businesses by 0.3 per cent and to physical persons - by 0.4 per cent. As of 1 January 2010, arrears amounted to 5.4 per cent, loans of the fourth and fifth category of quality – 8.7 per cent⁴.

Despite this fact, the leaders of the Central Bank continue to make optimistic statements about the prospects for credit market in 2010. Following A. Ulyukaev, the forecast for the growth in the loan portfolio in 2010 to 20 per cent was given by S. Ignatiev, Head of the Central Bank⁵. According to him, the rate of credit growth may be the greatest at the end of the year. During this period the Bank of Russia may be forced to limit the credit boom (in the wording of S. Ignatiev) in order to combat inflation.

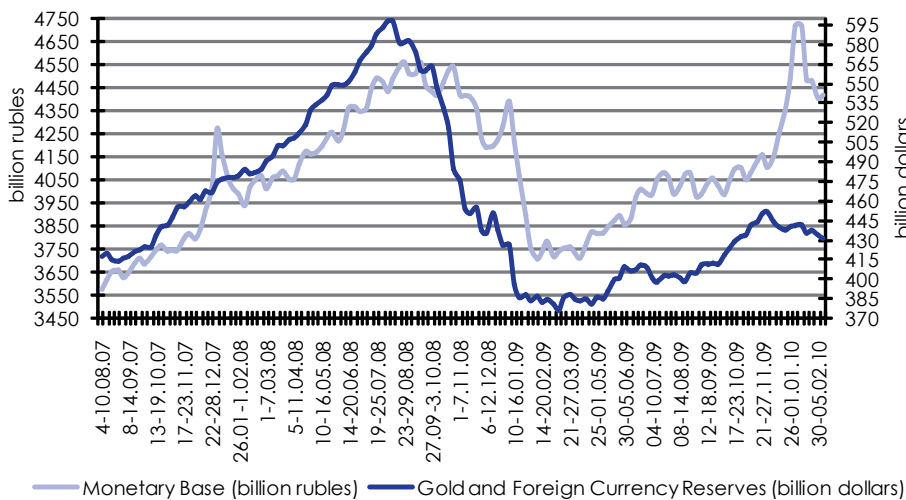
1 «Vedomosti» (<http://www.vedomosti.ru/newspaper/article/2010/02/26/226687>), 26.02.2010.

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

3 RIA News (<http://www.rian.ru/economy/20100115/204718318.html>), 15.01.2010.

4 Regardless Sberbank data. RBCdaily (<http://rbcdaily.ru/2010/02/08/finance/457387>), 8.02.2010.

5 «Fascinating boom in Russia» // Commersant, 5.02.2010.



Source: RF Central Bank.

Fig. 2. Changes in the Monetary Base and on the Gold and Foreign Currency Reserves in 2007 - 2010

(cash plus mandatory reserves)¹ by 6.6 per cent (see Fig. 2).

In January the volume of international reserves of the RF Central Bank has decreased by 0.7 per cent and by the end of the month amounted to USD 435.8 bn. The basic reasons of their decline were foreign currency revaluation due to reduced Euro, as well as the net capital outflow. In January international reserves continued to decrease, having made on February 19 USD 432.4 bn.

According to preliminary estimates of the Central Bank², in January 2010, a net outflow of foreign capital from the country was recorded again in the amount of USD 13 billion. According to A. Ulyukaev, First Deputy Chairman of the Central Bank, there was an almost equal decrease in stock market indices in all countries, including Russia (approximately by 10 per cent), as investors were attracted by other asset types. No «bullish» attitude among market participants was due to doubts about the stability of the economies of some countries in the Eurozone. As of mid-February problems with public finance in Greece were not resolved. The risks of the budget deficits for a number of other countries (primarily in Spain and other countries of the so-called PIIGS group - Portugal, Italy, Iceland, Greece, Spain). Dollar-denominated assets were in demand. In February, according to Mr. Ulyukayev estimates, we can expect a zero balance or an insignificant capital inflow. As of 2010 results, the Central Bank expects a decline in the export of capital to 10-25 billion dollars, as compared with 52 billion dollars in 2009.

Despite a net outflow of foreign of capital from the country, in January the real effective ruble exchange rate has strengthened by 2.5 per cent. As of the month result, index of real effective exchange rate has grown to 134.98³ (see Fig. 3). The basic reason for the growth of the ruble exchange rate in January was the inflow of export revenue to the country, caused by sustained high prices for hydrocarbons (75-78 dollars per barrel for Brent) in October-November 2009 (the lag between the dynamics of the world oil prices and export revenue is about 2-3 months).

Since the beginning of 2010, due to the above-mentioned problems in the Eurozone EURO has significantly decreased (-6.5 per cent), and on February 19, for the first time since December 2008, the dollar fell down below 41 rubles. This was encouraged by the decision of the US

The central bank also revised to the better its expectations regarding the dynamics of bad debts in the banking sector. If previously the Head of the Central Bank forecasted a peak of arrears by July 2010, now it does not exclude that the peak could happen as early as in December 2009, and certainly no later than in March 2010.

In January the decline of the volume of cash in circulation by 6.9 per cent with the grown mandatory reserves by 3.4 per cent urged the reduction of monetary base in narrow definition

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

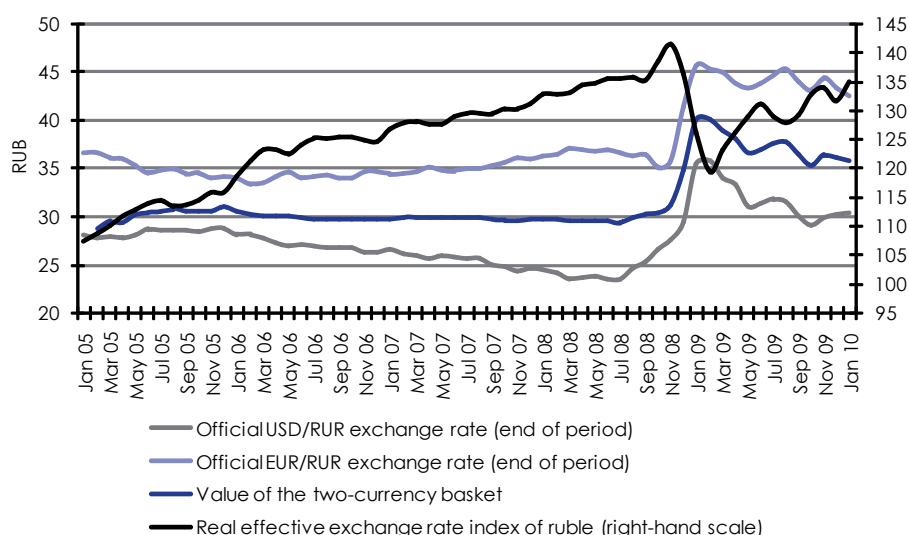
2 Interfax (<http://www.interfax.ru/business/txt.asp?id=124280&sw=%EE%F2%F2%EE%EA+%EA%E0%EF%E8%F2%E0%EB%E0&bd=18&bm=2&by=2010&ed=22&em=2&ey=2010&secid=0&mp=0&p=1>), 18.02.2010.

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

Federal Reserve to raise the interest rates on bank credits. In the period from the beginning of the month to February 25 volatility of ruble against dollar has notable declined: fluctuations range of dollar did not exceed 55 cents, staying within the range of Rb 29.98-30.52 for USD 1.

At the same time, the USD nominal exchange rate against Rb fell down by 1.3 per cent, to Rb 30.03, and Euro - by 4.3 per cent to Rb 40.65. As a result, the value of currency basket¹ continued to decline, amounting to Rb 34.81 (-2.9 per cent).

Since February 24, 2010, the Bank of Russia decided to reduce the refinancing rate and other key interest rates on the Central Bank operations. The refinancing rate was set up at the rate of 8.5 per cent per annum (see *Table. 1*).



Source: RF Central Bank, author's estimates.

Fig. 3. Indicators of RUR exchange rate within January 2005 – January 2010²

Table 1

INTEREST RATE UNDER RF CENTRAL BANK CREDIT OPERATIONS

	Term	From 25.11.09	From 28.12.09
Lombard credits (lowest interest rates)	14 days	6	5.75
	3 months	7.5	7.25
	6 months	8	7.75
	12 months	8.5	8.25
Direct Repo through an auction (Stock Exchange and OTC) (minimum interest rate)	1 day	6	5.75
	7 days	6	5.75
	90 days	7.5	7.25
	6 months	8	7.75
Overnight credits	Overnight	8.75	8.5
	«Foreign currency swop» (RUR share)	1 day	8.75
Lombard credits (under fixed interest rate)	1 day	7.75	7.5
	7 days	7.75	7.5
	30 days	7.75	7.5
Direct Repo (under fixed interest rate)	1 day	7.75	7.5
	7 days	7.75	7.5
	12 months	8.5	8.25
Credits, secured by assets or warranty (Credit, secured by assets or warranty)	Up to 90 days	7.75	7.5
	From 91 to 180 days	8.25	8
	From 181 to 365 days	8.75	8.5
Deposit operations (Credit, secured by assets or warranty)	«tom-next», «tom-next», «on demand»	3.5	3.25
	«Week 1», «Spot-week»	4	3.75

Source: RF Central Bank.

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

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

Therefore, the Bank of Russia has decreased the interest rate for the eleventh consecutive time and for the first time in the current year. As in preceding months, reducing the interest rates, the Bank of Russia was ruled by the continuing downward trend in inflation rate (as of January 2010 results, the CPI amounted to 8.1 per cent in annual terms). Interest rates reduction is aimed primarily at encouragement of real sector crediting and, consequently, the restoration of sustainable economic growth, as well as to limitation of the inflow of speculative capital to the country. Decision on further mitigation of monetary policy will depend on the inflation dynamics, as well as indicators of industrial and credit activity, and will be taken by the Board of Directors of the Central Bank in March. Nevertheless, the potential for further interest rates decrease is limited due to significant money supply growth in the last months of 2009. ●

FINANCIAL MARKETS¹

N.Burkova, E.Khudkova

In February¹ there was volatile dynamics in the Russian financial market, urged by both external and internal factors. Thus, the financial performance of major international and Russian companies, the positive macroeconomic statistics from the US and the forecast of the international rating agency Fitch Ratings on economic growth in Russia in 2010 by over 4.5 per cent contributed to the support of the corporate securities market and growth of the daily average turnover by more than 40 per cent. Similar trends were observed in the market of futures contracts, which demonstrated a 2-fold growth in trading volume as compared with the previous month. However, fluctuations in oil prices, uncertain prospects of the global economy, the volatility of the national Russian currency resulted in reduction of the government bond market by nearly 4 times. The situation in the domestic corporate bonds market was sufficiently stable. The volume of the market remained virtually unchanged, the index of corporate bonds continued to grow, while the effective yield was reducing, the volume of secondary trading again has overcome its record, the indicators of the primary market were improved. Meanwhile, the situation with the performance of issuers of their obligations to bondholders remained complicated, though all emitters managed to redeem their issues in the current month.

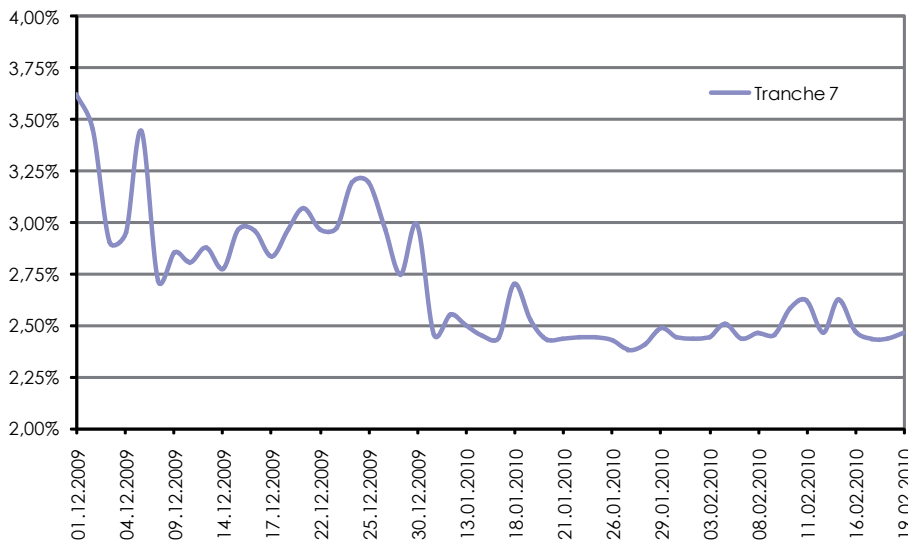
Government securities market

Since late January, there was started a correction in the government bond market, which was demonstrating increasing growth during the month, as well as high resistance to the negative indicators of internal and external financial markets. A sharp downfall in the market of government bonds in the late January - early February was provoked by the overall instability of other markets as a result of growing fears about the financial situation of Greece and Portugal, as well as Euro prospects, USD strengthening against major foreign currencies, changes in Japan's long-term credit rating, estimated by Standard & Poor's as "negative", the tightening of monetary policy in China, fluctuations in oil prices, the volatility of the Russian national and the reduction of ruble liquidity in connection with the onset of the next tax period in early February. Against this background, investors attitude was wait-an-see. Herewith, taking into account the factors of deteriorating external environment since the end of January and the reluctance of the Ministry of Finance to offer a reward to the secondary market with the acquisition of government securities, the only auction on government bonds placement in the primary market within that period actually failed (the volume of placement was only 3.71 per cent of the estimated total).

As of February 23, the Russian Eurobonds RUS-28 yield to maturity has decreased as compared with the level of January 24 from 6.17 to 6.12 per cent per annum (by 0.63 per cent), RUS-18 – from 5.03 per cent to 4.99 per cent per annum (by 0.74 per cent). At the same time, the yield to maturity of RUS-30 has increased from 5.32 per cent to 5.35 per cent per annum (by 0.56 per cent), and RUS-10 – from 0.38 to 0.83 per cent per annum (times 2.2). As of the same date, a similar upgrading trend was observed in the yields of external currency debt bonds. Thus, the yield to redemption of the seventh tranche of external currency debt bonds has increased from 2.45 to 2.47 per cent per annum (by 0.9 per cent) (see *Figs 1-2*).

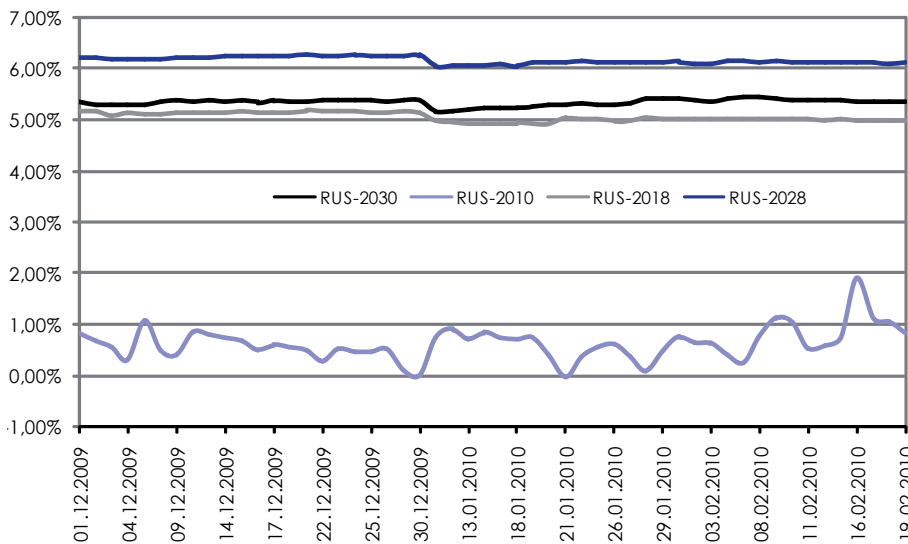
Within the period from January 25 to February 23 the total turnover of the secondary market of government bonds amounted to approximately RUR 93.62 billion with an average daily turnover of RUR 4.68 billion (about RUR 327.89 billion with an average daily turnover of RUR 18.22 billion in January), which means the downfall of an average monthly turnover nearly by 4 time.

¹ In the course of preparation of the survey, there were used analytical materials and surveys published by the "Interval", MICEX, RTS, RF Central Bank and the materials presented at web sites of Russian issuing companies.



Source: "Finmarket" Information Agency data

Fig. 1. Minfin bonds' yields to maturity in December 2009 – February 2010



Source: "Finmarket" Information Agency data

Fig. 2. Yields to maturity of the Russian Eurobonds with maturity in 2010, 2018, 2028 and 2030 in December 2009 – February 2010.

In the period from January 25 through February 23, like a month before, there was one auction on government bonds placement at the primary government bonds market. Thus, an auction for government bonds placement series 25073 for the amount of RUR 45 bn was arranged on January 27. Actual placement volume was RUR 1.67 bn with an average weighted yield of 7.19 per cent per annum. Therefore, the actual volume of placement for the period under review was only RUR 3.71 per cent versus the estimated level (86.58 per cent a month earlier), which demonstrates a sharp decline in the interest of the investors to placements in the primary government bonds market in February.

In addition, in the period under review there was also one auction on additional placement of government bonds in the secondary market. On February 17 an auction on government bonds series 25073 additional placement was arranged for the total volume of RUR 20 bn, actual volume of placement made RUR 6.87 bn (i.e., 34 per cent of the estimated volume) with an average weighted yield of

6.99 per cent per annum. This trend has reflected the general downgrading dynamics in the market of government bonds.

As of February 24, the volume of government bonds made RUR 1,476.43 bn at face value and RUR 1,454.42 bn at the market value (as compared with RUR 1,467.89 bn and RUR 1,439.85 bn accordingly as of January 24). The duration of the OFZ market portfolio was 1,616.92 days, having decreased by 5.38 days as compared with the preceding month (as of January 24).

Stock market

Stock market situation

In February, in contrast to the previous month, trading volumes in the stock market showed a marked increase on the background of the continuing volatility of the global financial markets, strengthening the national Russian currency against Euro, the forecast of the international rating agency Fitch Ratings on the growth of Russian economy in 2010 by 4.5 per cent, the growth

of industrial production in Russia in January 2010 by 7.8 per cent (as compared to January 2009), the RF federal budget surplus in January 2010, amounting to 66.12 billion rubles on the one hand, and a decline of the international reserves of Russia, as well as the Russian GDP in 2009 by 7.9 per cent to 39.16 trillion rubles (by estimates), decrease of foreign direct investment in the Russian economy by 38.4 per cent, decline of export volume and Russia's imports in 2009 (according to the tentative data) by more than 30 per cent, reduced sales of new cars in Russia in January 2010 by 37 per cent, as well as the growing number of unemployed in Russia in January (to 6.84 million people) and revocation of licenses from a number of banks on the other hand.

All those factors contributed to the volatile dynamics of the Russian financial market with a predominance of downward trend of quotations within the month. MICEX index has reached minimum value for the period on February 12 – 1,304.86 points (against 1,351.19 points in the preceding month). The maximum value the MICEX index has reached on February 2, having reached 1,436.63 points (1,484.03 per cent points in the preceding month) (Fig. 3).

In general, within the period from January 25 to February 23, the MICEX index has increased by 4.02 per cent, what makes about 56.63 points in absolute terms (within the year, from February 24, 2009 to February 23, 2010, the MICEX index has been upgraded times 2.5). Over the same period, the turnover of trades in shares, included in the MICEX index, made about RUR 1,145.84 bn at an average daily turnover of RUR 57.29 bn (against RUR 724.84 -13824 with an average daily turnover of RUR 40.27 -13824 in the preceding period). Therefore, the investors' average daily activity in the stock market in February has grown as compared with the preceding period by 42.3 per cent. The indicators of maximum and minimum daily turnover in the market trades made, accordingly, RUR 76.72 bn (as of February 5), and RUR 27.77 bn (on February 15).

As of the month results (from January 25 through February 23), all the "blue chips" securities have shown a declining trend, with the exception of VTB Bank. The leaders in downgrading were Sberbank of Russia, whose shares have decreased by 10.11 per cent, Gazprom Neft (by 9.19 per cent) and Mosenergo (7.72 per cent). Some less downgrading rates were noted in securities of Rosneft (6.06 per cent), Gazprom (6.03 per cent), Surgutneftegas (5.30 per cent) and LUKOIL (5.08 per cent). They were followed by "Rostelecom", GMK Nornickel and

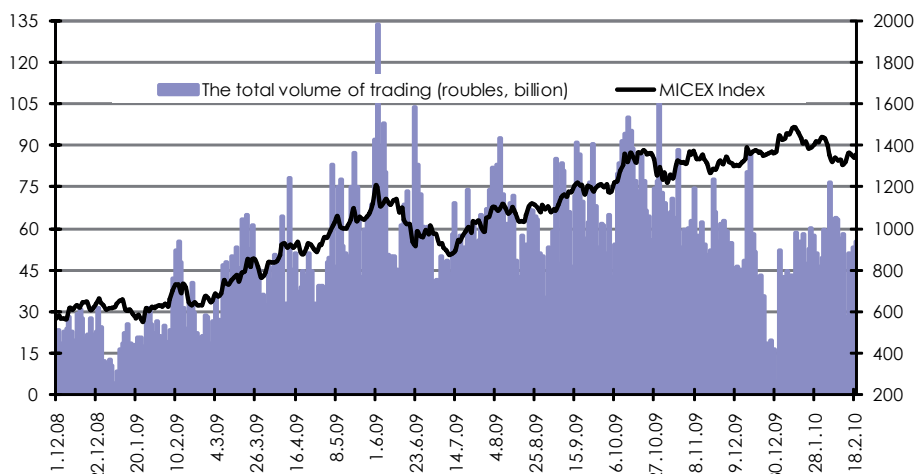


Fig. 3. Dynamics of MICEX Index and trading volume

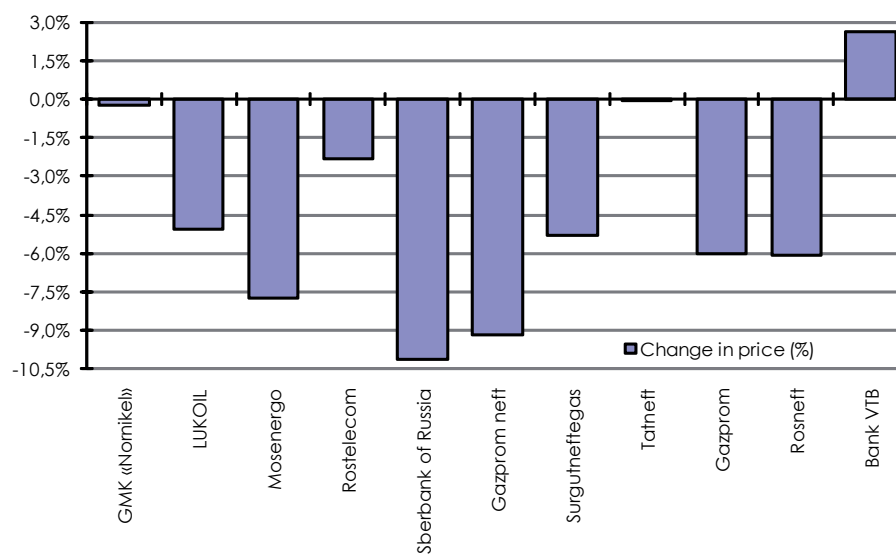


Fig. 4. Dynamic of the Russian Blue Chips from January 25 to February 23

“Tatneft” (2.33, 0.21 and 0.08 per cent accordingly). At the same time, growth by 2.64 per cent was demonstrated by VTB Bank (*Fig. 4*).

In February the MICEX turnover leaders were: “Sberbank of Russia” (30.61 per cent of the total turnover), “Gazprom” (22.88 per cent), Rosneft (8.55 per cent), (GMK “Nornickel” (7.12 per cent), and “VTB Bank” (6.39 per cent). Herewith, the significant growth of transactions with the shares of Rosneft has brought to the third place among the five «blue chips» leaders. The total volume of transactions with the shares of those five «blue chips» was about 75.6 per cent (all «blue chips» - 84.13 per cent) of the total trades in shares at the MICEX stock market during the period from January 22 to February 23.

According to MICEX information, as of February 23, the top five leaders of the domestic stock market in terms of capitalization were: “Gazprom” – RUR 3,989.22 bn (RUR 4,270.70 bn a month earlier), “Rosneft” – RUR 2,447.65 bn (against RUR 2,659.29 bn), “Sberbank of Russia” - RUR 1,685.29 bn (against RUR 1,882.81 bn), “LUKOIL” - RUR 1,332.64 bn (RUR 1,417.12 bn in preceding month) and “Surgutneftegas” - RUR 882.93 bn (RUR 951.35 bn).

Futures and Options Market

In February the total turnover in the MICEX (futures) market has grown by 70 per cent as compared with the preceding month. Thus, in the period from January 25 through February 23 the total turnover in the MICEX (futures) market made approximately RUR 80.98 bn (304.79 thousand of transactions, 1.41 mln of contracts), against approximately RUR 47.65 bn (148.97 thousand of transactions, 1.14 mln of contracts) in January. The largest volume of trading in February was observed in contracts on equity instruments (foreign currency futures in January), amounting to RUR 58 billion (302.74 thousand of transactions, 0.75 mln of contracts).

Herewith, futures for the MICEX index in the short-term MICEX market in terms of the volume of trade were followed by contracts for «Sberbank of Russia», Nornickel, Gazprom and LUKOIL shares. It should be noted, that the value of the MICEX index (the price of transactions) for March 2010 was in the range of 1,330–1,440 points, for June - 1340–1430 points.

The second place in terms of trading volume within the month was taken by foreign currency futures (RUR 19.83 bn). Herewith, contracts for the US dollar were in the first place in terms of trading in the MICEX futures market, followed by futures contracts for Euro and for Euro/USD rate. It is worth noting that prices of futures contracts, concluded in January for RUR/USD futures in the MICEX market were within RUR/USD 30.2-30.5 for March 2010, RUR/USD 30-31 for June, RUR/USD 30.9–31.4, for September and RUR 31.3–31.8 for December 2010. There were no contracts for interest rate in February.

Similar trends were observed in the RTS FORTS futures market, where the investors' activity in February has increased by 2 times as compared with the previous month. Thus, in the period from January 25 to February 23 the total market turnover of futures and options in RTS was about RUR 2,144.96 billion (9.88 million of transactions, 44.43 million of contracts) as compared with about RUR 973.79 billion (4.5 million of transactions, 20.78 million of contracts) in January. The greatest demand among the participants, as before, was demonstrated in Futures: trading volume in them during the period under review amounted to RUR 2 081.01 billion (9.76 million of transactions and 42.97 million of contracts). The first place in terms of futures trading volume were the futures contracts on the RTS index, which were followed by the futures contracts for dollar-ruble rate and for the shares of Sberbank of Russia and Gazprom. It should be noted that in the futures market of RTS FORTS prices of the recent transactions, concluded on futures contracts for the date of execution on March 15, 2010, were within RUR 30.1-30.6/USD, on June 15, 2010 - RUR 30.5-31/USD, on September 15, 2010 – RUR 30.9-31.4/ USD and on December 15, 2010 – RUR 31.2-32/USD. The value of futures of the RTS index (based on the prices of recent contracts) for March 15, 2010 was estimated on average at 1 400–1 500 points, for June 15 - 1 380–1 500 points and for September 15 - 1,380–1,480 points¹. Options enjoyed far less demand, the turnover made about RUR 63.95 bn (122.46 thousand transactions and 1.45 mln of contracts). The maximum daily turnover in the short-term RTS futures market in the period under review made RUR 150.08 billion (as of February 5), and minimum was RUR 63.32 bn. (on February 15).

1 RTS index as of 23.02.2010 made 1,489.46 points (See Table 2).

External factors behind the Russian stock market dynamics

In February the Russian financial market dynamics, as a month earlier, was largely dependant on the situation in the global financial markets. Among the basic factors of positive global market indicators, affecting the Russian market in February, one should mention:

- increased global oil price at the second half of February (up to USD 80 per barrel);
- increased IMF estimates for global growth in 2010 by 0.8 per cent, up to 3.9 per cent;
- GDP growth in the US and Great Britain as of quarter IV of 2009 by 5.7 per cent and 0.1 per cent accordingly;
- information on the increase of net profit as of 2009 results: of the company Yahoo! Inc. IBM by 42.5 per cent to USD 605.2 million, of the bank Barclays Plc - by 94.6 per cent to GBP 10.29 billion (EURO11.84 billion) and of BNP Paribas - by 87.5 per cent to EURO 6.47 billion in the second half of 2009: of the company Microsoft Corp. – by 60 per cent to USD 6.7 billion, as well as the results of quarter IV of 2009: profit of Kraft Foods increased 3-fold to USD 711 million, of the banks Deutsche Bank - to EURO1.3 billion and Santander - by 13.4 per cent to EURO 2.2 billion;
- information about the plans the U.S. Federal Reserve to maintain low interest rates for a long time;
- the U.S.– government's decision to allocate in 2010-2011 additional 100 billion dollars to combat unemployment;
- decision of the European Central Bank on the conservation of the discount rate at 1 per cent, and the Bank of England - at the level of 0,5 per cent;
- reduction of the US balance of trade deficit within 2009 to 45.3 per cent;
- growth in industrial production in the U.S. in January 2010 as compared with the previous month by 0.9 per cent and the volume of new houses construction by 2.8 per cent;
- plans of the US bank JP Morgan Chase & Co. For buying oil, metallurgical assets and business of the European energy company RBS Sempra Commodities, owned by British bank Royal Bank of Scotland in the amount of USD 1.7 billion.

Along with the above, the following events were restraining the global financial markets growth within the month:

- economic problems of Greece, Portugal and Spain as a result of increasing deficit of their budgets;
- downgrading of the long-term credit rating of Japan from "stable" to "negative" by the international rating agency Standard & Poor's;
- the US government plans to reduce the measures to support the economy;
- decreased world oil prices in late January - early February to 71 dollars per barrel;
- increased number of application for unemployment allowance in the United States in January;
- information on the net losses of the German bank Commerzbank AG in 2009 in the amount of USD 1.15 billion;
- lower net profit of Unilever in the IV quarter of 2009 by 24 per cent to EURO 906 million;
- Chinese central bank tightened monetary policy in the country, as well as raising reserve requirements for banks to 16.5 per cent;
- upgrading of the upper threshold for the USA public debt from USD 12.4 to 14.3 trillion;
- decline in industrial orders in Germany in December 2009 by 2.3 per cent as compared with preceding month;
- decline of Japan GDP 5 per cent to 5.1 trillion as of 2009 results.

All those factors have generally resulted in volatile dynamics of the global stock indices in February, as of the month results. Herewith, the markets of developed countries were demonstrating either growth in the indices by 0.2-2.4 per cent, or a decline by 2-3 per cent. At the same time, the stock markets of the majority of developing countries have fallen down over the month by 1-5 per cent with the exception was the Mexican and Chilean indices (IPC and IPSA), which have grown by 3.3 and 1.3 accordingly. Herewith, there was observed a decline in the basic stock market indices in the global markets as compared with early January 2010 results (See *Table 2* and *Fig. 5*).

Table 2
DYNAMICS OF THE GLOBAL STOCK INDICES (AS OF FEBRUARY 23, 2010)

Index	Ticker	Value	Dynamics within the month(%)*	Dynamics since the year beginning(%)
MICEX (Russia)	MICEXINDEXCF	1 353.75	-4.02	-1.19
RTS (Russia)	RTSI	1 423.13	-4.45	-1.49
Dow Jones Industrial (USA) Average (USA)	DJI	10 282.41	1.08	-1.40
NASDAQ Composite (USA)	NASD	2 213.44	0.37	-2.46
S&P 500 (USA)	SPX	1 094.60	0.26	-1.84
FTSE 100 (UK)	FTSE	5 315.09	0.23	-1.81
DAX-30 (Germany)	DAX	5 604.07	-1.60	-5.93
CAC-40 (France)	CAC	3 707.06	-2.98	-5.82
Swiss Market (Switzerland)	SSMI	6 649.09	2.39	1.58
Nikkei-225 (Japan)	NIKKEI	10 352.10	-2.25	-1.84
Bovespa (Brasil)	BUSP	66 108.31	-0.17	-3.62
IPC (Mexico)	IPC	31 850.24	3.31	-0.84
IPSA (Chile)	IPSA	3 817.57	1.13	6.59
Straits Times (Singapore)	STI	2 782.55	-1.32	-3.97
Seoul Composite (South Korea)	KS11	1 628.90	-3.29	-3.20
ISE National-100 (Turkey)	XU100	51 416.56	-4.78	-2.67
BSE 30 (India)	BSE	16 286.32	-3.40	-6.75
Shanghai Composite (China)	SSEC	2 982.58	-4.67	-8.99
Morgan Stanley Emerging Markets Free Index	EFM	746.18	-2.24	-4.68

* – Versus index indicator valid on January 24, 2010.

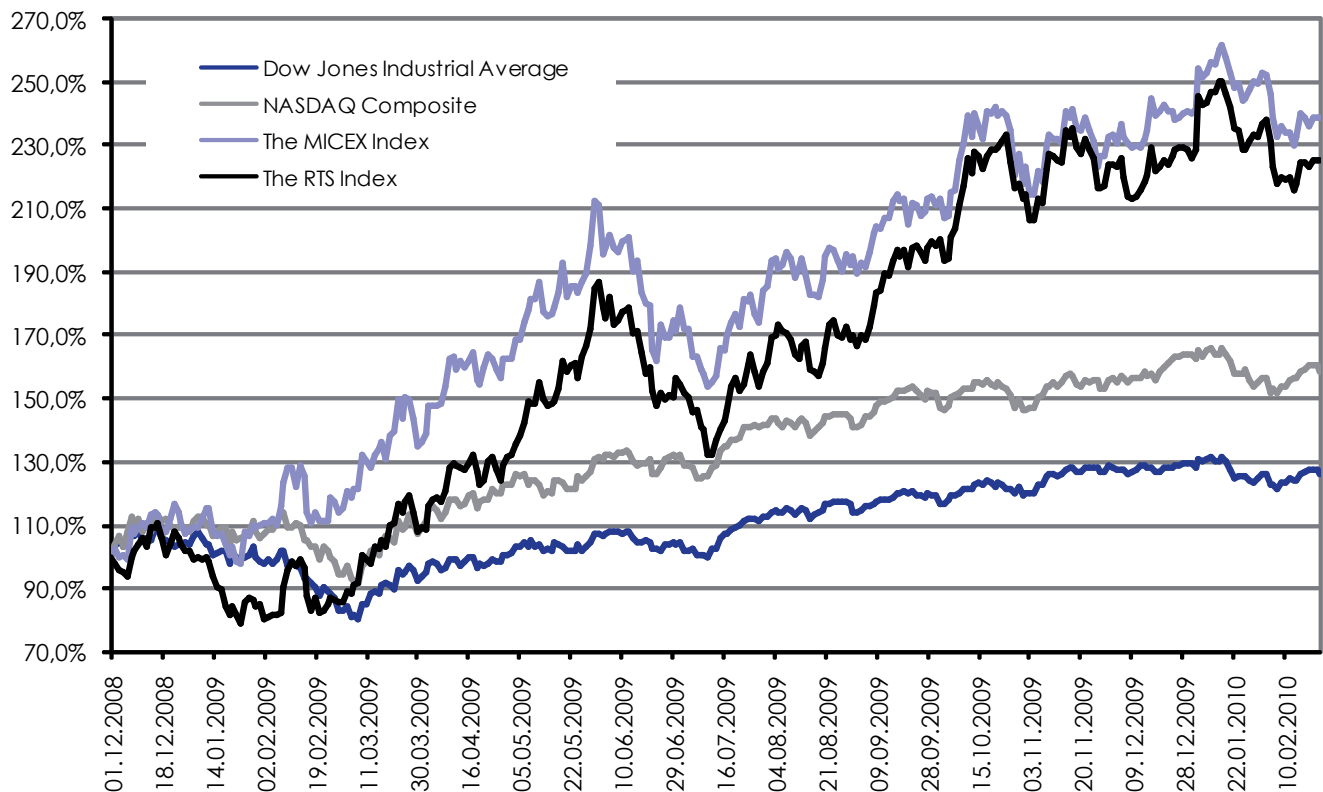


Fig. 5. Dynamics of the main USA and Russian stock indices (in % to the date 01.12.2008)

Corporate News***OAO "VTB Bank"***

On February 4 OJSC "VTB Bank" has disclosed unconsolidated financial reporting as of January 2010 prepared as per RAS: Assets on February 1, 2010 amounted to RUR 2,591 billion, as compared with RUR 2,673 billion on January 1, 2010. The net profit reached RUR 6.16 billion. On February 16, VTB Bank became the monitor of the syndicated loan "Belarusbank" in the amount of USD 60 million for trade financing.

OAO «Gazprom»

On January 28, OAO "Gazprom », PGNiG SA and AO "EuRoPol GAZ" have signed an agreement on the long-term cooperation in gas sector, including the extension of the contract for natural gas supply from Russia to Poland until 2037 and extension of the contract for transportation of gas to Western Europe through Polish territory by gas pipeline "Yamal - Europe" until 2045. Also on January 28, OAO "Gazprom" has signed a cooperation agreement with the State Corporation "Rostekhnologii" aimed at coordinating the actions of the parties in the development, production and deliveries of modern hi-tech import-replacing equipment and other products to Gazprom by organizations of the State Corporation "Rostekhnologii". On January 29, OAO "Gazprom" and HDB (Hungarian Development Bank) have established a joint venture with South Stream Hungary Zrt, the scope of activities of which will include the development feasibility study for the Hungarian section of the "South Stream", as well as financing, construction and operation of the pipeline on the territory Hungary. On February 1, OAO "Gazprom" has disclosed consolidated interim brief financial results under under IFRS for 9 months of 2009: net profit amounted to RUR 479,289 million (against RUR 751 676 million within the same period of 2008).

OAO «Gazprom Neft»

On January 28, OAO "Gazprom Neft" has signed a contract on development of Badra field in Iraq for 20 years with possible extension for 5 years; total investment in the project will amount to USD 2 billion. The share of OAO "Gazprom Neft" participation as the Project Manager is 30 per cent, the share of Kogas (Korea) is 22.5 per cent, Petronas (Malaysia) is 15 per cent, TPAO (Turkey) is 7.5 per cent, the Iraq government, represented by the Iraq exploration companies (Oil Exploration Company, OEC) is 25 per cent. On February 2, OAO "Gazprom Neft" has won a court trial at the second instance on the abolition of Federal Antimonopoly Service (FAS) penalty in the amount of RUR 4.7 billion. On February 18, OAO "Gazprom Neft" and the Swedish company Malka Oil completed the acquisition of OOO «STS-Service», the basic production unit of Malka Oil, amounting to SEK 820 million (about USD 113 million).

NK «Rosneft»

In late January, consulting company PFC Energy has allocated the 13-th place to Rosneft in the annual rating of the 50 largest public energy corporations in the world. On February 1, "Rosneft" has disclosed an audited consolidated financial reporting for 2009, developed under U.S. GAAP: EBITDA amounted to USD 13.6 billion, net income decreased by 35.8 per cent to USD 6.5 billion, net debt decreased by USD 2.8 billion to USD 18.5 billion, the dividends were paid in the amount of USD 622 million.

Sberbank of Russia

On January 25, Sberbank of Russia has disclosed financial reporting for 2009, developed under RAS (excluding the events after the reporting date): net profit amounted to RUR 36.2 billion against RUR 109.9 billion in 2008, assets increased by 5.8 per cent to RUR 7,110 billion; Russian enterprises were granted loans amounting to about RUR 4 trillion, Bank's capital adequacy ratio amounted to nearly 23 per cent. Herewith, on February 15, Sberbank of Russia has disclosed financial reporting for January 2010, developed under RAS: net profit increased 3.3 times to RUR 11.7 billion (against RUR 3.5 billion in January 2009). On February 11, Sberbank of Russia has early repaid subordinated debt amounting to USD 1 billion. On February 9, Sberbank of Russia resumed car credits for private individuals in the framework of the state program of subsidizing

interest rates (in 2009 under this program Sberbank of Russia has provided about 53 thousand car credits in the amount about RUR 12 billion).

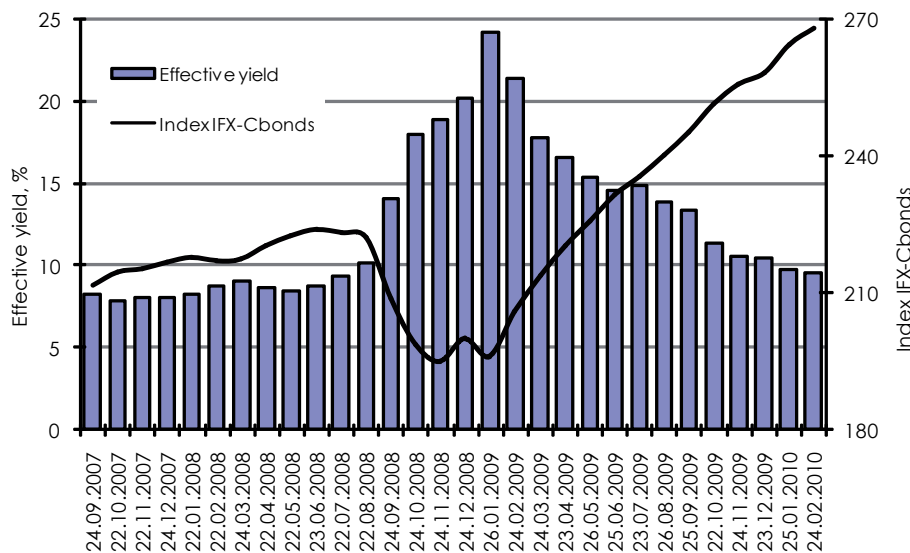
Corporate bonds market

The volume of the Russian domestic stock market (as per nominal value of shares in circulation, denominated in national currency) in February 2010 has remained virtually at the same level and at the end of the month reached RUR 2,404.4 bn, having declined only by 0.5 per cent against the relevant indicator of preceding month¹. The number of emitters and emissions in circulation has been significantly decreased from 404 to 386 emitters and from 692 to 666 emissions, denominated in national currency. This is the result of large volume of bonds maturity, as well as successful IPOs placements of large companies, which made a number of emissions in the fourth quarter of 2009. There are still one emission of bonds in circulation, denominated in Japanese yens and three emissions denominated in US dollars. In February of the current year the volume of trading in the secondary market of corporate bonds reached a new record level. The trading volume in the period from January 25 to February 19 of the current year reached its maximum over the last eighteen months and amounted to RUR 114 billion, which is by 25.4 per cent higher than in the relevant period of the relevant (from December 22 of the last year to January 22 of the current year, the trading volume was equal to RUR 90.9 billion)². In the period under review on the MICEX Stock Exchange there were committed 26.3 thousand of transactions in bonds (for the previous period, the number of transactions amounted to 26.4 thousand).

In February of the current year the trend to growing index of the Russian market of corporate bonds IFX-Cbonds, which was observed throughout the preceding year was continued. Within the period from January 26 to February 24, the index has grown by 3.3 points (or 1.2 per cent), having reached the highest level since the beginning of its assessments. The effective yield has decreased again from 9.8 to 9.6 per cent during the period under review (see Fig. 6). The duration of corporate bonds market portfolio dynamics was continuing to decline and at the end of February made 572 days, which is by 20 days less against the level of late January.

In February of the current year, large companies still were active in borrowing through the bonds emissions, registering 3-7 emissions at a time. The number and total amount of registered

emissions have decreased in comparison with the previous month more than twice. Thus, in the period from January 26 to February 24, ten emitters have registered 23 bond issues for the total amount of USD 78.7 billion (for comparison, from December 24 to January 25 eleven emitters have registered 38 emissions amounting to RUR 188.6 billion). Recently, large companies are paying special interest to the bonds issue under the simplified procedure without a state registration in the Federal Financial Markets Service of Russia – out of 23 totally issued, 14 were exchange bonds. The largest share of the reported emis-



Source: Cbonds data.

Fig. 6. Russian corporate securities index and average weighted yield dynamics

1 As per Responds information
 2 As per “Finmarket”Information agency.

sions were seven series of bonds of OAO “VTB Bank” for the total amount of RUR 50 billion and two series of bonds of ZAO “VTB-24” in the amount of RUR 15 billion¹.

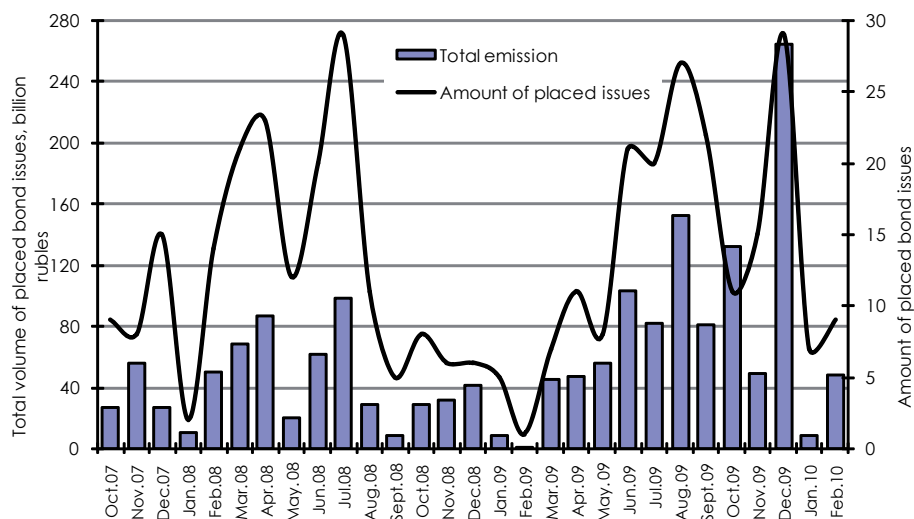
The dynamics of primary bond market, after the extremely low indicators of primary bond market in January, typical at the beginning of each year, in February this indicator has grown several times. Thus, in the period from January 26 to February 24 there were placed nine corporate bonds emissions totaling to RUR 48.1 billion (for comparison,

from December 24 to January 25 there were placed 7 emissions for the total amount of RUR 8.5 billion, while from November 25 through December 23 there were placed 41 emissions denominated in national currency for the total amount of RUR 264.2 billion (Fig. 7). During the period under review the largest bond issues were placed by OAO “Russian Railways» (one series of bonds worth RUR 15 billion), OOO «Severstal» (two series of stock bonds worth RUR 15 billion) and OAO “Russian Agricultural Bank” (two series of stock bonds worth RUR 10 billion).

In the period under review there was only one emission offered for open placement, recognized invalid due to non-placement of any security, which is a positive indicator, as throughout preceding year the Federal Statistical Service for Financial Markets of Russia has recognized as invalid 4-5 issues of corporate bonds each month².

Within January 26 – February 24 emitters were supposed to redeem their 13 bond issues totaling for RUR 24.8 billion. However, five emitters, have announced a technical default on repayment of their bond loan, totaling to RUR 6.6 bn (against one emitter announced a technical default on repayment of its bond loans, totaling to RUR 1.2 bn in preceding period). Therefore, the beginning of the current year demonstrates that the problem with the return of invested funds to investors is not resolved yet. In March, 26 issues of corporate bonds redemption for the total amount of RUR 23.9 bn are expected³.

Thus, from January 26 through February 24, the real default on bonds coupon yield redemption was announced by seven emitters (since December 24 through January 25 a real default on bonds coupon yield redemption was announced by 17 emitters on 19 emissions). Among them, two emitters managed to reach agreement with bondholders to restructure the debts. A real default on offer (bonds redemption), like in the last month was announced by one emitter⁴. Herewith, all emitters managed redeem the nominal value of their bonds, at least in the framework of technical default (in the previous period 9 issuers failed to repay 10 emissions totaling to 12.2 billion rubles). ●



Source: Rusbonds data

Fig. 7. Corporate securities primary placement dynamics, denominated in national currency

1 As per Rusbonds data
 2 As per FSS of Russia.
 3 As per Rusbonds data.
 4 Cbonds data

REAL ECONOMY SECTOR: TRENDS AND FACTORS

O.Izryadnova

As compared with January 2009 the industry is characterized by the positive output dynamics. In January 2010 the situation at the internal market is determined by the contraction of the investments in fixed assets (by 8.7% versus the level of last January). The total number of the unemployed (as calculated by the methodology of the International Labor Organization) went up by 10.8% as compared with the previous month and made 6.8 million or 9.2% of the economically active population. The number of officially registered unemployed rose at the beginning of the current year, making 2.2 million or 3.0% of the economically active population.

In January 2010 macroeconomic situation was determined by inertial effect of factors that had been formed in the second half of 2009. It was the contraction of investments in fixed assets by 8.7% and the decrease in the construction volume by 10.6% of last January level that considerably influenced domestic market. The negative consequences of the reduction in the investment demand have been somewhat weakened by the recovery of the consumer market.

The consumer expenses growth was secured by an increase in real incomes of the population by 7.1% and in the wages by 2.6% versus January 2009, which resulted in the growth of the retail trade turnover by 0.3%. It was the rise in consumer demand for foodstuffs which was accompanied with the growth of price index for this group of commodities up to 101.4% versus 100.6% in December 2009 which was the dominating factor. The demand for non-food goods remained at a low level, their price rise being 0.2% versus 0.5% on average in 2009. In January 2010 as compared with January 2009 foodstuffs turnover went up by 3.8%, non-food goods turnover going down by 3.0%. The changes taking place on the consumer market accounted for the increase in foodstuffs proportion in the structure of the retail trade turnover by 1.0 percentage points.

The aftermath of economic crisis has had a negative impact not only on the structure of consumer demand as broken by the groups of commodities, but also on the market development of paid services rendered to the population. The volume of paid services rendered to the population made 98.4% of the level of January 2009. Despite the fact that growth rates of prices and tariffs for services rendered to the population were slowing down to 3.9% (versus 6.3% a year ago), in January 2010 the increase in tariffs for communal and utilities services by 12.4%, for housing services – by 5.2% and for passenger transportation – by 1.9% could not improve the situation on the market of paid services. Since the proportion of the enumerated kinds of services accounts for more than 46% of the total volume of the services rendered to the population, they had a prevailing effect on the growth of the aggregated price and tariff index as well as on the changes in the structure of services provision. Under the existing level of consumer prices and tariffs for services, in January 2010 the level of provision with recreational services fell by 12.5%, of healthcare services – by 9.3%, of educational services – by 7.2%, of legal services – by 26.4% as compared with the corresponding period of the previous year.

Current expenses of the population are considerably affected by the steady trend towards the increase of savings as a sort of insurance in the wake of the crisis (which also reflects the fall in credits' availability). As a result of 2009 the proportion of savings in the monetary incomes of the population made 14.2% versus 5.3% in the preceding year.

Since more than 70% of the incomes of the population are accounted for by labor remuneration, the problems of employment and job placement are of primary importance for the incomes dynamics. The situation on the labor market has been worsening since October 2009 and remained quite tense in January 2010.

In January 2010 the unemployment (calculated according to the ILO methodology) went up to 6.841 million (or 9.2% of the economically active population) against 6.173 million in December

2009. Starting with November 2009 the number of unemployed registered in unemployment bodies has been increasing. Over January 2010 the number of officially registered unemployed went up by 55 thousand and made 2.202 million or 3.0% of economically active population. Unemployment benefit was paid to 1.9 million individuals. However, according to the data of IET's February business survey, enterprises do not exclude a possibility of additional hiring of employees and cutting the number of dismissals.

The number of employees working part-time, being on holidays initiated by administration or staying idle remains at high level. According to the data of monitoring of the situation on the labor market by the Ministry of Public Health and Social Development of the Russian Federation as of February 10, 2010 the number of such employees makes 1.616 million.

Despite the measures undertaken to create workplaces in order to decrease the tension on the labor market, demand for workforce submitted to the state placement services made 801.6 thousand in January 2010 and remained below the figures of the beginning of 2009. The tension coefficient on the labor market (number of the unemployed registered in the state placement services per 100 vacancies) went up to 310.6 in January 2010 as compared with 244.0 in the corresponding month of 2009.

It was the recovery of the positive production dynamics, branches of infrastructure and foreign trade turnover that had the positive influence on the overall economic situation in January 2010. In January 2010 increase in agriculture goods production made 3.2% versus the corresponding month of the previous year and was mainly accounted for by the growth of livestock sector products. The freight transportation turnover went up by 11.3%, and the railway transportation turnover – by 16.6%. In January 2010 the industrial production went up by 7.8% versus the level of January 2009.

Taking into account low basic level of January 2009, nearly all kinds of activities were affected by the recovery of positive dynamics. The minerals production went up by 6.9% versus January 2009, fossil fuels production – by 6.7%. Production of primary fuel and energy commodities increased by 9.9%, volume of oil production – by 3.1%, natural gas production – by 17.3%, coal production – by 11.6%. Electricity, gas and water production and distribution has grown by 8.4% as compared with the corresponding period of the previous year.

It should be noted that the trend for monthly growth of oil production versus the corresponding period of the previous year, which has been observed since March 2009, was maintained. According to the data of the Ministry of Energy of the Russian Federation, the net oil export is estimated to be 20.8 million tons in January 2010, which makes 100.5% versus January 2009, and the volume of domestic consumption – 20.7 million tons or 106.6% versus preceding January. Oil products production index made 108.7% in January 2010 as compared with the corresponding period of the previous year.

Growth of gas production is accounted for by cold weather, continuing recovery of export and increase in domestic consumption. Gas consumption in Russia (according to the preliminary data) went up by 14.6% in January 2010 versus January 2009, including by boiler and heat stations of the Unified Energy Systems – by 11.4%. In January 2010 gas export made 19.6 billion cu m, exceeding by 2.2 times corresponding figure of a year ago.

Growth of electric power production was accompanied by an increase in the proportion of heat power stations in the structure of general production up to 72.4% versus 70.4% in January 2009, and that of nuclear power plants- up to, correspondingly, 14.8% versus 14.4%, the proportion of hydro power plants falling to 12.8% versus 15.2%. A substantial slump in electricity production at hydro power plants is due to both disaster at Sayano-Shushensk hydro power plant, as well as to unfavorable hydrological situation on a number of Russia's rivers. Thus, electricity production at a number of hydroelectric power plants on Volga and Kama dipped by 20.4% in January 2010 versus January 2009, and on a number of hydroelectric power plants on Angara and Yenisei – by 14.8%. Energy consumption made 101.4 billion of kW, exceeding by 7.5% the figure of the corresponding period of the previous year, which is due to cold weather and production growth.

Output volume of processing industries in January 2010 went up by 7.6% versus last January. Level of January 2009 was exceeded by all types of processing industries excluding transport vehicles and equipment production (83.9%). Growth rates of processing industries differ substantially

depending on the basic level of January 2009 and the extent the productions have adapted to the changes in demand on domestic and external markets.

Table 1

PRODUCTION INDICES AS BROKEN BY MAIN KINDS OF PROCESSING INDUSTRIES

	January 2009 as percentage versus		January 2010 as percentage versus	
	January 2008	December 2008	January 2009	December 2009
Processing industries	75.9	67.3	107.6	73.1
Production of foodstuffs, including beverages	96.4	76.4	101.9	70.5
Textile and sewing	71.9	67.4	110.1	75.8
Leather, leather goods and footwear	74.0	71.5	137.3	77.2
Wood processing and timber goods	66.6	74.0	112.7	81.5
Pulp and paper, publishing and printing	78.9	78.3	109.7	82.6
Coke and oil products	95.7	95.9	108.7	97.3
Chemistry	67.1	88.6	134.1	99.0
Rubber and plastic goods	73.3	63.8	120.9	68.6
Production of other non-metal mineral commodities	65.7	68.3	107.0	83.0
Metallurgy industry and production of finished metal goods	69.9	79.2	106.5	71.3
Machinery and equipment	54.1	38.5	114.7	92.8
Electric, electronic and optical equipment	52.9	39.5	115.8	52.5
Transport vehicles and equipment	64.0	54.6	83.9	52.4
Other industries	84.0	69.1	109.1	92.1

Source: Federal State Statistics Service

Analysis of the main trends in the real sector allows to draw conclusion that though in the 4th quarter 2009 the Russian economy recovered from the acute phase of the crisis, the unsteady nature of dynamics of main macroindices, low indicators of investment activity, complicated on the state of labor market and set considerable limits to the development of the Russian economy in short-term perspective. ●

RUSSIAN INDUSTRY IN FEBRUARY 2010

S.Tsukhlo

The first data on the situation at enterprises in February 2010 have burnt out the mist that traditionally obscures the statistics of December and January, which was this time aggravated by the transition of the Federal State Statistic Service to the new structure of weights when calculating the free production index. For the second month in the row the industry has been demonstrating the dynamics of sales and output that is similar to pre-crisis one. However, at the moment exclusion of seasonality reduces the optimism of the initial values. But the excesses of finished goods stocks are minimal, as well as dismissals. In contrast, the plans for employees hiring are colossal.

Official Statistics in January

According to the data of the Federal State Statistics Service, in January 2010 the growth of the industrial production made 7.8% versus January 2009 (+2.7% in December 2009 versus December 2008, +1.5% in November 2009 versus November 2008). Such a record-breaking growth versus January 2009 is accounted for by the drop of output a year ago (effect of the base). At the same time in January 2010 the goods production was 20.4% lower than in the preceding month. This drop versus December 2009 figures is the consequence of the New Year holidays. Federal State Statistics Service transferring to new structure of weights when calculating the aggregated production index has obscured the statistical data even further. The Ministry of Economic Development of the Russian Federation upon exclusion of seasonality received the growth of the industrial production in January equal to 0.7% versus December 2009. The estimation made by the Fund for Economic Research "Development Center" is a drop of 0.5%. The attempt by the Centre for macroeconomic analysis and short-term forecasting to exclude the seasonality from the official data resulted in the increase of 0.2% versus December. The latest figures, however, do not seem reliable even to the authors of the calculation, "Nominally neither we nor the Federal State Statistics Service can give such statistics". Other estimations sound similar, "We do not know the real picture. That's a sort of arbitrariness", "We are in statistical vacuum"¹. In such a situation the surveys of the enterprises give more representative and reliable picture of the situation in the Russian industry.

Demand for Industrial Goods

According to the initial data the intensity of the demand growth improved in February by 34 points at once and became positive for the first time during the current crisis, i.e. the share of enterprises with increasing sales exceeded the proportion of enterprises with decreasing sales. Similar upsurge in February was observed in 2003-2008, together with the preceding drop of demand in January (fig. 1). For the second month in the row the industry has been demonstrating the dynamics of sales that is similar to pre-crisis one. However the exclusion of seasonality has lowered the optimism of the initial data – the only positive thing that has occurred is the cessation of the decrease in the demand for the commodities, which, nevertheless, seems to be quite an achievement when compared with the situation a year ago. Upon exclusion of seasonality the most intensive growth was registered in food production and light industry. The initial forecasts for demand have improved by only 3 points in February after a leap of 50 points in January, which resulted in the reduction of the February

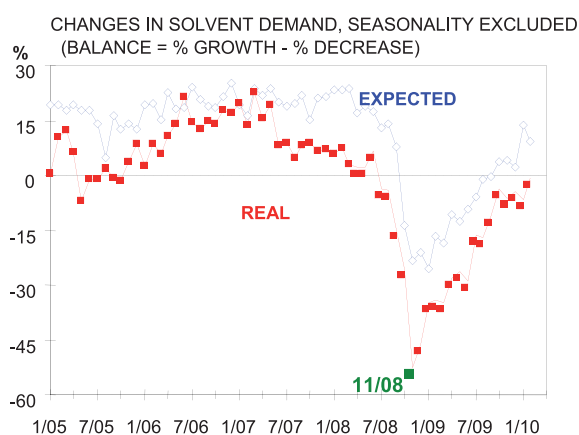


Fig. 1

1 <http://www.kommersant.ru/doc.aspx?DocsID=1323335>

figure upon exclusion of seasonality by 5 points. However the forecasts for the demand registered in 2010 still remain the best since August 2008. In March-April the sales growth is expected in all the branches of industry, excluding non-ferrous metallurgy.

Stocks of Finished Goods

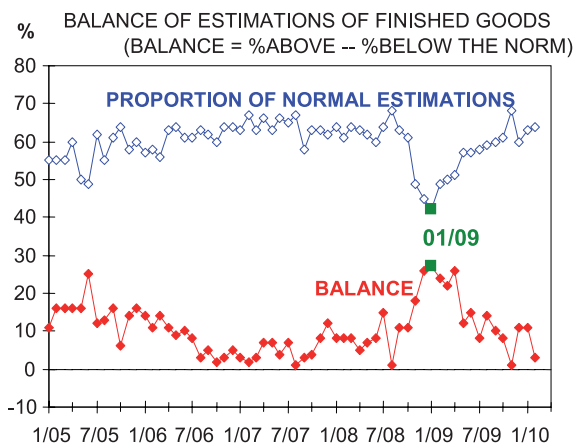


Fig. 2

Balance of estimations of finished goods went up by 8 points in February and have approached the zero value, i.e. the proportion of the responses “above the norm” is nearly equal to the proportion of the responses “below the norm” (fig. 2). The major part (nearly two thirds) of enterprises consider the stocks to be in line with the current situation (normal) and the possible prospects of its development. The highest proportion of normal estimation was registered in metallurgy, chemistry and petrochemistry (80% each), as well as in foodstuff production (76%).

Production output

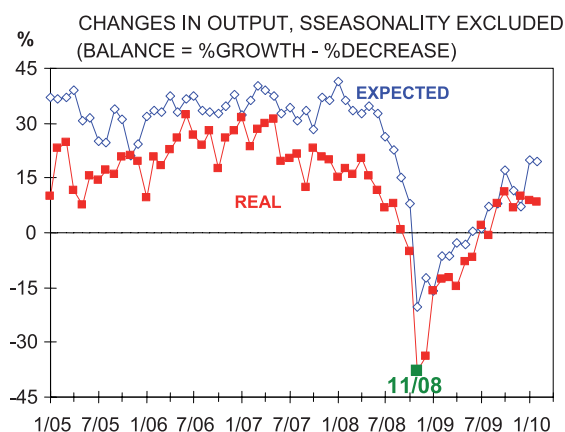


Fig. 3

Growth rates in the Russian industry (upon exclusion of seasonality) have changed but slightly since September 2009, remaining at the level of a moderately increasing output (fig. 3). At the same time the initial data, as well as the data on the demand, demonstrated a leap which is traditional for February 2003-2008. It seems that the dynamics of output in the Russian industry is returning to the pre-crisis path. In February the most intensive growth of production (upon exclusion of seasonality) was observed in foodstuffs production (+37 balance points) and light industry (+22). The positive growth of output was also registered in construction industry (+10 balance points), which was a natural reaction to the most modest contraction of the demand in the branch of industry.

The production plans of enterprises in February also additionally improved after a January leap in optimism. As a result according to the initial data over January-February 2010 the balance of the planned changes in the output went up by 68 points from -25 in December to +43 in February (in 2008 the growth over the corresponding period made 48 points, in 2007 – 43, in 2006 – 51 points). The exclusion of seasonality corrected the New Year growth till stabilization at the level of +20 points, which has been the maximum of the crisis. In March-April the growth is planned in all the branches, and the most intensive one is possible in machine-building and ferrous metallurgy.

Prices of Enterprises

For the second month in a row the growth of prices in industry has remained at the highest level over the last 18 months. It is the third time during the current crisis that the enterprises have resorted to a price attack, and this time it is quite successful. The first attempt in March 2009 was ended with the balance of prices changes going to the level of -2 points, second (September 2009) – at the level of +7, and now for the second month in the row the growth of prices is maintained at the level of +11 points (fig. 4). It is the foodstuffs (+18 points) and machine-

building (+16 points) branches of industry that take the lead. The absolute decrease of prices, and nearly negligible one, was retained only in the construction industry.

The pricing plans testify that the enterprises intend to continue or at least to maintain the growth of prices in the forthcoming months. The balance of the supposed change in prices has been increasing for the fourth month in a row. Earlier, during the current crisis, the growth of this figure has been registered for only two months in a row and was followed by the decrease. In the forthcoming months the growth of prices is planned by all the branches of industry (including the industry of construction materials).

Dismissals: Real Dynamics and Plans

In February the rate of staff dismissals in the industry have been the lowest for the current crisis (fig. 5). Over the month the balance went up by 23 points and was nearly equal to zero level (absence of dismissals on the whole in the industry). In foodstuffs production, light industry and industry of construction materials production the enterprises started to hire employees.

The balance of plans for changes in employment has become positive for the first time during the current crisis (and it should be noted for the second month in a row), thus, the enterprises testify the intention to transfer from dismissing the employees to their hiring. The continuation of dismissals (negative balance) in March-April is possible only in metallurgy, in other branches of industry the plans to increase the number of employees prevail. It is especially true for the industry of construction materials (+27), chemistry and petrochemistry (+19).

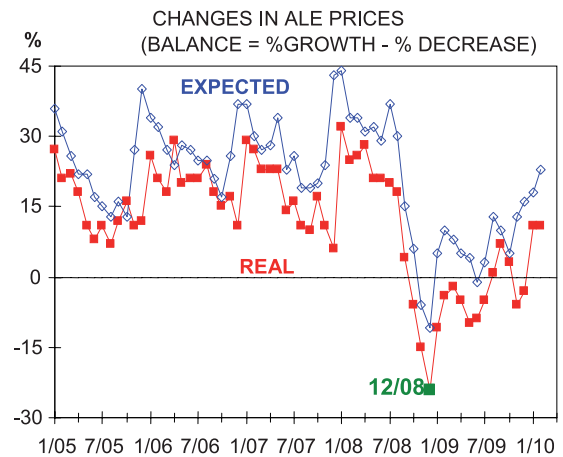


Fig. 4

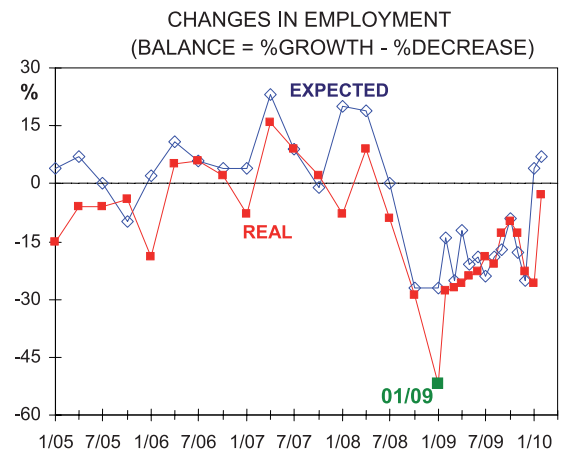


Fig. 5

FOREIGN TRADE

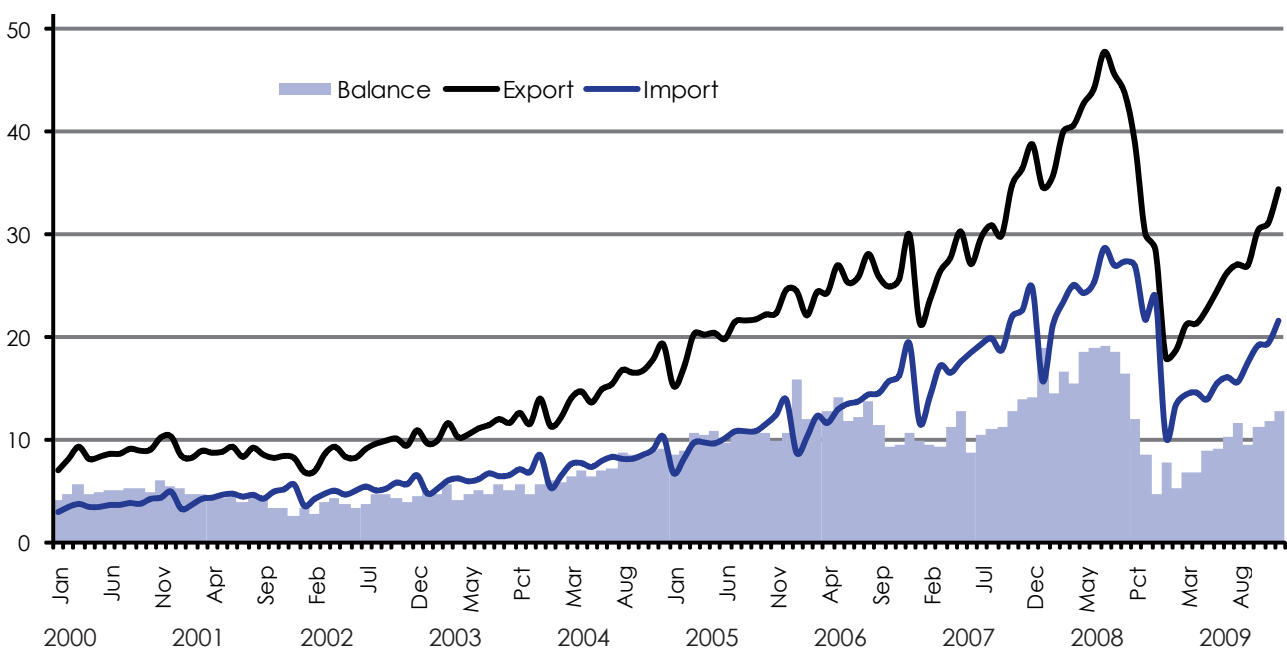
N.Volovik, K.Resenkova

The decrease in the volume of the world trade as a result of financial crisis made 12% in 2009. This has been the worst figure since 1945. However if compared with the Russian indices, this index does not seem to be so bad: the foreign trade volume of the Russian Federation dropped by 36.1% in 2009. And although during the whole last year a gradual recovery of export and import volume has been observed after their dramatic fall at the end of 2008 – the beginning of 2009, the resulting value volume of Russia's foreign trade turned out to be considerably below the pre-crisis level.

In December 2009 the Russia's foreign trade turnover made USD 56 billion, which exceeds by 11% the figure of the previous month and by 6.5% - the corresponding figure of the previous year. The recovery of the foreign trade turnover is occurring mainly at the expense of the growth of export supplies.

In December 2009 export continued to recover and reached USD 34.4 billion, which was 10.7% above the level of the previous year and 20.1% above the level of December 2008. The recovery of Russia's export value volume occurred owing to both the increase of world prices for fuels and raw materials and the growth in the physical volumes of export supplies. Thus, the index of average export prices made 62.9% over 9 months 2009 and 76.1% over the 4th quarter 2009, the figure of December being 76.9%. Index of export physical volume has also been gradually increasing and made 92.3%, 11.6% and 112.7%, correspondingly, over the periods mentioned. On the whole over 2009 the index of physical volume made 97%.

World prices for fuels and raw materials in December 2009 were retained at quite a high level, which was facilitated by the expectations of a fast recovery from the depression, steadily low dollar exchange rate and cold weather in the Northern hemisphere, which favored the growth of the demand for energy carriers and fuel.



Source: Central Bank of the Russian Federation

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

As a result of December 2009 prices for oil grade Brent went up by 43.55% versus December 2008, though reducing by 3.4% as compared with November 2009. Price for oil grade Urals made USD 73.68 per barrel in December 2009, whereas in December 2008 it was equal only to USD 39.22 per barrel.

Within the period of monitoring from January 15 to February 14, 2010 the average price of oil grade Urals made USD 72.31 per barrel. Thus, export duty rate for oil will make USD 253.7 per ton starting with March 1, 2010. At the same time duty rate for light oil products will decrease from USD 194.7 (established since February 1, 2010) per ton down to USD 183.2 per ton, and for dark oil products – from USD 104.9 per ton to USD 98.7 per ton.

According to the data of London Metal Exchange, in December 2009 as compared with November the prices for copper went up by 4.58%, for aluminum – by 11.85%, the price for nickel decreasing by 0.4%. On the whole, over the preceding 12 months average world prices for nickel have risen by 64%, for aluminum – by 48%, for copper – by 44%.

Table 1

AVERAGE MONTHLY WORLD PRICES IN DECEMBER OF CORRESPONDING YEAR

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Oil (Brent), USD/barrel	24.1	25.6	19.0	27.48	29.51	39.6	56.4	63.1	90.64	42.77	75.05
Natural gas, USD/1 million BTU	2.558	8.713	2.694	4.873	6.469	6.983	8.87	7.353	7.228	5.764	5.66
Petrol, USD/gallon	0.6986	0.7649	0.5398	0.836	0.889	1.141	1.875	1.638	2.353	0.976	1.93
Copper, USD/ton	1748.1	1914.4	1528.7	1618.6	2187.8	3137.0	4578.0	6643.9	6580.5	3072	6982.0
Aluminum, USD/ton	1470.7	1562.5	1346.3	1376.2	1553.8	1850.0	2248.0	2816.9	2380.2	1490.4	2179.7
Nickel, USD/ton	7984.2	7315.4	5219.5	7255.0	14060	13792	13423	34578	26003	9686.4	17066

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

In December 2009 export value volume made USD 21.6 billion, increasing by 11.5% versus November 2009 and decreasing by 9.8% versus December 2008. This contraction is primarily connected with the decrease in purchases of machine-building production by 24.3%, and that of textile goods and footwear – by 16.2%. Simultaneously, the import of chemistry industry goods was observed to increase by 12.2%, metal and metal goods – by 8.3%, whereas import value volume of foodstuffs and raw materials for their production has changed but slightly in December 2009 as compared with the corresponding figure of December 2008.

The decrease of Russia's import value volume as a result of the year was primarily connected with the contraction of the physical volumes of supplies, whereas during the year import in real terms has been increasing: index of import physical volume went up from 57.6% over nine months of 2009 to 81.9% in the 4th quarter 2009, in December 2009 being practically equal to the level of December 2008, making 97.6%. At the same time in the 4th quarter 2009 import prices exceeded by 4 points the level of the 4th quarter 2008, when the extreme of import prices and supplies decrease was observed. On the whole over 2009 index of import physical volume has made 663.3%, index of import prices being 99.1%.

The structure of goods import in December 2009 as compared with December 2008 was subject to considerable changes: the proportion of the investment import in value terms decreasing by 7.5 percentage points, the proportion of consumer import went up by 6.2 percentage points. Such a picture primarily reflects a much more significant decrease in volumes of production and investment activity than in the incomes of the population in 2009.

The foreign trade balance in December 2009 has grown nearly by thrice – up to USD 12.7 billion - when compared with the corresponding figure of 2008, when it went down to the lowest level

since July 2003. A considerable surplus of the trade balance was retained thanks to a fast recovery of export physical volumes, growth of export prices and quite a significant decrease of import in natural terms.

According to the data of the World Trade Organization, the volume of the world trade in 2009 as compared with the preceding year has reduced by 12%. The drop of the world trade turnover has been the maximum since 1945. The main reason for the decrease of the trade volume was the simultaneous reduction of the aggregated consumer demand in the world leading economies. The reduction of the trade turnover was facilitated, though to lower extent, by different protectionist measures – increase of the state duties, internal subsidies and adoption of additional antidumping measures. According to the data of the European Center for Economic Policy Research (CEPR), from November 2008 to the end of 2009 the governments of different countries introduced about 280 protectionist measures, and 121 of which is accounted for by the G20 countries. According to the data of CEPR, it is Russia that is the absolute leader according to the number of protectionist measures. Its share accounts for 20 most harmful protectionist measures. The second place is occupied by Germany, which adopted 15 measures, the third is divided between India and Indonesia –10 measures each. Italy, Spain and the Great Britain occupy the fourth place with 9 measures each¹.

In fact, the Government of the Russian Federation during 2009 adopted more than 60 decrees correcting import tariff of the Russian Federation. The customs duty rate were not only raised, but also reduced for a considerable number of goods and this primarily applies to the import duty rates on high-tech equipment. Out of 600 trading positions, for which import customs duty rates were changed in 2009, for 350 positions the rates were increased. Automobile industry, agriculture machine building, ferrous metallurgy, machine tools building are among the main industries to which the measures of customs and tariffs protections were adopted in order to increase the competitive ability.

In the environment of the world financial crisis and, as a consequence, the contraction of the demand, the foreign producers and government activated the protection of their own markets and expansion to the markets of other countries. There being no adequate measures from the Russian side, this, in the opinion of the Government of the Russian Federation, could have resulted in a bigger growth of production import and, as a consequence, in a contraction of proportion of domestic goods. Nevertheless, on the whole in 2009 as compared with the last year average weighted import duty in Russia also reduced: in 2008 it was equal to 11.45%, in 2009 – 10.7%.

The analysis conducted by the IET demonstrated that for a number of trading positions the adopted measures played a certain role in protection of domestic producers, however, it is difficult to speak of particular results of some since there is no recovery of the demand for the corresponding goods.

In regard to the Russian goods, in 2009 the trading partners initiated 4 antidumping investigations, 5 reconsiderations of the antidumping measures introduced earlier, as well as 10 special protective measures. As on December 31, 2009 95 limiting measures adopted by foreign states towards Russian goods, including 41 antidumping measures, 7 special protective measures and 47 measures of non-tariff regulation of trade, including the measures of administrative regulation². Maximum number of limiting measures is now in effect in Belorussia (24), the EU (17), Ukraine (13) and the USA (11). More than a half of all antidumping measures introduced were aimed against the export of Russian ferrous metals and goods thereof. The second place is occupied by mineral fertilizers and chemicals.

In 2009 the scale of worsening of the Russian indices of the foreign trade turned out to be thrice as bad as in the world. Russia's foreign trade turnover in 2009 lowered by 35.1% as compared with the preceding year and made USD 594.8 billion. Export reduced by 35.5% down to the level of USD 304 billion, import – by 34.3% down to USD 191.9 billion. Positive balance of the foreign trade of the Russian Federation reduced by 37.6% down to USD 112.1 billion.

After a dramatic drop of export and import in the 4th quarter 2008, in 2009 their volumes were observed to recover gradually. The main export growth factor was the increase of the world prices for hydrocarbons and raw materials, thanks to which the export of fuel and energy commodities, metallurgy and chemistry production was observed to recover fast. However after a

1 <http://globaltradealert.org/>

2 According to the data of the Ministry of Economic Development.

deep recession at the end of 2008, in 2009 export of machinery, mechanical equipment and cars virtually did not increase.

In the first half of 2009 import balanced at approximately one and the same level, its growth starting only in the second half of 2009. As a result of a year import of investment machinery decreased to the highest extent, and its recovery is still problematic due to the deep depression of investments.

At the beginning of 2009 there were apprehensions expressed that the foreign trade balance of the Russian Federation would fluctuate around zero level or go into negative values. However thanks to a fast growth of export prices, recovery of export physical volumes and quite a considerable decrease of import it was possible to retain a considerable surplus of trading balance. At the same time it should be noted that whereas in the 2nd and the 3rd quarters the rates of recovery of export value volumes (versus the preceding quarter) anticipated the corresponding rates of import recovery, in the 4th quarter the situation has changed: the value of Russian export in the 4th quarter went up by 15.3% as compared with the preceding quarter, and the import value – by 24%.

Thus, the main result of the development of the Russian foreign trade in 2009 is the sustention of positive foreign trade balance. At the same time the foreign trade balance did not fall below the minimum level of USD 4.6 billion, which was registered in December 2008. ●

THE STATE BUDGET

E.Fomina

In February 2010, the results of both federal and consolidated budget execution in cash terms in 2009 were published, thus making it possible to assess the situations on all levels of Russia's budgetary system over the past year. Due to the differently vectored dynamics of budget revenue and expenditure, general government budget deficit reached the level of 6.2 % of GDP, while federal budget deficit was no more than 6 % of GDP. The resulting deficit was covered mainly from domestic sources of financing, which has confirmed the feasibility of the specially created system for accumulating 'oil and gas' funds. At the same time, the crisis has once again demonstrated the negative consequences of the existing dependence of the budgetary system on revenues linked to a current economic situation, as well as the relatively low efficiency of the use of budget resources.

An analysis of the main parameters of the execution of the general government budget in 2009

In 2009, the volume of general government budget revenue dropped by 4.4 p.p. of GDP – mainly due to the considerably reduced federal budget revenue (by 3.7 p.p. of GDP against the corresponding period of 2008 (see *Table 1*). However, the dynamics of the actual execution of general government budget expenditure over the year demonstrated an upward trend. As of 1 January 2010, general government budget expenditure amounted to – 40.6 % of GDP, which is by 6.7 % of GDP higher than the corresponding 2008 parameters. This increase occurred mainly due to the higher volume of federal budget expenditure (of approximately 6.4 p.p. of GDP) associated with the implementation of the anti-crisis package.

Table 1

THE EXECUTION OF REVENUE AND EXPENDITURE OF BUDGETS AT ALL LEVELS OF AUTHORITY IN 2008 - 2009

	2009		2008		Deviation, p.p. of GDP
	in bn Rb	as % of GDP	in bn Rb	as % of GDP	
Federal budget					
Revenue	7,336.8	18.8	9,274.1	22.5	-3.7
Expenditure	9,636.8	24.7	7,566.6	18.3	+6.4
Deficit (-) / Surplus (+)	-2,300.0	-5.9	1,707.5	4.2	-10.1
Consolidated budgets of RF subjects					
Revenue	5,927.2	15.2	6,199.1	15.0	+0.2
Expenditure	6,256.3	16.0	6,253.5	15.2	+0.8
Deficit (-) / Surplus (+)	-329.1	-0.8	-54.4	-0.2	-0.6
General government budget					
Revenue	13,420.7	34.4	16,003.4	38.8	-4.4
Expenditure	15,847.3	40.6	13,989.2	33.9	+6.7
Deficit (-) / Surplus (+)	-2,426.6	-6.2	2,014.2	4.9	-11.1
For reference: GDP, bn Rb	39,016.1		41,256.0		

Source: RF Ministry of Finance, IET estimates.

Such a significant drop of the volume revenues in this country's budgetary system (see *Table 2*) resulted from the negative impact of the global financial crisis and the weakened state of the Russian economy, while the structure of RF exports, with its heavy reliance on raw materials and the extreme vulnerability of the related revenues to external shocks, remained just the way it had previously been shared up. First of all, sharp decline was demonstrated by the revenues from those taxes that directly depended on international prices for Russian export

commodities: the receipts of the *tax on mineral resources extraction and the revenues from foreign trade*. These revenues in the general government budget decreased by 1.3 p.p. and 1.7 p.p. of GDP respectively by comparison with the 2008 indices.

In this connection, it is planned to introduce, already in the medium term period, 'tax holidays' with regard to the payment of the tax on mineral resources extraction: from 2011 – for oil and gas deposits in Yamal and for oil fields in the basins of the Black and Okhotsk Seas. This measure may have a stimulating effect for the enterprises belonging to the fuel and energy complex by promoting interest in the development of those territories. At the same time, there also exists the risk of a further decline in the volume of revenues from the tax on mineral resources extraction, which the RF Ministry of Finance intends to control by increasing the annual rate of indexation of the base tax rate for the extraction of gas¹. On the whole, it can be noted that the share of revenues from oil and gas in the aggregate budget revenues is gradually decreasing.

Alongside the factors linked to the external economic situation, the size of budget revenue was also influenced by the difficult situation faced by the domestic economy in 2009, a slump in production and the general slow-down of entrepreneurial activity that resulted in a dramatic reduction of the volume of revenues from *tax on profits of organizations due to shrinkage of the taxable base*. As a result, in 2009 the revenues from tax on profits in the general government budget amounted to 3.2 % of GDP against 6 % of GDP in the previous year.

A similar drop of revenues in absolute terms was demonstrated by VAT, in spite of their slight growth in relative terms (by 0.2 % of GDP) due to the effect of the comparison base's accelerated shrinkage (GDP) over the year 2009. Beside the lowered business activity, the decline in tax revenues was also caused by the recent alterations introduced in the procedure of calculating and administering this tax.

Table 2

DYNAMICS OF THE TAX BURDEN LEVEL AND THE REVENUES FROM THE MAIN TAXES IN RF
GENERAL GOVERNMENT BUDGET IN 2005 – 2009, AS % OF GDP

	2005	2006	2007	2008	2009
Tax burden level (1 + 2 + 3)	34.4	35.9	36.1	35.6	30.8
Tax revenues (1), including:	23.7.6	24.4	25.7	23.9	20.5
tax on profits	6.2	6.2	6.6	6.0	3.2
PIT	3.3	3.5	3.8	4.0	4.3
SST*	2.0	1.9	2.0	1.9	2.1
VAT	6.8	5.6	6.9	5.1	5.3
Excise	1.2	1.0	1.0	0.8	0.9
Tax on mineral resources extraction	4.2	4.1	3.6	4.1	2.8
Insurance contributions to mandatory pension insurance (2)	2.9	2.9	3.1	3.1	3.4
Revenues from foreign trade (3)	7.8	8.6	7.3	8.6	6.9

* without insurance contributions to mandatory pension insurance

Source: RF Ministry of Finance; Rosstat; IET estimates.

It should be noted that, in 2009, revenues from the *personal income tax* (PIT) in the general government budget amounted to 4.3 % of GDP (by 0.3 % of GDP higher than the previous year's index), while the actual volume of revenues from this tax in absolute terms somewhat decreased. The slight growth of revenues from PIT in relative terms points not to an improved tax collection but rather to a greater drop of the economy's growth rate by comparison with that displayed by the population's incomes.

On the whole, under the influence to domestic and external factors, the index of the tax burden on the national economy in 2009 decreased by almost 5 p.p. of GDP and amounted to approximately 30.8 % of GDP. While the volume of revenue in the general government budget in 2009 declined, budget expenditure, on the contrary, was increasing (*Table 3*).

1 <http://www1.minfin.ru/ru/press/speech/index.php?id4=9304>

Table 3

THE EXECUTION OF THE GENERAL GOVERNMENT EXPENDITURE BUDGET
IN 2008 – 2009, AS % OF GDP

	2009		2008		Deviation, p. p. of GDP
	bn Rb	as % of GDP	bn Rb	as % of GDP	
Expenditure, total	15,847.3	40.6	13,989.2	33.9	+ 6.7
including					
Nationwide issues	1,290.6	3.3	1,287.6	3.1	+ 0.2
Of these, servicing of state and municipal debts	236.6	0.6	189.3	0.5	+ 0.1
National defense	1,191.2	3.1	1,043.6	2.5	+ 0.6
National security and law-enforcement activity	1,245.9	3.2	1,092.1	2.6	+ 0.6
National economy	2,782.3	7.1	2,253.1	5.5	+ 1.6
Housing and utilities system	1,005.9	2.6	1,149.2	2.8	– 0.2
Environment protection	29.7	0.08	31.2	0.1	– 0.02
Education	1,777.9	4.6	1,665.5	4.0	+ 0.6
Culture, cinematography and mass media	324.4	0.8	310.6	0.8	–
Public health care and sports	1,653.1	4.2	1,548.6	3.8	+ 0.4
Social policy	4,546.1	11.7	3,607.7	8.7	+ 3.0

Source: RF Treasury, IET estimates.

A historic high was achieved by the volume of financing allocated to the item ‘Social Policy’ – approximately 11.7 % of GDP against approximately 8.7 % of GDP in 2008; A similarly upward trend was displayed by the expenditures under the item ‘National Economy’ – up to 7.1 % of GDP in 2009 against 5.5 % of GDP in 2008. Besides, substantial volumes of state funding were additionally allocated to the items ‘National Defense’ and ‘National Security and Law-Enforcement Activity’ – 3.1 % of GDP and 3.2 % of GDP respectively, which is by 0.6 p.p. higher than the 2008 indices for each of these areas of spending.

The main burden of supporting the relevant sectors of the domestic economy and the social sphere during the crisis period has been shouldered by the federal budget. It was the federal budget that also had to sustain the blow produced by the shrinkage in revenue caused by the unfavorable prices for Russian export commodities.

Beside the need to provide funding for the measures envisaged by the anti-crisis program adopted by the RF Government that required some additional withdrawal of resources from the federal budget, the indexation of pensions planned for 2009 was also implemented in full. Thus, the first indexation in 2009 was introduced on 1 March – the basic part of labor pension was increased by 8.7 %. From 1 April, the insurance part of labor (retirement) pension was increased by 17.5 %. From 1 August the average size of the insurance part of labor pension was also increased by 221 Rb and so amounted to 5,536 Rb; in this connection, the average labor (retirement) pension was increased by 236 Rb - to 5,855 Rb, disability pension – by 130 Rb to 4,048 Rb, survivor’s pension – by 161 Rb to 3,323 Rb. Later on, from 1 December 2009, the basic part of labor pension was increased by 31.4 %. This indexation of pensions implemented in 2009 resulted in increased transfers to off-budget funds, and first of all those to the RF Pension Fund. The aggregate volume of these transfers increased to 5.4 % of GDP against 3.8 % of GDP in 2008. Growth in absolute terms amounted to more than 500 bn Rb.

At the same time, for a number of reasons, the consolidated budget of RF subjects, as demonstrated by the results of the year 2009, remained adequately balanced. Firstly, the resources of regional budgets had turned out to be more resilient when confronted with the negative changes in the foreign trade climate. Secondly, RF subjects received some significant support from the federal center in the form of additional interbudgetary transfers earmarked for equalizing the existing disbalances, as well as the implementation of the measures envisaged in the RF Government’s

anti-crisis program. According to preliminary estimates, the overall volume of support provided to the budgets of RF subjects from the federal budget in 2009 amounted to 1.5 trillion Rb (3.8 % of GDP), which is by 400 bn Rb (or by 1 p.p. GDP) more than in 2008. As a result, the aggregate deficit of regional budgets in 2009 did not exceed 0.8 % of GDP.

Nevertheless, if one looks at the consolidated budget of RF subjects from the angle of separate regional budgets, it will be noticed that the number of those subjects of the Russian Federation whose budgets were executed with a deficit increased from 44 to 62. In this connection, the bulk of funding was covered by credits granted from the federal budget. On the positive side, it can be noted that the regions' investment expenditures dropped only by 22 % instead of the previously expected 40 – 50 %. Most probably, this dynamics can be explained by the scale of 'money injections' from the federal budget.

The execution of the RF federal budget in January 2009 and 2010

According to the preliminary estimations by the RF Ministry of Finance of the execution of the federal budget, in January 2010 federal budget revenue amounted to 26.2 % of GDP, which is by 4.6 p. p. of GDP lower than its index recorded in 2009 (*Table 4*). The decline in federal budget revenue in January 2010 both in absolute and relative terms by comparison with the corresponding period of 2009 occurred as a result of the influence of several factors. Firstly, the growth rate of the Russian national economy as a whole was higher than in the same period of 2009. Secondly, in January 2009 the federal budget received revenues from the placement of the oil and gas funds for the year 2008, thus increasing its volume. Besides, the mechanism for administering VAT that was applied in 2008 envisaged that the tax was to be calculated for each quarter, with the subsequent payment of the due amount to the budget during the month following the reporting quarter. Thus, January 2009 was the period when part of VAT for Q IV 2008 was due to be transferred to the federal budget. Considering the impact of all the aforesaid factors, it would not be quite correct to say that in January 2010 federal budget revenue dropped on the same period of 2009.

Table 4

THE MAIN PARAMETERS OF THE RF FEDERAL BUDGET IN JANUARY 2009 AND 2010

	January 2009		January 2010		As % of budget revenue and expenditure	Deviation	
	bn Rb	% of GDP	bn Rb	% of GDP		bn Rb	p.p. of GDP
Revenue, including:	772.0	30.8	737.6	26.2	10.6	- 34.4	- 4.6
Revenues from oil and gas	179.1	7.0	294.6	10.5	9.2	+ 115.5	+ 3.5
Expenditure, including:	395.5	15.8	671.4	23.9	6.8	+ 275.9	+ 8.1
interest	14.8	0.6	17.0	0.6	5.6	+ 2.2	0
non-interest	380.7	15.2	654.4	23.3	6.8	+ 273.7	+ 8.1
Federal budget surplus (deficit)	376.5	15.0	66.1	2.4	2.3	- 310.4	- 12.6
Surplus (deficit) unrelated to 'oil and gas' revenues	197.4	8.0	-228.4	-8.1	3.7	- 425.8	- 16.1
GDP estimations	2,509.0		2,812.0				

Source: RF Ministry of Finance (preliminary estimations), IET estimates.

The federal budget expenditure in January 2010 increased by 8.1 p.p. of GDP and reached the level of 23.9 % of GDP against 15.8 % of GDP in 2009. This impressive growth of budget expenditure occurred due to the continuation of the government policy aimed at supporting both the country's population and enterprises in the real sector of the economy. Besides, it was attempted, from early 2010 onwards, to make expenditures more evenly distributed throughout the year. The purpose of this measure is to prevent a situation typical of the recent years when a substantial portion of state

expenditure was traditionally executed in the last quarter of a financial year, thus diminishing the effect of budget spending and increasing the risk of an upsurge of inflation early in the next year.

According to the preliminary estimates published by the Federal Treasury, federal budget surplus as of 1 February 2010 was 2.4 % of GDP against 15 % of GDP as of 1 February 2009. This type of dynamics occurred due to the accelerated growth rate displayed by budget expenditure against the backdrop of a moderate decline of the resource component of the federal budget. It should be reminded that in the law on the 2010 – 2012 federal budget it is envisaged that this year's budget is to be executed with a deficit of about 7 % of GDP.

An overview of the main developments in the sphere of state finance in February 2010

From 1 February 2010 the export duty on oil has been increased. Prime Minister V. Putin has signed a decree raising the export duty on oil to 270 USD/ ton¹. It must be remembered that in 2009 the export duty's dynamics was extremely unstable. Thus, following the changes in international oil prices, in January – June 2009 the size of the duty varied between 100 and 153 USD/ton of crude oil, then in July – August it increased to 222 USD/ ton, and in September – December it was between 231 and 271 USD/ton. In January 2010 it was cut to 267 USD/ ton.

The increased export duty on oil will make it possible to somewhat compensate for the loss of revenues in the budgetary system against the background of the currently applied zero rate regime for the export duty on oil supplied from the East Siberian oil fields. According to the estimations of the RF Ministry of Finance, as a result of establishing a zero rate of the duty levied on oil extracted in Eastern Siberia the state budget in 2010 may fail to receive approximately 120 bn Rb

On 25 February 2010, a representative of the RF Ministry of Finance stated that at present the Ministry was working on a draft law that addressed the issue of increasing the effect of budget spending². The concept of further reform of the budgeting process consists in shifting the main focus of attention, when exercising financial control, from recipients of budget funding to those who dispose of it. It is intended to distinctly divide control in the sphere of state finance between the following areas: audit of legal substantiation; audit of performance; and audit of reporting – in order to avoid duplication of the control functions vested in different government departments. Besides, the RF Ministry of Finance suggests that as early as 2011 the budget should be formed analytically, with a view towards the various target programs adopted by ministries and departments, and from 2012 onwards these must be approved in the new format. It is intended that the structure of distribution of allocations from the federal budget should be approved in connection with departmental target programs grouped in accordance with the long-term target programs. This may become a key step toward the ultimate switchover from budget-based funding to performance-based budgeting (PBB).

In a situation of limited budget expenditures coupled with the remaining high volume of state obligations to the population assumed by the government in recent years it is important to increase the effect of funding, so as not to exceed the established limits. Evidently, it must be acknowledged that the switchover to planning and execution of the state budget based on target programs will be an iterative process extended over many years and requiring that constant adjustments be made to the entire model of the organization functioning of the state sector.

In the light of all these considerations, the RF Ministry of Finance intends, over the period 2010 – 2014, to cooperate with the World Bank within the framework of implementing the initiative aimed at consolidating the existing potential in the sphere of state finance management³. The implementation of this program consists of three parts: the exchange of professional information and knowledge between practitioners; the rendering of analytical and consulting serviced by the World Bank's specialists; and the establishment of a special center in Russia whose activity will be aimed at improving financial management in the state sector. Over the 2010 through 2014 period, it is planned to allocate a sum of up to 30 mln USD to the implementation of the measures envisaged in this program. ●

1 <http://www.neftegaz.ru/news/view/92598>

2 <http://www1.minfin.ru/ru/press/speech/index.php?id4=9321>

3 <http://www.prime-tass.ru/news/show.asp?id=500085550&ct=news>

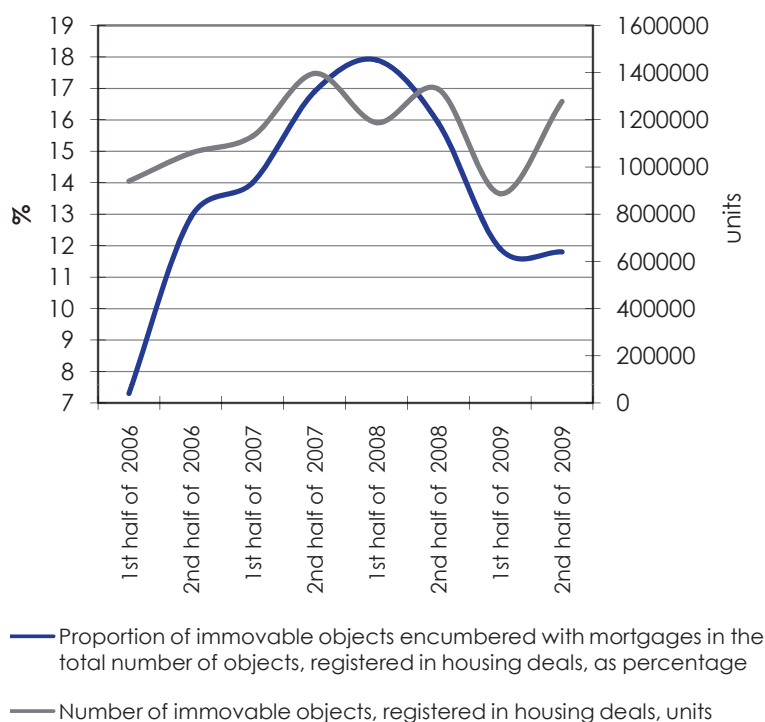
MORTGAGES IN RUSSIAN FEDERATION

G.Zadonsky

According to the data of the Federal Service on State Registration, Cadastre and Cartography in the second half of 2009 as compared with the first one, there was 42.5% more hypothecated objects, the number of registrations on the whole over 2009 decreasing by 40% as compared with the results of 2008. The systematic reduction of the refinancing rate of the Central Bank of the Russian Federation initiated the decrease of the rates on the market of housing credits. The Government of the Russian Federation intends to stimulate the construction of cheap housing through the mortgages.

According to the data of the Federal Service on State Registration, Cadastre and Cartography (further referred to as Rosreestr) in 2009 there was 256.9 thousand of hypothecated housing objects, which is nearly by 40% below the figure of 2008. In the first half there was 106 thousand hypothecated objects registered, and 150.9 thousand of such objects in the second half (fig. 1), which is 50.2% and 28.9% below the corresponding figures of 2008. Whereas in 2008 the number of objects with encumbrance registered in the first and the second half of the year was practically equal, in 2009 the figure of the second half was considerably higher (by 42.5%) than the first. The growth of number of deals with the housing objects in the second half of 2009 is not accompanied by the increase of the proportion of mortgage deals, but only by the stabilization at the level about 12%.

In 2009 the trend for the decrease of the proportion of mortgages registered as encumbrances in the total number of registered hypothecated objects.



Source: Rosreestr, AHML

Fig. 1. Proportion of Mortgage Objects in the Number of Registered Housing Deals

Table 1

PROPORTION OF MORTGAGES IN THE TOTAL NUMBER OF OBJECTS ENCUMBERED WITH HYPOTHECATION

Year	2005	2006	1st half of 2007	2nd half of 2007	1st half of 2008	2nd half of 2008	1st half of 2009	2nd half of 2009
Proportion of encumbrances, %	47.4	60.9	52.5	50.3	42.1	35.1	31.9	26.5

Source: Rosreestr, AHML calculations.

On February 19, 2010 the RF Central Bank made a decision to decrease the refinancing rate and the interest rates for some operations of the Bank of Russia by 0.25 percentage points to 8.5% starting with February 24, 2010.

Systematic decrease of the refinancing rate of the RF Central Bank affects the market of home mortgage lending. Starting with July 2009 a number of leading Russian banks have announced about the decrease of the rates. By the end of the year the majority of banks had reduced the rates two or three times.

Table 2

FIXED RATES FOR OWN PROGRAMS OF LEADING MORTGAGE BANKS FOR PURCHASE OF IMMOVABLE ON SECONDARY MARKET *

Bank	Rate in rubles		Rate in foreign currency	
	minimum	maximum	minimum	maximum
AHML refinancing rate	9.05	12.13	–	–
1. Absolute Bank	13	15	–	–
2. Alfa-bank	18	18.5	14.5	15.5
3. Bank of Moscow	16.8	17.1	12.4	13.3
4. Renaissance Bank	16	–	–	–
5. Bank Deltacredit	15	–	9	–
6. Bank Zhilfinance	14.75	16.75	9	10.75
7. BSGV	14.25	16.25	8	11
8. VTB 24	14.35	–	10.6	–
9. Gazprombank	15	–	11.5	–
10. Moscow Credit Bank	10	–	9	–
11. Nordea Bank	14	16	9	11
12. Raiffaisen-Bank	14.5	17.5	–	–
13. Sberbank	13.5	14.75	10.1	12.1
14. Uralsib	19	19.5	17	18
15. Unicreditbank	16.5	–	11.25	–

* – as on February 11, 2010

Source: Research and information portal Rusipoteka, basing on internet sites of banks

Among the large banks only Sberbank had a program for crediting the flats in houses under construction in the 1st half of 2009. At the moment nearly all banks that offer mortgage credits issue credits for purchase of flats in the houses under construction under the mortgage of rights for the purchased flat.

Table 3

CREDIT RATES FOR PURCHASE OF HOUSING UNDER CONSTRUCTION

Bank	(on stage of construction/after state registration of property rights)			
	Rate in rubles		Rate in foreign exchange	
	minimum	maximum	minimum	maximum
1. Bank of Moscow	15.75/14.75	–	9.75/10.75	–
2. VTB 24	16.85/14.35	–	13.1/10.6	–
3. Gazprombank	15.75/15.0	–	12.5/11.5	–
4. Deltacredit	17.0/15.0	–	11.0/9.0	–
5. Moscow Credit Bank	15.0/	–	11.0/	–
6. Nordea Bank	15.0/14.0	17.0/16.0	10.0/9.0	12.0/11.0
7. RosEuroBank	16.0/14.0	17.0/15.0	13.0/11.0	14.0/12.0
8. Sberbank	15.0/13.5	15.75/14.5	–	–

Source: Rushypotecation basing on internet sites of banks

According to the data of the Pension Fund of the Russian Federation, the citizens have submitted 119 thousand applications for the sum of RUR 33 billion on the intention to use maternal (family) capital to settle housing credits. According to the Decree of the Government of the Russian Federation from 04.12.2009 No 994 starting with 2010 it is allowed to use maternal capital not only to settle the mortgage credit but also to purchase or build residential housing by the deals and participation in housing, housing and construction and housing aggregating cooperatives, even if the deal is made by a husband of maternal capital recipient.

Amendments adopted by the State Duma to the Law of the Russian Federation “On mortgage securities” allow including credits with the proportion of own funds of a debtor decreased from 30% to 20% in the structure of mortgage coverage of mortgage securities. It is assumed that this measure will result in the corresponding decrease of requirements to the debtor by the bank and a considerable increase of home mortgage credits availability.

In February the State Duma passed all three readings of the amendment to the Law of the Russian Federation “On additional measures to support financial system of the Russian Federation” in order to prolong for five years (up to June 1, 2020) the period of credit issued by the Bank of Development (Vnesheconombank) to the Agency of Home Mortgage Lending of RUR 40 billion at the interest rate of 9.5% per annum. Besides, in concordance with this Law, Sberbank of the Russian Federation receives 10-year subordinated credit for RUR 500 billion at the rate of 8% per annum by its main stocks holder, Bank of Russia.

A bill on the changes to article 5 of the Law “On additional measures to support the financial system of the Russian Federation”, concerning the decrease of the rate for subordinated credits given to Sberbank of the Russian Federation at 4.75% per annum, which will enable the crediting organization to save up to RUR 16.25 billion a year.

In February the Prime Minister declared that the state support of the mortgage home lending will be considerably corrected. According to the declaration from now on the mortgage credits will be intended only for the purchase of cheap newly-built flats. That is why the maximum volume of standard mortgage credits will be limited by RUR 8 million in Moscow and Saint-Petersburg and RUR 3 million in other subjects of the Russian Federation. ●

INVESTMENTS OF PENSION SAVINGS IN THE MANDATORY PENSION INSURANCE SYSTEM IN Q III 2009

L.Mikhailov, L.Sychova

As demonstrated by the results of Q III 2009, the value of assets in the mandatory funded component of the pension system, less the amount of insurance contributions to the Pension Fund of the Russian Federation (PFR), increased by 2.2 %. The rate of return on the pension savings invested by the government asset manager (GAM) in the year's first three quarters amounted to 4.1 %. By the results of Q III, all the private asset managers demonstrated rates of return on their investments that were higher than those of the GAM. A number of changes were introduced to the normative base for investing pension savings. Some amendments were introduced in Federal Law FZ-111 'On the Investment of Funds for Financing the Funded Part of Labor Pension in the Russian Federation' whereby the available set of instruments for investing pension savings was somewhat expanded.

In 2009, the value of assets in the funded component of the mandatory pension system was displaying a rather uneven dynamics. In Q I 2009, their value less the amount of insurance contributions accumulated in the Pension Fund of the Russian Federation (PFR) continued to decline, having first demonstrated this trend in the autumn of 2008. From Q II onwards, the vector once again became positive, and growth of asset value over that quarter was 14.7 %¹. In Q III 2009, growth continued but amounted to only 2.2 %².

Table 1

VALUE OF ASSETS IN THE MANDATORY FUNDED PENSION SYSTEM, 2007 - 2009 (BN RB)*

Date	Value of assets in which pension savings transferred to asset managers were invested			Pension savings accumulated in IPF	Total
	subtotal	including in GAM	including in PAMs		
01.01.2007	276.2	267.1	9.2	9.96	286.2
01.01.2008	375.1	362.9	12.2	26.8	401.9
01.04.2008	360.7	348.7	12.1	42.6	403.3
01.07.2008	366.0	353.7	12.3	43.1	409.1
01.10.2008	360.6	350.1	10.6	39.9	400.5
01.01.2009	352.2	343.1	9.1	35.5	387.8
01.04.2009	334.8	325.7	9.1	46.9	381.6
01.07.2009	459.3	446.6	12.7	67.3	526.6
01.10.2009	466.6	452.5	14.1	71.7	538.3

* Less the amount of insurance contributions to the funded part of pension savings in the PFR.

Source: The indices of asset managers represent value of net assets as estimated on the basis of data published on the PFR's website www.pfrf.ru. The indices of IPF are based on the Summary Data on the activity of IPFs posted by the Federal Service for Financial Markets (FSFM) to its website www.fscm.ru

The share of the government asset manager (GAM), whose functions are performed by *Vneshekonombank (VEB)* (*Bank for Development and External Economic Activities*), in the asset value of the funded component of the mandatory pension system (less the amount of insurance contributions to the PFR) continued to decline, dropping over three quarters from 88.5 % to 84.1 %. **The share of the Independent pension funds (IPFs)** over the same period increased from 9.2 % to 13.3 % (see *Table 2*). The share of pension savings transferred by the PFR for in trust management to private asset managers (PAMs) changed little and remained at a level lower than

1 Although growth occurred mainly as a result of the transfer of pension savings from the PFR, there was also some increase of the assets' market value.

2 Hereinafter, the data published by the RF Pension Fund, the Federal Service for Financial Markets (FSFM), and *Vneshekonombank (VEB)* are applied..

it had been prior to the onset of the crisis (2.6 % as of the end of Q III 2009, as compared to 3.0 % in the first half-year 2008).

Table 2

THE DISTRIBUTION OF ASSETS BETWEEN ASSET MANAGERS AND IPFS WITHIN THE FUNDED COMPONENT OF THE MANDATORY PENSION SYSTEM, 2006 – 2009 (%)

	1.1.2006	1.1.2007	1.1.2008	1.1.2009	1.4.2009	1.7.2009	01.10.2009
Share of assets held by GAM	95.9	93.3	90.3	88.5	85.3	84.8	84.1
Share of assets held by PAMs	3.0	3.2	3.0	2.3	2.4	2.4	2.6
Share of assets held by IPFs	1.1	3.5	6.7	9.2	12.3	12.8	13.3
Total	100	100	100	100	100	100	100
Including share of PAMs and IPFs	4.1	6.7	9.7	11.5	14.7	15.2	15.9

Source: the indices of asset managers represent value of net assets as estimated from the data published on the PFR's website pfrf.ru; the indices of IPF are based on the Summary Data on the activity of IPFs posted by the Federal Financial Markets Service to its website fsmc.ru.

Investments of pension savings by asset managers.

Fig 1 – 4 demonstrate the structure of investments by the GAM and of the aggregate investment portfolio of the PAMs that were investing pension savings under their agreements with the PFR, as of the end of Q III 2008 and Q III 2009 respectively.

Investments by the GAM. The greatest changes in the structure of the investment portfolio held by the GAM were linked to an increased share of assets placed in the banking sector. While as of the end of Q III 2008 this index was 2.8 %, as of the end of III Q III 2009 it amounted to 18.8 %. Initially, this change in the investment structure was triggered by the transfer of pension contributions from the PFR at the end of Q II 2009. The share of securities then dropped technically both in the GAM's and the PAMs' investment portfolios, while the share of monies kept with credit institutions exceeded the then existing limit of 20 % of the investment portfolio established by the law. Later on, in Q III, the share of monies kept by PAM on bank accounts dropped to 3 %, while the share of monies kept by the GAM remained close to the upper limit.

The share of investments in RF external loan bonds in the GAM's investment portfolio remained at the same level (0.8 %). The share of the main instrument in which the GAM invests pension savings (RF domestic government loan bonds) dropped over the year from 95.1 % to 78.7 % as of the end of Q III.

In Q III, the normative base for investing pension savings underwent a few changes. Some amendments were made to Federal Law No FZ-111 "On the Investment of Funds to Finance the Funded Part of Labor Pension in the Russian Federation", whereby the set of instruments available for investing pension savings

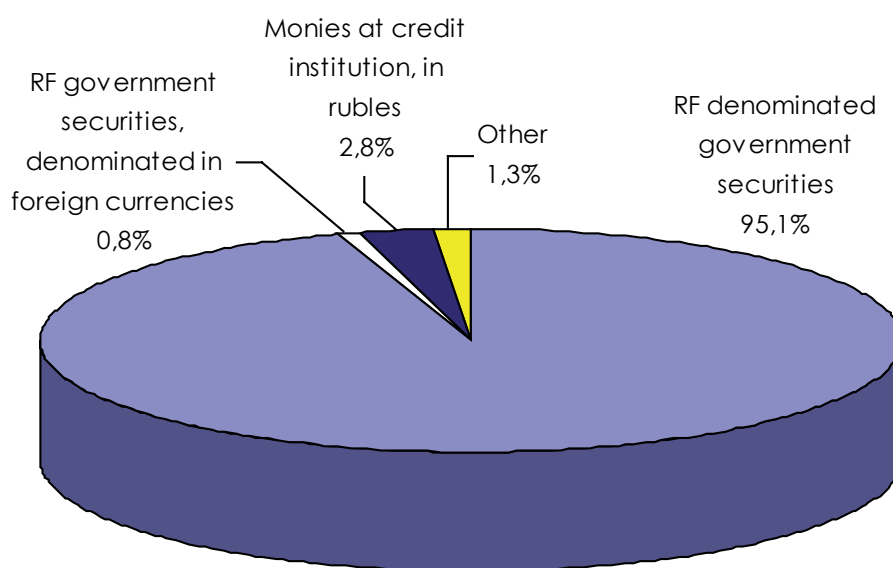


Fig. 1. The structure of the investment portfolio of the GAM (Vneshekonombank), as of the end of Q III 2008.

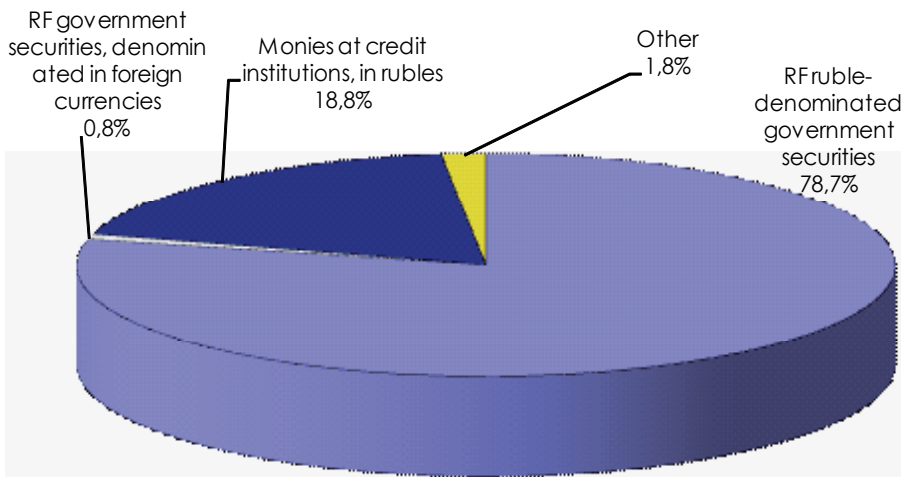


Fig. 2. The structure of the investment portfolio of the GAM as of the end of Q III 2009.

was expanded, including the investment of pension savings created in the name of those insured persons who had not made their choice of an asset manager.

The pension savings held in trust management by the GAM were divided into two portfolios: the default option; and the more conservative option – for those related persons who wished to limit their investments to government securities. They had to submit the applications to this effect before the end of September.

Due to absence of any large-scale campaign aimed at explaining the details of such an arrangement, the number of actually submitted applications was small, and so less than 1 bn Rb was transferred to the GAM's conservative investment portfolio. Thus, the bulk of pension savings was concentrated in the default investment portfolio (the so-called expanded portfolio). The investment declaration for that portfolio) was augmented by some new of instruments in which the GAM was allowed to invest from November 2009 onwards¹.

Investments by PAMs. The dynamics of the Russian stock market in 2009 was on the whole

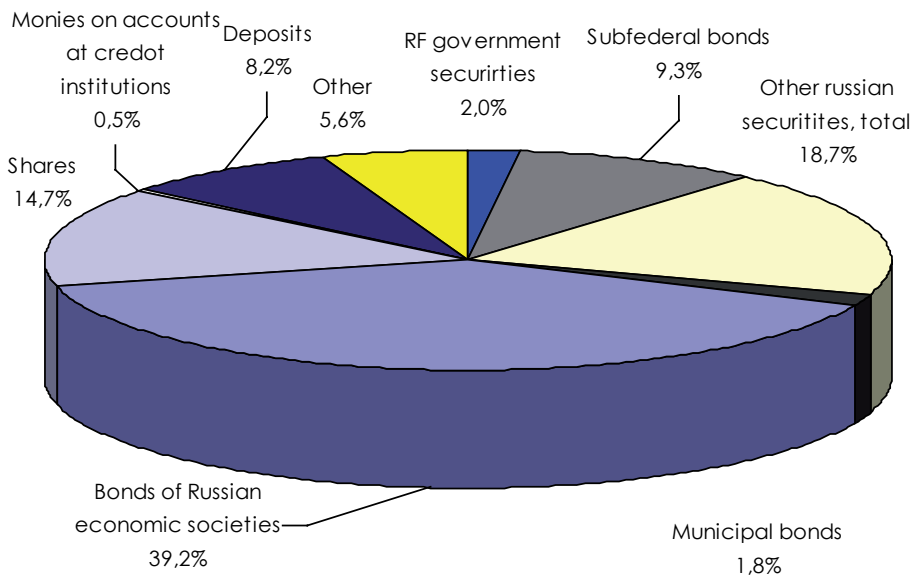


Fig. 3. The structure of the investment portfolios of private asset managers, as of the end of Q III 2008.

favorable for investing pension savings. As shown by the MICEX index, growth over the year amounted to 122 %. However, the consequences of the crisis continued to have their effect on the structure of the investment portfolios held by the PAMs. In particular, the PAMs increased the share of government securities in their portfolios. By comparison with Q III 2008, the share of federal bonds in the PAMs' aggregate investment portfolio increased from 2.5 to 7.7 %. The share of subfederal bonds during the same period increased from 11.4 to 16.1 %. The share of

1 By the end of 2009 the expanded investment portfolio continued to be dominated by government securities: their share amounted to 80.5 %. The share of the new instruments was approximately 6 % (the bonds of Russian economic societies – 1.6 %, mortgage bonds – 2.1 %, Rb-denominated bank deposits – 1.4 %). At the same time, the share of monies kept on credit institutions' accounts declined only slightly by comparison with the end of Q III and amounted to approximately 12.8 %.

equities changed even less – from 18.1 to 19.9 %¹. Besides, the PAMs noticeably decreased the share of corporate bonds in their portfolios (from 48.3 to 38.9 %).

Rate of return on investments

The rate of return on the GAM's investments in the first three quarters amounted to 4.1 %, and over three years – to 3.4 % per annum. Thus, VEB moved to 21st place among the investment portfolios of the asset managers investing pension savings under trust management agreements with the PFR (by the results of 2008, by that index VEB was in 8th place, having demonstrated a rate of return of 3.7 %). By the results of Q III, all the PAMs had a higher rate of return on their investments than did the GAM.

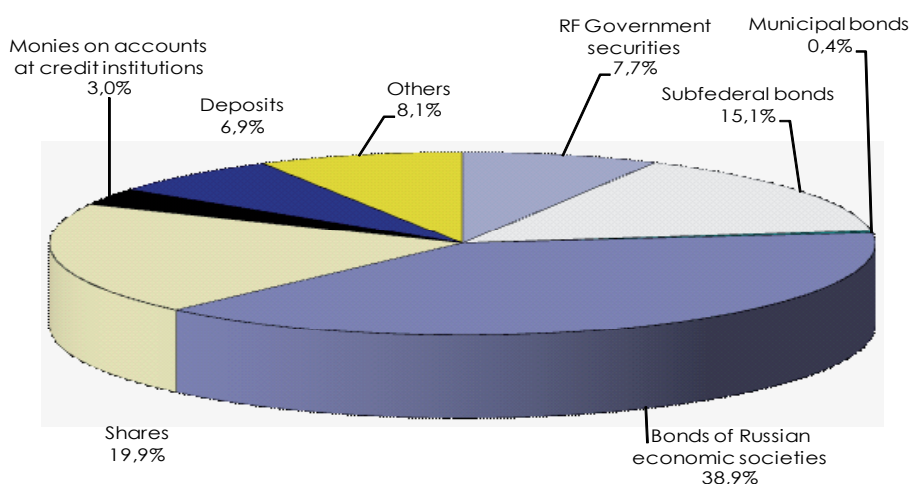


Fig. 4. The structure of the investment portfolios of private asset managers, as of the end of Q III 2009.

Table 3

ASSET MANAGERS – LEADERS BY THE RATE OF RETURN ON INVESTMENT OF PENSION SAVINGS IN THE FIRST THREE QUARTERS OF 2009

Place occupied by an asset manager	Asset manager	Rate of return on investment of pension savings, % per annum		
		For first 3 quarters 2009	in 12 months (Q IV 2008 – Q III 2009)	in 3 years (Q IV 2006 – Q III 2009)
1	TRINFIKO, long-term growth IP*	135.16	57.7	8.99
2	TSENTRAL'NAIA	110.19	30.3	1.06
3	YERMAK	99.14	30.12	4.5
4	TROIKA DIALOG	97.54	24.06	- 0.04
5	PORTFEL'NYE INVESTITSII	94.08	41.45	9.82

* IP – investment portfolio.

The average index of the rate of return on the PAMs' investments exceed 37 % per annum². Thirty-six investment portfolios, by their rate of return indices in the three preceding years, moved into the 'positive zone'. At the same time, the investment portfolios of the leaders by the rate of return indices belonged to the categories of medium-sized and small-sized ones (while the average sum of managed assets as of the end of Q III amounted to 231 bn Rb, the assets in the five investment portfolios with the highest rates of return in the three preceding years varied between 3 and 124 bn Rb). ●

1 By comparison, in Q III 2008 the decline in the percentage of shares in the PAMs' aggregate investment portfolio was 5.7 p.p.

2 Относительно средней стоимости чистых активов, рассчитанной в соответствии с требованиями ст. 16 Федерального закона «Об инвестировании средств для финансирования накопительной части трудовой пенсии в Российской Федерации».

FACTORS OF ECONOMIC GROWTH OF ADDED VALUE IN INDUSTRIAL SECTOR IN 2009¹

E.Astafieva

According to the data of the Federal State Statistics Service, in 2009 all the industrial kinds of activity lowered the volumes of added value. The gross added value (GAV) growth rates for processing industries went down by 15.1 percentage points as compared with 2008, for electricity, gas and water production and distribution – by 7 percentage points, for minerals extraction – by 2.3 percentage points. It is the contraction of the growth rates of the total factor productivity, which, according to the preliminary data (there being no data on the indices of efficiency of the use of the available production facilities) defines about 70% of this drop, is the main reason for such a considerable drop of the GAV growth rates in the industrial production in 2009.

Decomposition of the economic growth enabling apportioning of the influence of separate factors (labor input, capital input and total factor productivity (TFP)²) on the output growth rates is one of the approaches to the examination of the sources for differentiation of the development rates of different kinds of economic activity.

According to the data of the Federal State Statistics Service, in 2009 all industrial kinds of activity decreased the volumes of the added value (*table 1*). As compared with 2008, gross added value (GAV) in processing industries went down by 13.9%, in electricity, gas and water production and distribution – by 6%, in minerals extraction – by 1.9%.

Starting with 2005 the processing industries have been demonstrating the highest growth rates among the industrial kinds of activity. In 2009 this sector was characterized by the most dramatic drop of the GAV growth rates, which made 15.1 percentage points as compared with the previous year. In concordance with the results of decomposition, in 2009 the output growth rates in this kind of economic activity were nearly by half determined by the changes in the amount of labor input, which, it should be observed, can be accounted for by both the decrease of the number of the employed at the processing enterprises and by the reduction of hours of work. It should be noted that the processing sector demonstrated the contraction in the number of the employed and in the working hours that was the maximum for the industry. The positive growth rates of the fixed assets volume secured by high level of potential accumulated earlier defined negative contribution of capital input in the added value growth rates in this kind of economic activity. At the same time it should be observed that in 2009 the growth rates of input accumulation reduced nearly by half as compared with 2008. The structure of gross added value of this kind of economic activity is contrary to the structure registered a year ago: the contraction of the output at processing enterprises is mainly defined by the changes in labor input and TFP, whereas the capital input results in a slight decrease of the scales of this contraction. According to the preliminary data, the main reason for the observed decrease in GAV growth rates is the reduction of the productivity growth rates, though this estimation is rather shifted, since it does not take into account the changes in the extent of facilities load.

¹ The results of the decomposition of the growth of the output index (added value of industrial production) in 2009, have been obtained in concordance with the method, described in IET's work ("Factors of Economic Growth", series of Scientific Works, No 70, IET, Moscow, 2003) is presented in this section.

² In concordance with the methodology for estimation that is used the estimation of the factors' input includes the changes in stocks (accumulated volumes) of factors and changes in the intensity of their use (load of production facilities, average working day). The TFP is defined as a remainder unexplained by other main factors (labor and capital), which characterizes the influence of the scientific and technological progress, innovations, increase in efficiency of production organization, as well as price situation.

Table 1

DECOMPOSITION OF ADDED VALUE GROWTH RATES IN INDUSTRIAL SECTOR IN 2008-2009¹

	Minerals extraction		Processing Industries		Electricity, gas and water production and distribution		Industrial production ²			
	2008	2009	2008	2009	2008	2009	2008		2009	
GAV	0.4	-1.9	1.2	-13.9	1	-6	0.9		-9.4	
Input of factors	1.72	1.57	-0.19	-5.21	1.04	0.25	-0.21	(0.53)	-3.04	(-2.38)
Labor ³	0.02	-1.94	-1.18	-7.49	-0.35	-1.18	-0.85	(-0.73)	-5.52	(-4.96)
Number of the employed	0.07	-1.14	-0.57	-4.37	-0.68	-0.72	-0.44	(-0.38)	-3.26	(-2.90)
Hours of work (per one employee)	-0.05	-0.80	-0.62	-3.13	0.34	-0.46	-0.41	(-0.34)	-2.26	(-2.06)
Capital	1.70	3.51	1.00	2.28	1.39	1.43	0.63	(1.26)	2.48	(2.58)
Volume of fixed assets ⁴	5.31	3.51	3.69	2.28	1.39	1.43	3.52	(3.96)	2.48	(2.58)
Level of facilities load	-3.61	-	-2.69	-	0.00	0.00	-2.89	(-2.71)	-	-
TFP ⁵	-1.32	-3.47	1.39	-8.69	-0.04	-6.25	1.14	(0.39)	-6.34	(-6.99)

¹ – Preliminary estimation.

² – Estimations of the industrial production are based on the aggregation of the initial calculated data as broken by kinds of economic activities (result of decompositions obtained by combining the estimations for kinds of economic activity are presented in parentheses).

³ – Preliminary estimation of the growth rates of the number of the employed in the industrial sector is based on the data on the number of vacancies filled in January-November 2009 on assumption that the ratio of the employed by kinds of economic activities to the number of vacancies filled is constant. The preliminary estimation of the growth rates of hours of work worked by one employee in a year in the industry sector is estimated on the basis of data over 9 months of 2009.

⁴ – Preliminary estimation of the growth of physical volumes of fixed assets in 2009 is based on the supposition on the coefficient of withdrawal of fixed assets being constant and the proportion of investments in their renewal being stable.

⁵ – In 2009 the estimation of the TFP in extractive and processing sectors and in the industry on the whole is shifted due to the lack of the data necessary to estimate the changes in the load of facilities at enterprises of these kinds of economic activities.

Minerals extraction is characterized by the most moderate reduction of GAV growth rates out of all the industrial kinds of activities, making 2.3 percentage points as compared with the previous year. The same as in the processing industry, the labor input in the output growth rates for this kind of economic activity in 2009 is positive in 2009 as a result of the decrease in hours worked by the employees at extractive enterprise and the reduction of the number of the employed. Despite the decrease in the growth rates of the fixed assets at extractive enterprises it is the increase in capital accumulation that is the only factor contributing to the slow-down of GAV growth rates – it secures the decrease in the input of the main factors in the output growth rates at the enterprises of the extractive industry sector.

It is the contraction of the total factor productivity that is the main cause of the negative growth rates in this kind of economic activity in 2009. The TFP dynamics of the extractive sector is more dependent on the price situation at the world market of raw materials than that of other industrial production. Taking into account the changes in price situation at the world markets of raw materials, whose contribution is defined on the basis of the dynamics of the average prices for oil over that period, “technological” component of the TFP¹ at extractive enterprises is positive but only slightly differs from zero.

¹ The technological component is defined as an ultimate residue obtained after exclusion of the component accounted for by the dynamics of world prices for oil out of the estimation of productivity.

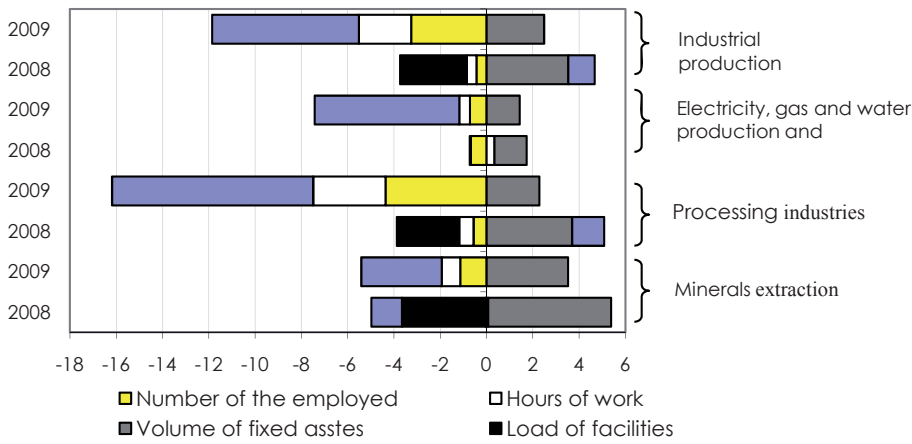


Fig. 1. Structure of the Growth of Gross Added Value of Industrial Production in 2008-2009

As a result of 2009 the reduction of GAV growth rates in electricity, gas and water production and distribution as compared with the previous year makes 7 percentage points. The same as in other sectors labor input in output growth rates of this kind of economic activities is positive in 2009, as a result of reduction of hours worked by the employed and the decrease in the number of the employed (this kind of activity, however, demonstrates the most insignificant changes

of these indices throughout the industry). At the same time, taking into account the fact that the growth rates of fixed assets at the enterprises have but slightly changed as compared with the previous year, and the total input of the main factors in GAV growth rates in this kind of economic activity is negative. The contraction of the output volume in this kind of economic activity in 2009 is fully determined by the decrease in production.

Aggregation of the data by kinds of economic activities testifies that on the whole added value growth rates in industrial production in 2009 reduced by 10.3 percentage points, making -9.4% versus 0.9% in 2008. And this decrease is defined not by the contraction of the input of the main factors but rather by the decrease in their productivity. In 2009 the industry demonstrated a considerable increase in the decrease rates in the number of the employed and the hours worked by them, as well as the reduction of growth rates of capital accumulation, and consequently the input of the main factors are characterized by negative growth rates, defining their positive input in the drop of GAV growth rates in industry. According to the preliminary estimations for 2009, TFP of the industrial production has also demonstrated negative growth rates, but the input of this factor in the decrease of added value growth rates was considerably higher (makes about 70%). Apportionment of the component characterizing the redistribution of added value, labor and capital input by kinds of economic activities¹ out of TFP results in the increase of the productivity input in the drop of GAV growth rates of the industrial production. At the same time the reduction of the differences in TFP estimations obtained by aggregated data and by sectors points to the decrease in the intensity of the process of resources redistribution between the kinds of economic activities in 2009 as compared with the previous year.

Thus, the changes in the added value growth rates dynamics in the industrial sectors observed in 2008-2009 were accompanied by the transformation of the growth rates structure, characterized by the reduction of the labor input with simultaneous decrease in capital input growth rates. At the same time in contrast to the economy on the whole, the reduction of labor input at industrial enterprises was determined not but the variations in their facilities load (hours of work), but rather by the reduction in the number of the employed.

At the same time it is the total factor productivity that is the main factor determining the reduction in GAV volumes in the industry in 2009 – in all the sectors TFP demonstrated a considerable reduction according to preliminary data (there being no data on the intensity indices for the use of available facilities. ●

1 Input of redistribution of output, labor and capital input is defined as a difference between the growth rates estimation of the aggregated TFP and weighed sum if TFP growth rates by kinds of economic activities.

LEGAL PROBLEMS EXISTING IN THE SPHERE OF DEVELOPING THE ORGANISATION-LEGAL FORMS FOR THE SUPPORT INNOVATION

A.Kireeva

One of the promising directions of the innovation-oriented policy is the organizational support of the activity aimed at implementation of new technologies in the form of developing an appropriate infrastructure necessary for the functioning of start-up enterprises, as well as some new forms of interaction between venture investors, copyright holders and producers of innovative products.

Among the currently existing forms of state support for innovations in the Russian Federation, the following ones can be distinguished:

- financial (budget) support – in the form of subsidies, credits granted by federal development institutions, as well as government guarantees;
- tax support – in the form of granting exemptions from certain types of taxes (in particular, exemption from VAT of the operations involving the realization of exclusive rights to the results of intellectual activity (hereinafter – RIA), as well as sale of licenses; exemption from VAT of the research and development projects being implemented by research institutions and educational establishments, and also the research and development projects being implemented by other entities in accordance with the list established by the Tax Code of the Russian Federation; in the form of an accelerated depreciation of the equipment applied in research and development projects; the possibility of writing off the cost of those research and development projects that yielded no positive results; the possibility of charging to costs, with coefficient 1.5, the expenditures on the implementation of those research and development projects that fall within the directions established by Government of the Russian Federation; etc.);
- organizational support by means of creating preferential conditions for the operation of innovation-oriented companies, as well as by creating organizational incentives for companies to implement in their practice the results of intellectual activity previously obtained by those same companies or by some other entities.

The organizational support for innovation-oriented companies is of specific interest for the following reasons:

- this firm targeted for support, as a rule, requires no significant budget allocations (and in this it differs from the instances of granting credits and subsidies to support the innovation-oriented activity) and entails no significant loss of budget revenues (in contrast to tax exemptions);
- in the presence of high quality legal regulation, the provision of organizational support, in contrast to tax incentives and direct budget funding, is associated with a relatively low risk of misuse of its recipients, because the latter gain no tax savings and receive no budget resources that they can use for purposes other than the stated targets.

Over several recent years, the State has implemented a number of mechanisms designed to ensure an adequate organizational-legal support of innovations; there are also some other mechanisms that are currently being elaborated and will probably be implemented in the nearest future. It is noteworthy that almost all such mechanisms have been recognized as entirely new from the point of view of Russian law, and so were treated with certain apprehension by the legal community¹. They have often been discussed at conferences and in the mass media.

Among the principal forms of the organizational support of innovation-oriented activity, the following ones can be noted:

¹ Thus, a large-scale discussion was started with regard to the issue as to whether the right of budget-funded organizations to create small-sized innovation-oriented enterprises is contrary to the provisions stipulated in the RF Civil and Budget Codes. See, for example, the materials of conferences held at РНИИС in 2009 <http://rniiis.ru/content/blogcategory/14/34/>

- the creation of technoparks;
- the creation of special hi-tech zones (HTZ);
- the introduction in (the new) Part IV of the Civil Code FK of the Russian Federation of a provision to the effect that, under a general rule (if not stipulated otherwise in a contract), the rights to the results of intellectual activity created on the basis of government contracts should belong to their implementers. In most cases, the implementers of research and development projects are those research institutes and higher educational establishments that enjoy the status of budget-funded institutions;
- the permission for budget-funded institutions (research institutes and higher educational establishments) to create legal entities for implementing the RIAs the rights to which belong to those budget-funded institutions.

As one of the promising forms of supporting innovations, State Corporation *Rossiiskaia korporatsia nanotechnologii* [The Russian Nanotechnologies Corporation] (*ROSNANO*) suggests the establishment of the so-called investment partnerships (investment societies)¹. The legal base for their operation was developed by the Institute of Corporate Law and Corporate Governance². At present, a special task force (including representatives of the IET) has been created for further elaborating and completing the draft law.

And, although the spectrum of organizational opportunities for the support and development of innovations is currently rather broad, the actual application of each of the aforesaid organizational forms is fraught with certain legal problems which significantly diminish their effect. Below we are going to briefly discuss the main ones among them.

Technoparks

The modern technoparks were created in order to support innovations in accordance with the Federal Target Program ‘The Creation in the Russian Federation of Technoparks in the Hi-Tech Sphere’, which was approved by Decree of the Government of the Russian Federation, of 10 March 2006, No 328-R³. Under this Program, the creation of technoparks was to ensure ‘territorial concentration of financial and intellectual resources for the purpose of accelerating the development of the hi-tech sectors of the national economy’, as well as to unite the enterprises belonging to hi-tech sectors, including the sectors involved in the production of nano-, bio-, information and other technologies, research organizations, the educational establishments responsible for providing such enterprises with appropriate human resources, and also other enterprises and organization whose activity is technologically linked to organizations functioning as part of such sectors or is aimed at providing them with necessary services.

A legal entity that functions in the territory of a technopark receives, as a rule, organizational support in the form of preferential conditions for the lease of premises, which is especially important for start-up small-sized innovation-oriented enterprises, as well as has access to the collective use of expensive equipment, which makes it easier to complete their projects and to bring them on to the production stage. Some technoparks also provide legal support to their participants, which is necessary at the stage of evaluation and formalization of the rights to the results of intellectual activity. The list of the types of support offered by different technoparks is rather variable⁴.

1 As the idea of an investment partnership is now just being elaborated, no well-established terminology has been introduced as yet. In the draft papers one can find both terms - investment *partnership*, and investment societies.

2 See <http://www.iclg.ru/>

3 Some experience of their creation has already been accumulated (some big higher educational establishments set up their own technoparks already in the late 1980s), but it was mostly rather negative because the main outcome of their operation was ‘swallowing up’ of budget resources. See, for example, <http://www.raexpert.ru/researches/technopark/part3/>

4 On the whole, technoparks offer the following types of services: lease of production premises and offices on preferential conditions; information services to small-sized enterprises; consulting services in the fields of business-planning; help in the implementation of research and development projects and the realization of their results; training and retraining of human resources for entrepreneurial activity in the sphere of science and technologies; organization of workshops, exhibitions, conferences and other events; evaluation and legal protection of intellectual property; elaboration and implementation of programs for priority development of regions; help in the attraction of investments and credits; promotion of foreign trade; provision of scholarships to students who work in small-sized companies; creation of centers for the collective use of equipment; creation of new enterprises in specific spheres of activity. See, for example, <http://www.raexpert.ru/researches/technopark/part3/>

On the whole, the idea of a technopark seems to be feasible, but the practical experience of recent years has demonstrated that this instrument is not efficient enough. Regretfully, in many cases technoparks were established by the regions not so much for the purpose of promoting the implementation of hi-tech technologies as to receive federal support (at present, subsidies are allocated from the resources earmarked for the Federal Target Program to the creation of technoparks at the regional level). However, their residents were actually involved in no (or very little) real innovation-oriented activity. In this connection, in 2009 some technoparks were closed, and the funding of new technoparks in many fields has been suspended. In particular, under the Program 'The creation in the Russian Federation of technoparks in the hi-tech sphere' it was envisaged that technoparks for IT-companies were to be created in nine subjects of the Federation. However, so far this plan has not been implemented, and no technopark with residents in the form of IT-companies was put in operation in 2009.

Such a situation has largely become possible because the quality of legal regulation of technoparks' activity is still very low. At the federal level there exist practically no legal acts adequately determining the organizational-legal form of their operation and establishing any uniform requirements to the organizations and entrepreneurs operating in the territory of technoparks. In particular, at present, at the level of federal normative-legal acts, there exist no clearly determined requirements for the preparation of business plans for the functioning of technoparks, as well as the conditions and timelines for their recouplement.

The lack of uniform requirements to technoparks and their residents results in their operation being non-transparent. It is very difficult to prove that they perform inefficiently, and also that the organizations responsible for running technoparks spend the resources allocated to them on purposes other than their stated targets, because these targets actually are not stated clearly in any document. According to many experts, at present the projects that involve the creation of technoparks continue to be used as a vehicle for 'swallowing up' budget resources and taking over plots of land, just as it was done in the 1990s by those higher educational establishments that had created their technoparks before the adoption of the Federal Target Program.

Hi-tech zones

The legal mechanisms behind the functioning of HTZs are, in fact, much better elaborated than those for technoparks. Their status, as well as the minimum requirements to HTZ residents, are regulated by Federal Law of 22 July 2005, No 116-FZ, 'On special economic zones in the Russian Federation'.

In order to receive the status of an HTZ resident, an organization or individual entrepreneur must conclude a specialized agreement with the administrative bodies of a HTZ. Under the agreement concerning the implementation of hi-tech products, the resident during the period of the agreement assumes the obligation to engage in the activity envisaged in the agreement, while the administrative bodies of special economic zones (hereinafter to be referred to as SEZs) are obliged, during the period determined by an agreement, to conclude with the residents of SEZs contracts of lease of state and (or) municipal property¹ situated on the plots of land within the territory of a special economic zone, for carrying on therein their activity involving the implementation of hi-tech products.

The main advantage to be gained by being established in the territory of a HTZ is the possibility to enjoy the regime of a free customs zone (i.e., exemption from the payment of taxes and customs duties on the goods imported into its territory). Thereafter, if goods are removed from the territory of a HTZ into the customs territory of the Russian Federation, that regime is no longer applied, and so the relevant taxpayer must pay all the established payments. Other privileges include the advantages linked to the preferential use of the infrastructure of a SEZ by its residents, including preferential conditions for lease of premises and plots of land.

¹ Such an agreement can envisage that the administrative bodies of a SEZ must conclude with a resident of a special economic zone a contract of lease of a plot of land situated in the territory of a SEZ and entered into a cadastre register at the resident's expense for the period of the agreement on the implementation of hi-tech products, unless a shorter period is stated by the resident.

The control over the activity of HTZs is currently the responsibility of the RF Ministry of Economic Development and the specially created and subordinated to it Federal Agency for Special Economic Zones (*RosOEZ*)¹. Besides, the administrative bodies of a HTZ include a supervisory board.

On the whole, the experience of making use of zones of the hi-tech type can be estimated as successful. However, from the year 2010 onwards, residents of HTZs have been deprived of some of the advantages previously enjoyed by them, which can be very detrimental to their interest in pursuing the implementation of hi-tech products. Prior to 2010, in addition to customs exemptions, they were exempt from the single social tax. In accordance with Article 241 of the Tax Code of the Russian Federation, residents of HTZs were to pay the tax at a rate of 14 % (instead of the standard rate of 26 %).

The importance of this particular exemption for innovation-oriented companies was especially high due to the fact that in the sector of science and technologies a considerable share of expenditures is taken up by specialists' remuneration and the taxes linked to it, while for the other sectors of the national economy which are not associated with scientific innovations this factor is of less importance.

However, in 2009, a law was introduced whereby from the beginning of 2010 SST was to be replaced by separate insurance contributions payable to off-budget funds. The new law abolished the exemptions that were previously granted to residents of HTZs with regard to the 'taxes linked to wages'. And – although this measure is going to be introduced gradually until 2014 – its negative effect for innovation-oriented companies is quite obvious: the prospect of losing the right to tax exemptions in the medium term can already at this point lower the attractiveness of making hi-tech implementations in the territories of HTZs in the eyes of potential investors.

It seems that this situation has resulted from the lack of proper coordination between two directions of state policy: when carrying out reform of mandatory insurance, the law-makers put to the fore the task of liquidating deficit in the Pension Fund's budget, and when they were modernizing the economy they had in mind the task of creating proper organizational and tax incentives for implementing innovations. As a consequence, the pursuance of these two goals at the same time gave rise to some political contradictions which were resolved to the detriment of the innovation-oriented policy.

The transfer to the implementers of government contracts of the exclusive rights to their development products

After the adoption of Part IV of the Civil Code of the Russian Federation, which came into force in 2008, under a general rule the exclusive rights to the development products created under government contracts must belong to their implementers. However, the terms of a government contract may envisage that the exclusive rights be distributed otherwise (Article 1373 of the Civil Code of the Russian Federation).

This provision was introduced in order to define more precisely the entity on whose balance sheet a given intangible asset created at the expense of budget resources is to be kept; and, secondly, to create incentives for its subsequent commercialization. When taking this decision, the law-makers, quite reasonably, believed that it would be easier for a potential investor to deal with a given budget-funded organization in possession of an exclusive right than with some abstract right-holder defined as the State. The provisions of Article 1373 of the Civil Code of the Russian Federation turned out to be a first step towards allowing budget-funded institutions to commercialize on their own the development products created by them. In 2009, the law-makers made a second step along this way by granting to them the permission to establish small-sized innovation-oriented enterprises.

Thus, from the point of view of formal law, in 2008 – 2009 budget-funded institutions were presented with quite a few organizational incentives for developing their innovations. However, unfortunately, the practical implementation of the norms stipulated in Article 1373 of the Civil Code of the Russian Federation turned out to be rather tricky. As a matter of fact, the terms of a government contract are actually determined by one of the parties thereto – namely the governmental customer represented, as a rule, by a specific ministry or department. The contract

1 See <http://www.rosuez.ru/>

implementer cannot effectively influence the content of a government contract. At the same time the customer, as a rule, is not interested in transferring to the implementers the exclusive rights to the RIA created in course of implementing a government contract¹. As a consequence, the process of transferring licenses through budget-funded institutions to the private sector becomes seriously complicated.

It seems that this problem can be solved in part only by means by a more detailed regulation, in the Civil Code of the Russian Federation, of the conditions under which the customer can claim an exclusive right to the development products created under a government contract. As long as the customer's freedom in determining the contract's terms remains unrestricted, the process of implementing innovations will, most likely, be hindered by former through depriving budget-funded institutions of their exclusive rights to the RIAs created by them.

The permission for budget-funded institutions (research institutes and higher educational establishments) to create economic societies

The possibility to create economic societies was granted to research institutes and higher educational establishments together with the status of budget-funded institutions in 2009 as a result of the adoption of Federal Law, of 2 August 2009, No 217-FZ 'On the Introduction of Alterations into Some Legislative Acts of the Russian Federation on Issues Concerning the Creation, by Budget-Funded Research Institutions and Educational Establishments, of Economic Societies for Purposes of Practical Application (or Implementation) of the Results of Intellectual Activity' (hereinafter to be referred to as Law No 217-FZ).

As a result of the adoption of Law No 217-FZ, budget-funded institutions obtained the right to exercise their exclusive rights to RIAs in order to create economic partnerships and societies. In this connection, as a contribution to the charter capital of the newly created organizations, they may transfer their rights to *the use of* RIA, which means that any complete transfer of the exclusive rights to RIAs is forbidden. Besides, the Law allows contributing some other types of property and property rights belonging to budget-funded institutions². The share of a budget-funded institution must be no less than 25 % in a joint-stock company and one-third in a limited liability society.

At present it can be argued that the Law allowing budget-funded institutions to create legal entities has begun to work. Its implementation is stimulated, in particular, by the fact that sectoral ministries and departments regard the creation of innovation-oriented companies by the research institutions and higher educational establishments subordinated to them as one of the relevant criteria for assessing their performance level.

At the same time, quite a few practical issues relating to the actual execution of Federal Law No 217-FZ need to be further elaborated. Firstly, better regulation is needed with regard to property and rights other than the right of usage of RIAs that can also be contributed by a budget-funded institution to the charter capital of a newly created organization. Theoretically, on the basis of Federal Law No 217-FZ a founder may contribute the following types of property: money; fixed assets; property rights (for example, the right of lease); and the rights to use RIAs. However, the Budget Code of the Russian Federation stipulated no direct permission to do so, and does not regulate the procedure for the transfer of the rights to property placed in operative management by a budget-funded institution, or the transfer of money and the rights to use RIAs to the charter capital of some other organizations. Moreover, the laws on the federal budget adopted every year maintain that it is directly forbidden to spend the off-budget resources of budget-funded institutions on making any contributions to the charter capital of other legal entities and on purchasing securities. Thus, for example, this ban was stipulated in the Law on the 2009 federal budget and the 2010 - 2011 planning period; in spite of the coming into force of Law No 217-FZ, this ban was reconfirmed in the Law on the 2010 federal budget and the 2011 - 2012 planning period.

1 This, in particular, is what the Republican Scientific–Research Institute for Intellectual Property's experts have said. See <http://www.rniis.ru/>

2 In Law No 217 - FZ it is directly stated that budget-funded institutions 'shall contribute, as their contribution to the charter capital of such economic societies, the right of usage of the results of intellectual activity [...] the exclusive rights to which are to remain consolidated with these scientific-research institutions'. The Law also stipulates that budget-funded institutions shall have the right to contribute 'monetary means, equipment and other property being under their operative management in accordance with the procedure established by the Civil Code of the Russian Federation.

In this connection, it is impossible in actual practice to contribute to the charter capital of a newly created organization the money and property belonging to a budget-funded institution. Existing legislation offers no opportunities for applying a right of lease as a contribution to the charter capital of the organization being created by a budget-funded institution because the right to lease property belonging to a budget-funded institution can be granted exclusively on the basis of a tender¹.

Secondly, the restrictions imposed on the right of a full transfer of an exclusive right to a newly created budget-funded institution by means guarantee protection of intellectual property owned by the State – the owner of budget-funded institutions. As a matter of fact, a license agreement involving the transfer of a right to the use of RIAs may contain certain stipulations granting a very broad range of rights to the newly created organization, while at the same time limiting the opportunities of a budget-funded institution to issue a license to third parties or to use the RIAs for its own needs. In this case, if the rights to RIAs remain as an intangible asset on the balance sheet of the budget-funded institution, this can be regarded only as a mere formality.

Thirdly, the Law lacks precision in stipulating the obligations of a newly created organization to commercialize the RIAs the rights to the use of which are transferred as a contribution to its own charter capital. From a formal point of view, it is obliged to do so, but the Law says nothing as to the timelines for actually beginning their commercialization. Likewise the Law stipulates no requirements to the commercial effect of the use of RIAs. It means that a budget-funded institution can, for example, make a contribution to the charter capital of a newly created company in the form of a right to the use of software or a database, while the newly created organization can install these products on one of its computers. Thus the requirement concerning ‘the use’ of RIA will be complied with, and so it will become impossible to liquidate the new legal entity on formal grounds. At the same time, if such a company is ‘affiliated’ to the management of the relevant budget-funded institution, it will be able to gain an almost unlimited access to its material and human resources in order to make profit.

And finally, the political choice that has been made in favor of commercializing the RIAs belonging to budget-funded institutions through creating new innovation-oriented enterprises with their participation can hardly be regarded as the best solution possible. The transfer of the rights to the use of RIAs from a budget-funded institution to the private sector can theoretically be effectuated in two ways: by concluding a licensing agreement (to the use of RIA) envisaging the payment of license fees (or royalties) or by contributing the rights to the use of RIAs to the charter capital of a newly created organization (in this case, the budget-funded institution can claim an income in the form of dividends). However, the dividends received by the founder of an innovation-oriented company represent a more risky type of income than license fees, because the size of dividends depends on the profit of the innovation-oriented company, while the size of a license fee does not. This means that in many cases it would be much more profitable for a budget-funded institution to grant the rights of usage of RIAs to companies already created by third parties on the basis of a tender, rather than share the latter’s commercial risks in the hope of possibly receiving an income in the form of dividends. Nevertheless, the law-makers decided that the usage rights for RIAs must be transferred specifically in the form of contributions to charter capital; in other words, they chose a more risky way of commercialization for state-funded development products.

The creation of investment partnerships

At present, the idea of adopting the Law “On Investment Partnerships’ is being actively discussed. It is expected that investment partnership will become a new organizational form providing venture investors with opportunities for hedging their risks. This form is to take a somewhat intermediate position between trust partnership (that is, a legal entity) and simple partnership (an agreement on joint activity). The creation of investment partnerships will make it possible to attract both the resources of the organizations participating in the management of an innovative project and the

¹ See Paragraph 3, Article 17.1 of Federal Law, of 26 July 2006, No 135-FZ ‘On the Protection of Competition’, and also Resolution of the Government of the Russian Federation, of 30 June 1998, No 685 ‘On the Measures Designed to Ensure the Reception by the Federal Budget of the Revenues from the Use of Federal Property’.

resources of persons acting as 'contributors'. Besides, one and the same organization will be able to invest simultaneously in several innovative projects.

The possibility of hedging risks can be provided by granting to a venture investor the right to add up the profits and losses resulting from the simultaneous participation in several investment partnerships. Thus, if one venture project turns to be loss-making, the investor will be able to set off the losses against the profits received from the other projects (or partnerships). Besides, the suggested form will help to provide solutions to a number of problems belonging to the domain of civil law that cannot be solved within the framework of an agreement on joint activity and trust partnership. One example is the possibility to grant to the partners different scope of rights with regard to the partnership's management (by determining the managing partner in the agreement) and to assign different degrees of responsibility to different participants, etc.

At the same time, a solution must be provided to the issues of preventing the possibility of misuse of rights by the participants in such a partnership. For this purpose, it is planned to limit the activity of investment partnerships to the implementation of innovations and to ban their creation in other sectors like trade or construction that have nothing to do with technological innovations.

The idea of creating investment partnerships as a form of providing organizational support to innovations seems to be promising. Its implementation will probably require no significant alterations in existing civil legislation; however, the norms of the RF Tax Code that make it possible to exempt from taxation the cash flows from an investment partnership to its participants – as well as those that, on the contrary, allow those venture investors that invest in several projects simultaneously to hedge their risks – will have to be thoroughly revised.

So, the main problem associated with the organizational support for innovations remains the lack of proper coordination between the government policies towards certain specific forms of support. One example is the introduction of tax exemptions for HTZs as part of the policy aimed at promoting innovations and their subsequent abolition as part of pension reform; or granting to budget-funded institutions the right to contribute money to the charter capital of the innovation-oriented enterprises created by them and then placing a ban on this form of investment in the law on the federal budget, etc.

Considering all the arguments discussed above, it can be concluded that the legal potential for improving the mechanisms for providing organizational support to innovations has by no means been exhausted. Firstly, nearly all the existing forms of organizational support of innovations (technoparks, HTZs, and legal entities created by budget-funded institutions) are in need of being further improved. Secondly, there also exist many attractive forms of organizational support of investments in technological development that so far have not been implemented in practice. In particular, this applies to such a promising organizational form as investment partnerships. ●

AN ANALYSIS OF THE CORRESPONDENCE OF RUSSIAN LEGISLATION TO THE OECD REQUIREMENTS IN THE SPHERE OF DIRECT INVESTMENT

A. Levashenko

A country intending to become a member of the OECD should make its legislation in the sphere of investment activity correspond to the regulations adopted by this organization. Russian legislation does not impose any restrictions on direct foreign investment in the territory of the Russian Federation, and the general terminology used in it is similar to that of the OECD Code of Liberalization of Capital Movements. However, some Russian normative-legal acts contain provisions which envisage the possibilities of restrictions being introduced for foreign investors in the territory of the Russian Federation.

One of the means for ensuring the success of investment activity in one or another country is the existence of investment legislation harmonized in accordance with the international principles, which would guarantee the formation of a favorable investment climate in the country.

The experience of the Organization for Economic Cooperation and Development (OECD) as well as its recommendations and decisions could contribute to the development of a harmonized system of Russia's legislation in the sphere of investment activity, and, as a result, to the creation of a stable economic environment in our country, that would attract foreign investments thereto.

At present, Russia is not a member of the OECD. However, for a long period of time Russia has been cooperating with this organization within the framework of the Center for Co-operation with Non-Members, including in the sphere of creating a favorable investment climate in this country. However, foreign investors still consider the business climate in Russia to be unfavorable¹.

Among the flaws of the investment policy of the Russian Federation, the OECD places special emphasis on the following ones:

- strong government control over economic activities as a whole;
- restrictions on access of foreign investments to Russia's strategic sectors;
- a large number of large state-controlled companies with dominant market positions;
- a relatively limited volume of freely available information on Russian medium-sized and small businesses (the ways of spending funds, the description of the existing system of governance in one or other company, etc.).

In its latest survey for 2009, the OECD points it out that in Russia barriers to direct foreign investment are higher than in OECD member-countries. In particular, as noted earlier, one of the main barriers to the inflow of direct foreign investments to Russia is the emergence of large state-controlled conglomerates with dominant market positions. The scope for foreign investors to acquire equity in these conglomerates or participate in government procurement contracts in the sectors they occupy is strictly limited². Also, legislation of the Russian Federation restricts the inflow of non-resident investments to some administrative and territorial zones (for example the RF continental shelf). Moreover, there exist a number of restrictions on establishing branches of non-resident companies in the sphere of financial services (insurance and banking activities).

The Roadmap for the Accession of the Russian Federation to the 1960 OECD Convention³ stipulates that one of the conditions for Russia's accession should be the establishment, by her, of an open and transparent regime for foreign direct investment including in key sectors such as energy.

1 The OECD official web-site. Официальный сайт ОЭСР. Overview of the 2008 Investment Policy Review of the Russian Federation/ <http://www.oecd.org/dataoecd/37/20/40277735.pdf>.

2 The OECD official web-site. Economic Survey of the Russian Federation / Policy Brief, OECD, June 2009 P. 10-11. Available on the site: <http://www.oecd.org/dataoecd/50/18/43225190.pdf>.

3 The official web-site of the OECD. Available on the site: http://www.oecd.org/document/7/0,3343,en_2649_201185_1915847_1_1_1_1,00.html (Convention on the Organisation for Economic Co-operation and Development, 14th December 1960).

Also, Russia is expected to make key commitments under investment protection and other international agreements, etc ¹.

As regards the sphere of investment, the OECD's major aim is to properly regulate investment activities in as many countries as possible and to remove any barriers (tax, customs, administrative) to foreign direct investment. Primarily, its goal is to contribute to gradual liberalization of transactions via current accounts and capital accounts, including direct investments in OECD member-countries. The main OECD document designed to regulate this sphere of activity is the Code of Liberalization of Capital Movements (Decision of the OECD Council on the Adoption of the Code of Liberalization of Capital Movements OECD/C(61)96)². A country intending to become a member of the OECD should make its legislation correspond to the relevant provisions of the OECD Codes. At the same time the OECD permits this country to lodge reservations in respect of these Codes before the moment of signing them. These reservations would be reflected in corresponding annexes.

The Code of Liberalization of Capital Movements envisages cross-border mobility of capital including capital in the form of direct investments. The Code contains a list of capital movements subject to liberalization. The list of these transactions begins with direct investments. Liberalization of capital movements ensures a better distribution of savings in different countries for the purpose of their further use. This has a direct impact on investment activity because investment risks become lower.

The Code envisages a number of measures designed to eliminate restrictions on foreign investment in the territory of a corresponding OECD member-state. Such measures are defined in the Code as 'measures of liberalization'. In accordance with the Code, Russia should take the following major obligations within the framework of legal regulation of direct investments:

- to immediately notify the OECD of any existing measures affecting the freedom of movement of direct investments;
- to ensure that any measures concerned with movement of direct investments do not discriminate against any members of the OECD;
- after having signed the Code the country does not have the right to introduce new restrictions on various operations involving movement of direct investments;
- active participation in international cooperation in the field of information exchange, which is extremely important for development of a favorable investment climate.

The Code's measures envisage that OECD member-countries should not impose any restrictions on the conclusion and execution of transactions and the transfer of payments relating to investment operations. At the same time they have the right to lodge reservations in respect to these obligations, that is, to temporarily retain part of the existing restrictions. However, OECD member-countries should endeavor to avoid introduction of any new restrictions on movement of investments.

The procedure for carrying out direct investments, determined in the Code of Liberalization of capital movements comes within the purview of the following basic laws of the Russian Federation: Federal Law, of 9 July 1999, No 160 – FZ 'On Foreign Investments in the Russian Federation', Federal Law, of 10 December 2003, No 173 - FZ 'On Currency Regulation and Currency Control', Federal Law, of 2 December 1990, No 395 –I 'On Banks and Banking Activity', Federal Law, of 22 April 1996, No 39 - FZ 'On the Securities Market'³, the Law of the RSFSR of 26 June 1991 'On Investment Activity in the RSFSR', Federal Law, of 25 February 1999, No 39 - FZ 'On Investment Activity in the Russian Federation Effectuated in the Form of Capital Investments', Federal Law, of 29 April 2008, No 57 - FZ 'On the Procedure for the Effectuation of Foreign Investments in Economic Societies Having Strategic Significance for Ensuring the Defense of the Country and the Security of the State'⁴, Федерального закона от 31 марта 1999 г. № 69-ФЗ 'On Gas Supply in the

1 Appendix A. I to the Roadmap for the Accession of the Russian Federation to the OECD Convention (adopted at the 1163rd session of The OECD Council on 30 November 2007) / OECD Council Document C(2007)103/FINAL.

2 The official web-site of the OECD. The Code of Liberalisation of Capital Movements, OECD, 2009. Available on the site: <http://www.oecd.org/dataoecd/10/62/39664826.pdf>.

3 Собрание законодатель'ства Россииской Федератсии [Collection of Legislation of the Russian Federation]. No 17, 22.04.1996, p. 1918.

4 Собрание законодатель'ства Россииской Федератсии, 05.05.2008, No 18, p. 1940.

Russian Federation'¹, Federal Law, of 8 January, No 10 – FZ 'On State Regulation of Development of Aviation'², Federal Law, of 7 August 2001, No 119 – FZ 'On Auditor Activity'³, etc.

On the whole, the above Russian legislation does not impose any restrictions on foreign investment in the territory of the Russian Federation, and the general terminology used by the RF in the sphere of investment legislation is similar to that of the OECD Code of Liberalization of Capital Movements.

However, Federal Law, of 9 July 1999, No 160 – FZ 'On Foreign Investments in the Russian Federation' contains provisions that envisage a number of possibilities for introducing restrictions for foreign investors in the territory of the Russian Federation. Thus, one of the provisions of the said Law permits the government to establish exceptions restrictive for foreign investors where necessary for the protection of the Constitutional order, public morals and health, the rights and lawful interests of other persons and the security of the State. Or, in pursuance of Article 15 of the Law, foreign investors should have the right to acquire rights to land plots and other natural resources, buildings, and other real estate in accordance with legislation of the Russian Federation and legislation of subjects of the Russian Federation which could introduce any restrictions. Thus, although the general provisions of the Federal Law 'On foreign Investments in the Russian Federation' do not contain any direct restrictions on the activity of foreign investors and stipulate that the legal regime of the activity of foreign investors may not be less favorable than the legal regime of activity and the use of profit received from investments granted to Russian investors, the Law includes numerous reference norms that envisage the possible introduction of such restrictions by other normative-legal acts.

Federal Law, of 10 December 2003, No 173 – FZ 'On Currency Regulation and Currency Control' likewise does not establish restrictions on trans-border capital movements. However, according to this Law, non-residents in the territory of the Russian Federations should have the right to open bank accounts (or bank deposits) in foreign currencies only with the authorized banks. This norm cannot be considered as anything else but restriction.

The OECD Code contains FDI liberalization norms not only for investment operations carried out by juridical persons but also for those carried out by physical persons. However, the Federal Law 'On Currency Regulation and Currency' establishes measures of control over transfers of foreign currency and securities to and from Russia. In fact, these measures are restrictions, but they are primarily targeted against money laundering and absolutely compatible with similar measures of restriction used in other countries.

According to the OECD Code, loans for a term of 5 years should be considered as one of the types of direct investments. In accordance with the Federal Law 'On Currency Regulation and Currency Control', transactions between residents and non-residents, including major transactions such as granting and receiving financial credits and loans (classified as one of the types of direct investments) should not be subject to restriction. The only exception is the requirement that residents should ensure the transfer, from non-residents, to their bank accounts in the authorized banks of the sums in foreign currencies or the currency of the Russian Federation due to be paid to them under the terms of corresponding agreements (or contracts) for the commodities transferred to the non-residents or for the work performed for them; and the requirement that the monetary means paid to non-residents for commodities not delivered to the customs territory of the Russian Federation (or not received in the customs territory of the Russian Federation), non-performed work or non-performed services. This norm can also be considered as a restriction.

Also, the OECD Code describes the possibilities for residents to conduct transactions via deposit accounts in foreign countries. The conduct of such transactions by residents is one of the means of capital transfer, including for the purpose of investment. As regards the possibility for residents to open bank accounts abroad and to conduct transactions via these accounts, Federal Law, of 10 December 2003, No 173 – FZ 'On Currency Regulation and Currency Control' establishes some restrictions. In accordance with Article 12 of the Law, residents should have the right to open, without any restrictions, accounts (or deposits) in foreign currencies with banks situated in the

1 Sobranie zakonodatel'stva Rossiiskoi Federatsii, 05.04.1999, No 14, p. 1667.

2 Sobranie zakonodatel'stva Rossiiskoi Federatsii, 12.01.1998, No 2, p. 226.

3 Sobranie zakonodatel'stva Rossiiskoi Federatsii, 13.08.2001, No 33 (Part I), p. 3422.

territory of foreign states which belong to the OECD or the Financial Action Task Force on Money Laundering (FATF). This norm restricts the possibility of opening a bank account only with the banks of the said groups of countries, and can be considered as incompatible with the corresponding provisions of the OECD Code on Liberalization of Capital Movements.

In accordance with Federal Law, of 2 December 1990, No 395-I 'On Banks and Banking Activity', Russian authorities have introduced restrictions on the acquisition, by RF credit institutions, of foreign securities, including securities certifying property rights (in particular, participation in the capital of foreign persons). Thus, a credit institution having a general license and its own financial means (capital) in an amount of no less than the ruble equivalent of 5 mln Euro in has the right, on having obtained the permission of the Bank of Russia and in accordance with its requirements, to establish its branches in the territory of a foreign state and to establish its representations there after having notified the Bank of Russia to this effect. A credit institution having a general license and its own financial means (capital) in an amount of no less than the ruble equivalent of 5 mln rubles has the right, on having obtained the permission of the Bank of Russia and in accordance with its requirements, to establish its subsidiaries in the territory of a foreign state.

Thus, there indeed exist restrictions on acquisition of foreign securities by Russian credit institutions. These legislative norms limit the possibilities for Russian investors involved in the sphere of banking services to carry out oversea investments.

Besides, the Federal Law 'On Banks and Banking Activity' stipulates the following restrictions with regard to the procedure for carrying out direct foreign investments. First of all, restrictions apply to the way the aggregate participation of foreign capital in the Russian Federation's aggregate banking capital is to be determined: they must be subject to a quota. Then, in violation of the principle of extending the national legal regime to foreign investors, foreign credit institutions must submit some additional documents in order to register as a Russian legal entity.

In accordance with the OECD Code, the State should create equal opportunities for all participants of investment activity and should prevent monopolization of individual segments of the economy by one of the investors or a group of investors. At the same time Federal Law, of 29 April 2008, No 57 – FZ 'On the Procedure for the Effectuation of Foreign Investments in Economic Societies Having Strategic Significance for Ensuring the Defense of the Country and the Security of the State' envisions the introduction of a number of restrictions for some categories of foreign investors. The Law establishes that foreign states, international organizations and organizations controlled thereby, including those created in the territory of the Russian Federation should not have the right to conclude transactions leading to the imposition of their control over economic societies having strategic significance for ensuring the defense of the country and the security of the State. The case in point is 42 types of activities (services provided by natural monopolies, publishing activity, TV and radio broadcasting, etc.) where direct foreign investment is restricted.

Also, a number of restrictions for foreign investors are introduced by the following sectoral laws of the Russian Federation: Law of the Russian Federation, of 27 November 1992, No 4015-I 'On Insurance'¹, Federal Law, of 12 January 1996, No 101 – FZ 'On Non-for-Profit Organizations'², Federal Law, of 24 July 2002, No 101 – FZ 'On the Turnover of Lands of Agricultural Designation'³, Federal Law, of 31 March 1999, No 69 – FZ 'On Gas Supply in the Russian Federation'⁴, Federal Law 'On State Regulation of Development of Aviation'⁵, Federal Law, of 31 May 2002, No 63 – FZ 'On Advocate Activity and the Bar in the Russian Federation',⁶ etc. In the main, such restrictions are concerned with establishing a ceiling for foreign investor participation in one or other Russian organization involved in various spheres of activity and with setting special demands on foreign investors, which are not extended to Russian investors.

Thus, before Russia signs the OECD Code of Liberalizing Capital Movements, experts should thoroughly analyze existing Russian legislation and determine the list of exceptions (or

1 Rossiiskaia Gazeta [The Russian Gazette], No 6, 12.01.1993.

2 Sobranie zakonodatel'stva Rossiiskoi Federatsii, 15.01.1996, No 3, p. 145.

3 Sobranie zakonodatel'stva Rossiiskoi Federatsii, 29.07.2002, No 30, p. 3018.

4 Sobranie zakonodatel'stva Rossiiskoi Federatsii, 05.04.1999, No 14, p. 1667.

5 Sobranie zakonodatel'stva Rossiiskoi Federatsii, 12.01.1998, No 2, p. 226.

6 Sobranie zakonodatel'stva Rossiiskoi Federatsii, 10.06.2002, No 23, p. 2102.

reservations) concerning the procedure for carrying out direct foreign investment, i.e., the list of deviations from the general package of liberalization measures.

An analysis of Annex B to the OECD Code of Liberalization of Capital Movements containing the reservations made by all OECD member-countries makes it possible to conclude that in practice most of the countries has lodged reservations to the Code with regard to the measures of liberalization being implemented in their territory.

The majority of reservations are concerned with the procedure for investment in the following spheres of activity: banking and insurance activities, transport, ownership or acquisition of ships under the flag of the country in question, the energy and mining sectors, the fishing industry, accounting and juridical services, and about thirty other types of activities. Also, practically all EU countries with membership in the OECD have introduced or are introducing restrictions on the level of investment into various companies for foreign investors from non-EU countries.

Thus, the liberalization of capital movements in the form of direct investments suggested by the OECD would give Russia access to international capital markets thus making it easier to finance her economy. However, a reckless acceptance of all the OECD's demand concerning the procedure for direct investments movement could jeopardize the state interests of Russia at the current stage of her development.

As regards the influence of liberalization of capital movements on the economic effectiveness of OECD member-states, it should be noted that the universally accepted point of view is that the openness with respect to inflow of foreign capital in the form of direct investments has produced a rise in competition and, as a result, increased the effectiveness of the financial institutions of OECD member-countries¹. ●

¹ The official web-site of the OECD. Overview Forty Years' Experience with the OECD Code of Liberalisation of Capital Movements. 2002 / Available on the site: <http://www.oecd.org/dataoecd/10/62/39664826.pdf>.

REVIEW OF MEETINGS OF THE GOVERNMENT OF THE RUSSIAN FEDERATION

M. Goldin

In February at the meetings of the Presidium of the Government of the Russian Federation the following issues were considered: amendments to the Civil Code of the Russian Federation, specifying the notion of “endowment”; changes to the acts of the Government of the Russian Federation specifying the authority of the federal executive bodies in the field of energy saving and increase in energy efficiency.

On **February, 4** at the meeting of the Presidium of the Government of the Russian Federation the bill introducing changes to article 582 of the Civil Code was considered. The version that is currently in the effect defines endowment as a donation or, in other words, gratuitous transfer of belongings or rights for general utility. At the same time in the current version of article 5 of the Federal Law from 11.08.1995 No 135-FZ “On charity and charity organizations” it is stated that the charitable endowment can be made in the following forms:

- Disinterested (gratuitous or on privileged terms) transfer of property into the ownership, including monetary funds and (or) objects of intellectual property;
- Disinterested (gratuitous or on privileged terms) vesting with the right of ownership, use and management for any objects of the property rights;
- Disinterested (gratuitous or on privileged terms) execution of works, rendering services by economic entities acting as philanthropists.

However, according to paragraph 2 article 3 of the Civil Code of the Russian Federation the norms of the civil right that are included in other laws are to correspond to the RF Civil Code, which means that there is an unsolvable collision between the mentioned norms of the legislation. In this connection taking into account that in practice the donation can be made in the form of unpaid execution of works and services for the purposes of charity, it is making changes to article 582 of the RF Civil Code that would enhance the meaning of the term “endowment” included in the RF Civil Code that is the most acceptable way to overcome the collision mentioned.

It should also be noted that according to paragraph 2 article 251 of the RD Tax Code when defining the taxation base for the profit tax the endowments for maintenance of non-commercial organizations and their implementation of the statutory activity are not taken into account. Thus, the amendment will enable to apply the corresponding norms of the tax legislation on provision of gratuitous aid to non-commercial organizations in the form of work execution and services rendering.

The RF Government approved the project of the Federal Law “On making changes to article 582 part 2 of the RF Civil Code” and decided to submit it to the State Duma for consideration.

On **February, 16** at the meeting of the Presidium of the RF Government the issues concerning introduction of changes to acts of the Government on determination of the authority of federal executive bodies in the field of energy saving and increase of energy efficiency were discussed.

The project of the governmental decree concerning this issue was submitted by the Ministry for the economic development of the Russian Federation in correspondence with paragraph 1 of the Plan of measures for energy saving and increase of energy efficiency in the Russian Federation aimed at fulfilling the Federal Law from 23.11.2009 No 261-FZ “On energy saving and increase in energy efficiency and making changes to some legislative acts of the Russian Federation”. The law mentioned establishes a number of additional authority of the executive bodies in the field of energy saving and increase in energy efficiency. The fulfillment of these authorities will proceed within the limits of the limit number of the employees of the federal executive bodies, as well as of the budget allotments to these bodies in the federal budget in the corresponding year for management and administration in the field of established functions.

According to the idea of the authors of the project, its adoption will create a basis for the management system of the process for energy efficiency increase in the Russian economy. ●

REVIEW OF ECONOMIC LEGISLATION

I. Tolmacheva

The following changes were made to the legislation in February 2010: a immediate compensation to some categories of citizens of the Russian Federation in connection with 65th anniversary of Victory in the Great Patriotic War will be made; the value of indexation coefficient of monthly insurance payment for compulsory casualty insurance and insurance against professional diseases was defined; the value of minimum subsistence level in the 3rd quarter 2009 was determined; the procedure for contests and tenders for the right to sign contracts envisaging transferring of property rights or rights of use concerning state or municipal property was specified.

I. Decrees of the President of the Russian Federation

1. "ON IMMEDIATE COMPENSATION TO SOME CATEGORIES OF RUSSIAN FEDERATION CITIZENS IN CONNECTION WITH 65TH ANNIVERSARY OF VICTORY IN THE GREAT PATRIOTIC WAR OF 1941-1945" from 24.02.2010 No 247.

In April 2010 some citizens of the Russian Federation that are permanent residents in the territory of the Russian Federation will receive immediate compensation in connection with the 65th anniversary of the Victory in the Great Patriotic War. Thus, a immediate compensation of RUR 5000 will be made to the following categories of citizens: disabled veterans of the Great Patriotic War, some categories of veterans, former underage prisoners of concentration camps, ghettos, widows of military personnel that died during the war with Finland, Great Patriotic War, war with Japan, widows of the deceased disabled veterans and veterans of the Great Patriotic War; a immediate compensation of RUR 1000 will be made to people who worked no less than six months on the home front from June 22, 1941 to May 9, 1945 (excluding the period of the work on the temporary occupied territories of the USSR), people, awarded by orders or medals of the USSR for selfless work during the Great Patriotic War and former adult prisoners of the Nazi concentration camps, prisons, ghettos.

II. Decrees of the Government of the Russian Federation

1. "ON ESTABLISHMENT OF INDEXATION COEFFICIENT FOR MONTHLY INSURANCE PAYMENT FOR COMPULSORY CASUALTY INSURANCE AND INSURANCE AGAINST PROFESSIONAL DISEASES" from 02.02.2010 No 36.

According to the Federal Law from 24.07.1998 No 125-FZ "On compulsory social insurance against industrial accidents and professional diseases" the value of the mentioned monthly insurance payment is indexed taking into account the level of inflation within the limits of the funds envisaged for these purposes in the budget of the Fund for Social Insurance of the Russian Federation for the corresponding financial year. It is established that starting with the 1st January the indexation coefficient of the monthly insurance payment fixed before January 1, 2010, makes 1.1 (starting with January 1, 2009 the coefficient equal to 1.13 has been applied).

2. "ON ESTABLISHMENT OF MINIMUM SUBSISTENCE LEVEL PER CAPITA AND FOR THE MAIN SOCIO-DEMOGRAPHIC GROUPS OF THE POPULATION ON THE WHOLE IN THE RUSSIAN FEDERATION FOR 3RD QUARTER 2009" from 20.02.2010 No 69.

On the whole throughout Russia the value of subsistence level per capita in the 3rd quarter 2009 made RUR 5198 (RUR 5187 in the 2nd quarter), RUR 5620 for able-bodied population (RUR 5607 in the 2nd quarter), RUR 4134 for pensioners (RUR 4129 in the 2nd quarter), RUR 4978 for children (RUR 4963 in the 2nd quarter).

III. Instructions, Orders, Letters

1. Order of the Federal Antimonopoly Service of the Russian Federation "ON PROCEDURE FOR CONDUCTING CONTESTS AND TENDERS FOR THE RIGHT TO CONCLUDE RENT

CONTRACTS, CONTRACTS OF GRATUITOUS USE, TRUST MANAGEMENT CONTRACTS OR OTHER CONTRACTS THAT ENVISAGE TRANSFERRING OF PROPERTY RIGHTS AND (OR) RIGHTS OF USE CONCERNING STATE AND MUNICIPAL PROPERTY AND THE LIST OF KINDS OF PROPERTY TO WHICH THE CONCLUSION OF CONTRACTS BY CARRYING OUT THE TENDERS IN THE FORM OF CONTRACTS CAN BE APPLIED” from 10.02.2010 No 67.

Registered in the Ministry of Justice of the Russian Federation from 11.02.2010 No 16386.

The regulations approved define the authority of contest and tender committees, whose number of members should not be less than five, requirements for the contest and tender participants, any legal entities regardless of the organization and legal form, form of property, location, as well as the place of capital origin or any natural persons, including individual entrepreneurs being able to act as such. The procedure for information support for contests and tenders, requirements for the contest documentation and tender documentation, procedures for contest or tender conducting, procedure for conclusion of agreements as a result of them have also been determined.

The list of property to which the conclusion of contracts envisaging the transfer of rights of property or use by means of a contest or a tender can be applied has also been established. This list includes the objects of railway transportation, pipeline transportation, sea and river ports, airports, hydraulic facilities, objects producing, transferring and distribution of electric and heat energy, systems of communal infrastructure, underground railways and other public transport, nonresidential premises of infrastructure of small- and medium-scale business support, included in the special list.

2. Letter of the Federal Tax Service of the Russian Federation “ON DATA NECESSARY TO CALCULATE SEVERANCE TAX ON OIL OVER JANUARY 2010” from 16.02.2010 No ShS-22-3/118@

Coefficient, correcting the severance tax rate concerning oil over January 2010 was defined to be 6.9644. The value of coefficient in December 2009 was lower and made 6.7086. ●

REVIEW OF LEGISLATIVE DOCUMENTS CONCERNING TAXATION OVER JANUARY–FEBRUARY 2010

L.Anisimova

1. According to the Letter of the Ministry of Finance of the Russian Federation (RF Ministry of Finance) from 05.02.2010 No 03-11-11/25 the question on the general application of the criterion of the limited average number of the employees on the books (not exceeding 5 people over the taxation period), including those attracted on the basis of civil legal contracts, established by paragraph 2.1 article 346.25.1 of the Tax Code of the Russian Federation (RF Tax Code), to the individual taxpayer who pays the tax on the basis of a patent (patents), regardless of the total number of the kinds of entrepreneurial activities carried out by him, which are taxed on the patent basis, and, correspondingly, the number of patents.

2. According to the Letter of the RF Ministry of Finance from February 2, 2010 No 03-11-06/1/03 the question on accounting of advance payments received by a taxpayer over the taxation period for the purposes of application of the single agriculture tax.

In concordance with subparagraph 1 paragraph 5 article 346.5 the cash method for incomes accounting is established for the purposes of the single agriculture tax. Since according to article 251 no advance payments are envisaged for organizations applying cash methods for incomes accounting, the RF Ministry of Finance explains that the taxpayers of the single agriculture tax do not have a right to exclude them when calculating the taxation base. In agreement with this, the sums of preliminary payment (advance payments) received by organizations that pay single agriculture tax in 2009 from the customers for goods that will be made independently by the single agriculture tax payer out of his own raw materials in the following taxation period (in 2010) are to be taken into account within the incomes of the single agriculture taxpayer in 2009 when calculating the proportion of its agriculture production in his own total earnings in 2009.

3. According to the Letter of the RF Ministry of Finance from February 1, 2010 No 03-05-06-02/12 the question on payment of the land tax was clarified. The land plots in the territory of municipal formation in which the tax is introduced (paragraph 1 article 389 of the RF Tax Code). The basis for collection of the land tax is the documents proving the right for the land plot that a taxpayer has. If the right for constant (unlimited) use of the land plot is registered for the organization that develops it,, it is recognized as a taxpayer of the land tax on the land plot.

4. According to the Letter of the RF Ministry of Finance from February 1, 2010 No 03-03-06/3/4 the question on taxation of incomes from the sale of a share in the authorized capital stock of a company is clarified. According to subparagraph 2.1 paragraph 1 article 268 of the RF Tax Code when selling the property right (share, interest) a taxpayer has a right to decrease the profits from such an operation by the price of purchase of the of the property rights (shares, interests) mentioned and by the some of expenses connected with their purchase and sale. At the same time the RF Ministry of Finance notes that the price of purchase of a share in authorized capital stock of a company is formed basing on the primary and additional contributions of a participant of a society. According to the explanation of the RF Ministry of Finance the contribution of a society's participant in the property of a society does not increase the price of purchase of a share in the authorized capital stock of a company. It should be additionally mentioned that the positional of the RF Ministry of Finance is based on the Federal Law from 8.12.1998 No 14-FZ "On limited liability companies", which distinguishes between "contribution to the capital" (articles 14-19) and "contribution to the property" (article 27). Contribution to the capital and additional contributions to the capital (made in proportion to the share of a participant in the capital) change the rate and nominal value of shares of participants in the authorized capital stock of a company,

while the contributions to the property do not do so. Within the framework of the RF Tax Code the contribution to the capital is not considered to be a taxable profit of a society, and the same applies to the payment within the limits of the contribution (payment to the capital), which is not considered to be taxable profit of their participants. The procedure of taxation when making contributions to the capital is reflected in articles 251 paragraph 1, subparagraph 3 and article 277 paragraph 1. The term “contribution to the capital” in the RF Tax Code is not used and the term “incomes in the form of property received gratuitously” is applied. The procedure of taxation of such incomes is reflected in article 252 paragraph 1 subparagraph 11.

5. According to the Letter of the RF Ministry of Finance from January 29, 2010 No 03-07-11/12 an answer to a private inquiry on VAT recovery when selling the main assets at depreciated cost. The RF Ministry of Finance explains that in concordance with subparagraph 2 paragraph 3 article 170 of the RF Tax Code VAT sums that were earlier accepted to deduction by the taxpayer for goods, including fixed assets, are to be recovered in case they are further used to conduct operations not levied with VAT since the sale of the main assets does not belong to operations not levied with VAT, the sum of Vat that was earlier accepted for the deduction is not to be recovered. In the letter under consideration the earnings for the purposes of VAT is defined on the basis of the depreciated cost. It should be remembered that for the purposes of profit tax the sum of amortization premium is to be recovered in case the fixed assets are sold before fixe years after their purchase have elapsed (subparagraph 4 paragraph 9 article 258 of the RF Tax Code). At the same time the sales prices of the fixed assets for the purposes of payment of profit tax and VAT will coincide and be equal to its depreciated cost. The recovered amortization premium is included when calculating the profit tax in the list of outstanding profits, and the taxation base from the sale of a fixed asset is defined as a difference between the price of its sale and the depreciated cost, calculated as a price of purchase subtracted by amortization deductions (including amortization premium).

6. According to the Letter of the RF Ministry of Finance from January 29, 2010 No 03-11-06/2/11 the question on the procedure for reflection of expenses for purchase of material stocks in accounts of a taxpayer is explained in case on the date of their purchase it was not clear whether they would be used within the framework of activity levied in concordance with the simplified taxation system or that levied with taxes in concordance with the system of the single tax on the imputed income. The RF Ministry of Finance, for instance, explained that in this case in graph 5 “Expenses” of the Accounting book of incomes and expenses of organizations and individual entrepreneurs applying simplified taxation system the total cost of the purchased raw materials (materials) is reflected on the date they were fully paid for. If the raw materials (materials) are transferred for entrepreneurial activity levied with the single tax on the imputed income, the sum of the expenses for raw materials and materials, which are transferred for the activity levied with the single tax on the imputed income, reflected in the Book of expenses should be reversed in graph 5 of the Book in prices of the date of their purchase and payments.

7. According to the Letter of the RF Ministry of Finance from January 29, 2010 No 03-07-08/21 the question on taxation with VAT of marketing and consulting services rendered by a Russian organization to a representative of a foreign organization situated in the territory of the Russian Federation, In concordance with subparagraph 1 paragraph 1 article 146 of the RF Tax Code the operations of sale of goods (works, services) in the territory of the Russian Federation are recognized as the objects of VAT taxation. The place of sale of the services under consideration is defined by the place of the customer location in concordance with subparagraph 2 paragraph 1 and subparagraph 4 paragraph 1.1 article 148 of the RF Tax Code. Since the representative of a foreign organization is not a permanent representative of a foreign organization conducting entrepreneurial activity in the territory of the Russian Federation, in this case marketing and consulting services, in the opinion of the RF Ministry of Finance are made directly by the foreign organization, that is out of the borders of the Russian Federation. Consequently, these services are not levied with VAT in the territory of the Russian Federation.

8. According to the Letter of the RF Ministry of Finance from January 29, 2010 No 03-11-06/2/10 the question on the possibility of transfer to the simplified taxation system for organizations which at the moment of submission of the application on transfer did not correspond to the requirements on the share of participation of other organization in their capital (in concordance with subparagraph 13 paragraph 3 article 346.12 of the RF Tax Code cannot apply the simplified taxation system, if the share of other organizations makes more than 25%), but had not fulfilled the requirement by the beginning of the taxation period.

9. According to the Letter of the RF Ministry of Finance from January 28, 2010 No 03-11-06/2/8 it is clarified that the expenses for payment for services of third organizations on printing and distribution of a publication can be taken into account when calculating the taxation base according to the simplified system of taxation among the material expenses, since such services are rendered within the framework of the technological process of publishing printed goods.

10. Letters of the RF Ministry of Finance from January 21, 2010 No 03-03-06/1/14 and January 26, 2010 No 03-03-06/1/24 clarify some issues of incomes and expenses accounting for the purposes of taxation by lessor and lessee in connection with the property leasing. According to subparagraph 10 paragraph 1 article 264 of the RF Tax Code leasing payments of lessee belong to other expenses connected with production and sale, taken into account for the purposes of profit taxation. The costs of the lessee are recognized as expenses in case they were made to carry out the activity aimed at profit earning. The RF Ministry of Finance draws attention to the fact that due to the principle of free economic activity (part 1 article 8 of the Constitution of the Russian Federation) the taxpayer carries it out independently at his own risk and has a right to estimate its efficiency and purposefulness independently and single-handedly. In this connection there are no formal grounds not to take into account as expenses of a lessee the leasing payments accrued for the period when the leased property was not used in production. It can be added that there is no loss of the aggregated tax base as result of such a position of the RF Ministry of Finance, since leasing payment are included in the taxation base at their recipient - the lessor. As for the calculation of the amortization for the property at lease if the leasing agreement envisages that the subject of the lease is to be taken on the balance of the lessor, for the purposes of taxation amortization for this property is accrued on the tax accounts of the lessor. The calculation of the amortization for the object of the amortized property starts with the 1st day of the month following the month when this object was put into commission (paragraph 4 article 259 of the RF Tax Code). The moment of the object of the leasing being put into commission for the purposes of taxation is defined by the date it is transferred to the lessee.

11. According to the Letter of the RF Ministry of Finance from January 22, 2010 No 03-03-06/1/17 it is clarified that the expenses for insurance of the liability of contest participant for the right of state contracts conclusion envisaged by the tender conditions can be taken into account as expenses of organization for the purposes of profit taxation on the basis of subparagraph 10 paragraph 1 article 263 of the RF Tax Code.

12. According to the Letter of the RF Ministry of Finance from January 27, 2010 No 03-07-14/03 the situation connected with the calculation of VAT when transferred in to the simplified taxation system is clarified. When transferring from the general taxation system to the simplified taxation system the sums of the incoming VAT accepted for deduction by the purchased goods (works, services) are to be recovered in the taxation period preceding such a period (subparagraph 2 paragraph 3 article 170 chapter 21 of the RF Tax Code). At the same time the calculation of the sum of the tax on the amortized property that is to be recovered is made basing on the depreciated cost of such property formed according to the data of the accounting. The sums of the tax on immovable property that are to be recovered are not included in the property cost and are included in the list of other expenses in concordance with article 246 of the RF Tax Code.

It should be noted that when transferring from the simplified taxation system to the general system, as it is underlined by the RF Ministry of Finance, the VAT sums that were recovered earlier are not accepted for deduction.

13. According to the letter of the RF Ministry of Finance from January 28, 2010 No 03-03-06/1/28 the question on the procedure for calculation of the amortization norm when transferring to the linear method of amortization calculation for the purposes of profit tax payment is clarified. For this purpose the residual (and not primary or recovered) cost of each of the amortized objects is distributed to the number of years, basing on the remaining period of its useful utilization.

14. According to the Letter of the Federal Tax Service of the Russian Federation from February 3, 2010 No ShS-22-3/84@ some question on application of chapters 26.1 and 26.3 of the RF Tax Code are clarified. Articles 346.24 and. 346.5 (paragraph 8) of the RF Tax Code state that the taxpayers applying simplified taxation system or paying single agriculture tax are to conduct the accounting of incomes and expenses for the purposes of the tax base calculation in the corresponding Book for incomes and expenses accounting of organizations and individual entrepreneurs (further referred to as the Book), the procedure and the form for whose filling are established by the RF Ministry of Finance. The procedures for keeping these books established by the RF Ministry of Finance envisage the responsibility to submit the books to the taxation bodies. At the same time the RF Ministry of Finance explains that the tax bodies do not have a right to require compulsory submission of the books mentioned for certification and they are certified only at the will of the taxpayers.

15. According to the letters of the RF Federal Tax Service from February 4, 2010 No ShS-22-3/86@ and the RF Ministry of Finance from 21.01.2010 No 03-07-15/08 the question on VAT application when rendering services of rent of the immovable property is clarified. In concordance with paragraph 1 article 148 the services on leasing the immovable in the territory of the Russian Federation are not to be levied with VAT. The RF Federal Tax Service explains some difficult questions connected with the formation of the rent payments. For instance, non-inclusion of the sums of compensation for communal payments, maintenance, security of the leased premises directly into the rent does not mean that the cost of real services of rent does not involve these additional services (they can be formalized by separate contracts). According to the explanations of the RF Federal; Tax Service (with the reference to the Ruling of the Supreme Arbitrary Court of the Russian Federation from 25.02.2009 No 12664/08), the additional services mentioned were inseparably connected with the services of the rent. Further, particular situations and the procedure of payments for these additional services are analyzed.

1). The RF Federal Tax Service explains that the taxpayers that are lessors and render services of rent of immovable property and define the taxation base for the purposes of VAT calculation on the rent payments (including both the constant and the variable part, also in the form of the compensation payment which is the compensation of lessor's costs for maintenance of the leased premises, communal services etc.) can apply tax deductions to the tax sum they were levied with when purchasing communal services (including communication, security and cleaning services), included in the rent. In this case the lessor in concordance with paragraph 3 article 168 of the RF Tax Code draws an invoice to the lessee no later than in 5 calendar days counting from the day the service was rendered, in which regardless of the date of payment for a variable part of the rent, he states the single value of the service consisting of permanent and variable value (filling either one line in the invoicing with the total sum or two lines mentioning permanent and variable parts separately).

2). If payments for communal services (including use of communication, security and cleaning) of the leased premises are not a variable part of the rent and are collected by the lessor from the lessee without VAT on the basis of a separate contract for compensation of the costs of the lessor himself, then on the basis of the letters of the RF Federal Tax Service from 27.10.2006 N ShT-6-03/1040@ and from 23.04.2007 No ShT-6-03/340@, the mentioned compensation payments are not taken into account by the lessor when defining taxation base for VAT and, correspondingly, invoice for the sum of the mentioned payments (compensations) is not made by the lessor to the lessee.

3). In case the lessor renders services to the lessee on renting premises (basing on the cost of the square of rented premises defined by the leasing contract) and according to separate contracts – service, for instance, of maintenance of the rented premises and operation costs (including on the basis of a separate contract for rendering the services of maintenance of the rented premises and

exploitation services), the calculation of VAT by the lessor, drawing of invoices and application of the tax deductions by the lessee is made separately to each kin of services.

16. According to the Letter from January 28, 2010 No 03-05-05-01/02 in response to a private inquiry the RF Ministry of Finance explained the procedure of accounting the object of immovable property in the organization's accounting for the purpose of definition of the taxpayer and payment of the property tax.

For instance, the RF Ministry of Finance explained that the state registration of the rights for the purchased object of immovable property is the reason to transfer the purchased object of immovable property to the fixed assets by the organization acting as a customer. When selling the immovable property the organization acting as a seller cannot take off the books the object recognized as a part of fixed assets before the earnings from its sale are recognized as in accounting, including the period of transfer of the corresponding right for the immovable object to the organization that is customer. The basis for taking the immovable object off the books will be, correspondingly, the state registration of the transfer of the right for this object to the organization acting as a seller.

Taking into account the facts mentioned above, the taxpayer of the organization property tax when concluding deals with the immovable property is the person, who, according to the Single state register of the rights for immovable property and deals with it, has the right of property (right of live management, right for maintenance) for the corresponding object of immovable property.

17. Letters of the RF Federal Tax Service from February 2, 2010 No ShS-17-3/20@ and the RF Ministry of Finance from 23.12.2009 No 03-07-15/169 comment on the procedure for application of the changes in articles 149 and 162 of the RF Tax Code, made by the Federal Law from November 28, 2009 No 287-FZ.

Starting with January 1, 2010 in concordance with subparagraph 29 paragraph 3 article 149 of the RF Tax Code communal services rendered by the managing organizations, condominiums, housing and building, housing and other specialized consumer cooperatives that have been created in order to satisfy the needs of citizens in housing and that are responsible for internal engineering systems with the use of which the communal services are rendered on condition that the communal services are purchased by the taxpayers mentioned from the organizations of communal complex, suppliers of electric energy and organizations providing gas.

At the same time the exemption of the communal services rendered by the suppliers of the communal services, electricity supply and gas supply to these managing companies, cooperatives, condominiums etc is not envisaged. On the basis of subparagraph 1 paragraph 2 article 170 of the RF Tax Code the sums of incoming VAT will be automatically included in the cost of the communal services of managing companies, condominiums and other cooperatives and will not be subject to deduction. It is obvious that there will be no alleviation of the tariff load on the population.

Similar procedure for application of exemption from VAT is established by subparagraph 30 paragraph 3 article 149 of the Code on works (services) for maintenance and repair of communal property in block of flats.

At the same time, the RF Ministry of Finance and the RF Federal Tax Service clarified that starting with January 1, 2010 according to paragraph 3 article 162 of the RF Tax Code, the VAT base does not include monetary funds received by managing companies and condominiums to carry out current and thorough repair works of the communal property in a block of flats. Nevertheless the repair works paid by the funds of this reserve are not envisaged to be exempted from VAT.

18. According to the Letters of the RF Federal Tax Service from February 8, 2010 No ShS-17-3/23@ and the RF Ministry of Finance from 28.01.2010 No 03-05-04-01/04 pthe procedure for application of normative legal acts of representative bodies of local government concerning the tax on person's property in connection with the adoption of the Federal Law from 28.11.2009 No 283-FZ "On making changes to some legislative acts of the Russian Federation". In concordance with paragraph 1 article 3 of the Law of the Russian Federation from December 9, 1991 No 2003-1 "On taxes on property of natural persons" (further referred to as Law No 2003-1) the tax rates for the property of natural persons are established by normative legal acts of representative bodies of local

government depending on the total inventory cost within the limits established by Law No 2003-1. Article 1 of the Federal Law from November 28, 2009 No 283-FZ that came into the effect on January 1, 2010 it is envisaged that the limits of groups by the property groups and corresponding tax rates on the property of natural persons envisaged by Law No 2003-1 will be specified. In connection with the adoption of the Federal Law No 283-FZ from November 28, 2009 the normative legal acts of the representative bodies of local government concerning the tax on property of the natural persons should be brought in concordance with the amended federal legislation (as applied to the established procedure they should be adopted and officially promulgated before December, 1 of the current taxation period). Before the local legislation is brought in concordance with the federal one, taking into account the fact that the tax rates that were in effect in 2009 were more privileged than those established in 2010 at the federal level, the normative legal acts of representative bodies of local government concerning the tax on the property of natural persons that were in effect in 2009 are applied. In concordance with paragraph 3 article 6 of the RF Tax Code the recognition of a legal act of a local government as inconsistent with the RF Tax Code after 1.12.2010 can be made only in the court of law. ●

CHANGES IN REGULATORY BASIS OF BUDGET PROCESS

M. Goldin

In February 2010 the following events took place in the sphere of budget legislation: the bill creating the legislative base for the transfer of the budget organizations from the estimate financial provision to result-oriented budgeting within the framework of execution of the government task and rendering bigger financial independence to them passed the first reading; the Decree of the RF Government specified the Rules of rendering subsidies to organization of defense and industrial complex to carry out innovation and investment projects on output of high-tech goods in 2010; the effect of the Guidelines for calculation of normative of expenses formation to maintain the government bodies of the RF subjects was prolonged for 2010 by the Decree of the Government of the Russian Federation.

On February 12, 2010 the project of the Federal Law No 308243-5 “On making changes to some legislative acts of the Russian Federation in connection with the improvement of the legal status of the state (municipal) organizations” (further referred to as bill), which was submitted by the Government of the Russian Federation, passed the first reading.

Issues regulated by the bill can be divided into 4 categories:

First, the mechanism of the financial provision of the budgetary organizations with the simultaneous enhancement of their rights is changed. Starting with January 1, 2011 they are transferred from estimated financing to granting subsidies within the framework of execution of the government task;

Second, the budgetary organizations are granted a right to carry out profitable activities with profits coming into independent disposal of these institutions;

Third, the subsidiary responsibility of the state for liabilities of budgetary organizations is abolished;

Fourth, the rights of the budgetary organization concerning the management of any movable property on the books of organization excluding especially valuable property, whose list is established by the public government body acting as a founder of this institution, are broadened.

Alongside considerable changes in the legal status of the budgetary institutions the bill introduces another category of budgetary organizations – state organizations. The status of state organizations will coincide with the contemporary status of budgetary organizations. In other words, the state organization will be provided with funds on the basis of estimate financing and will not be able to manage the property on their books and their profits will come into the budget. At the same time the statements on autonomous organization are sustained in part 1 of the RF Civil Code. Thus, the legal status of autonomous organizations and budgetary organizations will be practically the same. The differences between them, according to the bill, will consist in that the state and municipal tasks will be set only for state and municipal organizations.

It should be noted that according to the bill the procedure for the formation of the state (municipal) tasks and the procedure for provision with finances to fulfill the task should be defined by the Government of the Russian Federation. Thus, the key stage of the process of implementation of result-oriented financing to the budgetary sphere – the procedure of formation and distribution of the budgetary tasks between budgetary organizations is still out of the reach of the project. Thus, the mechanism for implementation of the result-oriented financing in the budgetary net is still unclear.

According to the Decree of the Government of the Russian Federation from 04.02.2010 No 55 “On making changes to the Regulations on rendering subsidies to organization of defense and industrial complex to pay interests for credits received in the Russian crediting organizations to carry out innovation and investment projects on output of high-tech goods in 2010” the grounds

for refusal to provide subsidies to organization of defense and industrial complex to carry out innovation and investment projects on output of high-tech goods were specified.

According to the Decree of the Government of the Russian Federation from 31.12.2009 r. No 1224 "On making changes to the Decree of the Government of the Russian Federation from December 29, 2007 No 990" , the effect of the Guidelines for calculation of the normative standard for expenses formation for maintenance of the government bodies of subjects of the Russian Federation will be prolonged for 2010.

The given Guidelines were earlier applied to the subjects of the Russian Federation in whose budgets the proportion of interbudgetary transfers (excluding subventions, as well as subsidies rendered to subjects of the Federation from the Investment Fund of the Russian Federation) out of the federal budget within two out of three previous accounting years exceeded 20% of the volume of own profits of consolidated budget of a subject of the Russian Federation.

It is specified that the given Guidelines are to be applied also by subjects of the Russian Federations in whose budgets the proportion of interbudgetary transfers rendered from the federal budget and by the Investment Fund of the Russian Federation within two out of three preceding accounting financial years exceeded 20% of the volume of own incomes of the consolidated budget of the subject of the Russian Federation.

It should be noted that in contrast to subsidies, interbudgetary transfers rendered by the Investment Fund are not taken into account within the limit of interbudgetary transfers from the federal budget on whose exceeding starting with 2010 the guidelines mentioned are applied. ●