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RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES

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RUSSIAN ECONOMY IN JANUARY 2011: TENTATIVE DATA AND BASIC TRENDS

Social and Political Background: Business under government cover

The main developments of the socio-political background in January 2011, became a major terrorist attack at the "Domodedovo" airport, the announcement of the BP transaction with Rosneft, a visit of a representative delegation of Russian government officials to the Davos Forum, held against the background of the Western world reaction to the second sentence to Michael Khodorkovsky, as well as Vladimir Putin's order to start the development of a new program of government actions.

Terrorist attack in Domodedovo is the second major terrorist attack in Moscow in the past 10 months, which has carried away 36 lives and held on a specially protected transport facility - most acutely raises the issue of the effectiveness of intelligence and law enforcement services. Meanwhile, President Medvedev has tried to bring out from under the fire of criticism the Ministry of Internal Affairs and FSB, having laid much of the blame for the attack on the airport staff. This has provoked suspicions that the attack will be used for redistribution of property, in particular - to implement the plan for consolidating Moscow airports within a single company.

The transaction on exchange of BP shares with "Rosneft" has become a major image success of the Russian national oil company, which was under the threat of lawsuits on the part of the former owners and investors of "YUKOS". However, the deal is clearly an insufficient step in the realization of the goals of "Rosneft" to be transformed into a global energy company, the actual economic effect of the transaction looks limited, and joint plans of offshore development are uncertain. At the Russian part of the Davos Forum the delegation of senior Russian officials was absolutely prevailing, which in itself demonstrated the vector of the political economy of Russia: the role of government in the Russian economy and business is conceived as a leading and decisive. Instead of plans to improve the investment climate, it was openly announced that an exclusive course of protection of investments carried out under the auspices of government institutions. President Medvedev announced the creation of a sovereign fund, through which foreign companies can invest in the Russian economy (in the infrastructure objects above all) on principles of parity with the government.

Finally, in January, Prime Minister Vladimir Putin instructed to develop a new program of the government's actions over the medium term. He therefore, above all, emphasized his role as a man who is truly deliberative and controlling the country's development strategy, and indirectly confirmed the assumption of a firm intention to return to Kremlin. Despite the fact that the program development is entrusted to economic centers with a liberal reputation (ANE and HSE), it is clear that their credentials will be fairly limited and are unlikely to be extended to address the most pressing institutional problems in the field of law enforcement, judicial system and corruption combating.

Macroeconomics and Finance: on the oil wings

In January, oil prices again rose for the first time since the crisis and have exceeded USD 100 per barrel (for the last time oil prices were at that level in February 2008). Therefore, the rise in prices is continued for six consecutive months and reached about 30% growth as compared with summer prices. This circumstance affected the main trends of macroeconomic dynamics in late 2010 and early 2011: improvement of the trade balance, stabilization of the dynamics of foreign currency and gold reserves and RUR strengthening.

After the failure in August, the trade surplus at the end of the year consistently exceeded the indicator of 10 billion dollars. After stagnating in November, in December the growth in imports, according to the FCS tentative assessments (for foreign countries), was accelerated again to 11% as compared with the previous month. However, rising oil prices compensate for this acceleration. Reserves of the Central Bank in January, for the first time since the second half of October 2010, have ceased to decline. On January 21 they amounted to 482 billion against 476 billion on December

24. We would like to remind, that from the third week of October until December 24 the reserves have decreased by 27.6 billion (5.5%). Throughout this period, an intense outflow of capital was recorded in Russia, which exceeded 38 billion dollars for the year. Moreover, three quarters of this outflow occurred in September - December 2010.

In December 2010 the RUR real effective exchange rate rose by 3.7%. As a result of 2010, the ruble strengthening in real terms in the two-currency basket has reached 7.1%, as compared with the weakening in 2009 to 3.9%. In January, this trend was continued. The value of the two-currency basket in January continued to decrease: on January 25, it amounted to 34.67 rubles. (-0.7% as compared with the end of December).

As expected, the trend towards higher inflation acceleration has spilled over to the new year. However, the rate of inflation in January - 102.4% - was higher than even the pessimistic forecasts of Ministry of Economic Development (2,1-2,3%). The largest contribution to the rise in prices was made by seasonal factors - increases in tariffs for water supply and heating, common to the beginning of the year, and the rising prices for fruit and vegetables. Contribution to the jump in prices has been also made by increased excise taxes for gasoline from January 1, 2011. As a result, the official forecast of annual inflation (at 7.6%) in 2011 ceased to play any role. Inflation risks will remain high during the first half of 2011.

Against this background, the Bank of Russia has still left at the same level the interest rates on operations to provide liquidity, but increased the deposit rates and reserve requirements. However, such tightening of monetary policy is not enough to slow down inflation, which, according to our estimates, in 2011 may well be higher than in 2010, while the Bank of Russia opts for the purposes of stimulating the economy, but if prices growth in February remain high enough, it will have to adjust its policy.

In December, the excessive reserves of commercial banks increased significantly: as per the month result, they have reached RUR 2.2168 bn, which is 1.4 times more than in November. The growth of reserves was caused primarily by more than fourfold increase in bank deposits with the Bank of Russia, as well as more than 1.5 -fold growth of banks' correspondent accounts with the Central Bank. Such dynamics is explained by a seasonal increase in budgetary expenditure at the end of the year.

Real Sector

On January 31, Rosstat has disclosed the estimates as of GDP growth rate in 2010, which amounted to 4%. Such assessment indicates a significant acceleration of economic growth in late 2010. Basing on previous quarterly growth (I quarter – 3.1% versus the same period of 2009, in II quarter – 5.2%, in III quarter – 2.7%), the growth in the IV quarter should reach at least 5% of the IV quarter of previous year. Moreover, the economy should grow relative to the previous quarter at a rate significantly higher than the rate typical for the whole recovery period (from III quarter 2009).

It looks amazing when you consider that, according to Federal State Statistics Service, the pace of growth in major industries in the IV quarter were significantly lower than in the most successful quarter II. Thus, the volume of industrial production increased in the IV quarter by 6.5%, against 10.9% in the II quarter, production grew by 2% in the IV quarter against 4.8% in the II quarter, manufacturing activity - by 9.9% versus 16.3%, transport freight turnover - by 2.4% against 13%. Trade turnover has also showed a slowdown in the IV quarter (4.1% versus 5.3% in the II quarter and 5.9% in the quarter III). Among the clearly positive trends of the year end, it should be noted a significant acceleration in investment growth in fixed assets (up to 12.8% in the IV quarter against 7.2% in the previous quarter and negative growth in the early years), as well as increase the amount of work in the construction of 5 6%. Thus, we can say that construction is the last area in which the economy has recovered from recession and demonstrates the positive (and accelerating) growth for two consecutive quarters. However, investment and construction are usually delayed in its dynamics in relation to other areas of the economy.

Another disturbing trend in 2010 was the actual restoration of import share in cash resources of retail trade. In 2007-2008 the proportion was 47% in 2009, at the background of the crisis, fell to the level of 39-41%, but in the III quarter of 2010 reached the pre-crisis value. This indicates that the recovery resource in domestic demand that could have a significant impact on the growth of domestic production, is close to exhaustion.

The Rosstat index of business confidence demonstrated in January 2011 a positive trend, which, however, was regarded by the Rosstat as seasonal factor (normal for January increased optimism of manufacturers). Business surveys of the Gaidar Institute demonstrated a sustained situation typical of recent months: the relative satisfaction with the present situation and the considerable uncertainty in the future. Purified from seasonal demand growth in December, showed growth, with the satisfaction of demand remained the same. Purified from seasonal factors, the dynamics of the actual demonstrate the output index for the next crisis peak. Against this background, the companies refuse from the plans to reduce staff. However, a more subtle indicator of the forecast shows the continued pessimism in the evaluation of the future. The negative balance of answers regarding the stock of finished products shows that the company definitely does not want to replenish their stocks of finished products per new customer and prefer to have it made production much less than usual for the month volume.

The surveys demonstrate that companies transferred to the tactics of raising product prices in the last months of the last year, do not intend to abandon it. The industry is planning significant price growth during the first months of the new year, probably even to the detriment of sales. But it seems, that increasing tax burden does not leave any other choice to the companies. Such a drastic revision of the price plans were not in the Russian industry since September 1998.

THE POLITICAL AND ECONOMIC RESULTS OF JANUARY 2011

S.Zhavoronkov

In the very end of December last year, it came to knowledge that the court of law sentenced M. Khodorkovsky and P. Levedev to 14 years of imprisonment on a charge of stealing crude oil from their own company YUKOS, i.e. from themselves. The prosecution requested this sentence, and so publicly had wished PM V. Putin before the sentence was pronounced. It became clear that the rules of the game under which authorities can send an entrepreneur behind bars on arbitrary charges would remain unchanged. Despite a great number of his public addresses, the expert community became far less attentive to the incumbent president, even more so as Mr. Medvedev publicly admitted he might not run in 2012 (while earlier he voiced equivocal formulations about a possibility for him to run for presidency). Rosneft and BP announced a swap whose prospects are yet to be confirmed, as AAR consortium filed a lawsuit in London against the alliance. The Act 'On Police' was finally passed. The Act comprises just a handful of novelties vis-a-vis the previous Act, and en route was stripped of just its most notorious provisions. Russia saw a huge terrorist attack in Domodedovo airport – yet another proof of the existing terror threat.

The passing of a sentence on the second criminal case of M. Khodorkovsly and P. Lebedev on 30 December 2010 made headlines in January 2011. This second criminal case was opened against the executives/owners of YUKOS back in 2005, right at the moment the first trial was coming to an end. In 2009, Messrs. Khodorkovsky and Lebedev were convoyed back to Moscow to stand the second trial. Mr. Khodorkovsky believes there have been political and corruption motives behind his second case. On 27 December 2010 the district court of law found Messrs. Lhodorkovsky and P. Lebedev guilty to part. 3 Art. 160 (embezzlement) and part 3 Art. 174 (money legalization (laundering) of the Criminal Code of RF and sentenced them to 14 years in general regime penal colony, inclusive of the term of the first sentence (they had been behind bars since 2003) – thus precisely matching the prosecution's request.

In contrast to the first trial when the YUKOS's executives faced allegations under 10 articles of the Criminal Code of RF, of which the central one was tax dodging, the second trial became an absurdist theater from the very start. The first trial criminalized one of disputable tax practices, which turned out a staggering development, though - because of its obvious selectivity, as it was not applied to other companies – and a severe punishment. In the course of the second trial it was found that Messrs. Khodorkovsky and Lebedev had stolen crude oil from themselves, that is, from the company they owned, and subsequently legalized thus stolen cash. According to the verdict, the fact of stealing was found in Mr. Khodorkovsly and his partner's administering of transactions between JSC YUKOS and its own subsidiaries at "wrong" prices, while they had to do it at a "right" price (never stipulated in any law), and such acts constituted nothing but stealing. Mr. Khodorkovsky's sentence has appeared a kind of Russian authorities' legal manifesto, which reads that any entrepreneur can be sent behind bars on the basis of the two articles to which Mr. Khodorkovsky was found guilty. This, however, does not imply that this concerns all and any entrepreneurs. Rather, it sends a message to those who would be unhappy with the authorities.

The fact of the matter is, Mr. Khodorkovsky's case is another proof of grave challenges facing the institution of private property in Russia. This institution bears signs of feudalizing (granting and/or withdrawal of property at the authorities' discretion), like in ancient China, medieval Turkey, to name a few historical examples.

As well, the verdict on the case once again raises the problem of excessive severity with which the Russian criminal law treats businesses, as one can be sentenced for an economic crime to a term of imprisonment longer than for an assassination. Russian authorities and Mr. Medvedev in particular have recently spoken much of fair trial for the accused of economic crimes and the inadmissibility of depriving them of liberty prior to the trial, except for some very special cases. They even approved a string of amendments to the criminal law in this regard; however, hardly anybody has paid attention to the fact that the term of imprisonment for those who were found guilty to economic crimes remained very severe, nontheless.

The verdict in question was another blow to Mr. Medvedev's image. Most observers, both in Russia and overseas, have been anticipating a verdict of guilty of course, but there were hopes for its relative lenience. In December 2010, Mr. Medvedev weighed in on an indirect debate with Mr. Putin, who had tagged the YUKOS executives criminals. Mr. Medvedev in his turn noted that he did not want to comment on the matter until the pronounced verdict, thus exercising pressure on the court. In an interview to Bloomberg already post-verdict, Mr. Medvedev asserted he had no right to comment on it, as that would otherwise hurdle the advancement of the judicial system. Meanwhile, during his Qs and As session in Davos, he explicitly endorsed the verdict and drew some parallels between Mr. Khodorkovsky and Mr. Madoff: "*…No one reflects on the fact the prosecution has the right to raise additional charges against those who are behind bars, no matter how this could be perceived.. Investor must comply with the law. Otherwise he might get what Khodorkovsly and Madoff got*".

Against the backdrop of various hints some presidential staff (N. Timakova, A. Dvorkovich) dropped regarding what Mr. Dvorkovich put as Mr. Medvedev's "willingness" to run, while in Davos Mr. Medvedev voiced what every barber has long come to know in Russia – that is, he might not seek re-election: "*…As for me, I will make up my mind this year, no doubt, as to what I shall do… If I believe this is the right thing for the country, for the political system, and, first and foremost, for citizens of our state, I will participate. If I think otherwise, I will tell it openly and will tell what in my view is better for the society and the state*".

In fact, once in December 2011 in compliance with the law Mr. Putin clinched his nomination as the United Russia's candidate, the best strategy for Mr. Medvedev would be not to run. Indeed, the incumbent RF President has no right to seek an automatic nomination, nor there is a parliamentary party that would nominate him. Mr. Medvedev sure might try to change the situation in the country, for significant cadres decisions are in his hands. For example, the RF President can dismiss the Prime Minister without the Parliament's consent. Should he realize his powers, the official party of power would no sweat accept the new reality. But time works against Mr. Medvedev: in less than a year to go, he has no campaign team, nor, in contrast with Mr. Putin, has he a substantive program. Plus, the status level of his backers is clearly far from the national elite.

At the Davos Economic Forum in January Russia boasted a high-profile delegation led by Mr. Medvedev and the First Vice Prime Minister I. Shuvalov. Meanwhile, they practically fell short of voicing any earthshattering or at least groundbreaking ideas. They talked at length of Russia's openness to investment and business, about modernization, the Skolkovo innovation center, and plans to create an international financial center - in short, about all the issues that have recently formed the official "meaningful" agenda. Notably enough, against the backdrop of the terrorist attack on Domodedodov airport some statements, such as an international financial center, which the government plans to somehow establish by administrative means, or attraction of investments to the North Caucasus, sounded pretty bizarre. Against the routine practices of the Forum, Messrs. Medeved and Shuvalov found themselves in a barrister's shoes and faced a squall of questions. They were grilled on Khodorkovsky case, the visible absence of changes in the judicial system, Skolkovo's opacity, and uncertainty of when the promised large-scale privatization would kick off. An expelled from Russia investor reminded of Magnitsky case. The Russian delegation responded in the following vein: "*…We must focus on the positive trend in our country. Rome was not built overnight. There are many things we must change, and we do not like them. My task is to change day and night, this is my job. If the people say it is getting better, then I win home. We must cut the share of the state and learn how to manage corporations in a new way. We understand what needs to be done and our agenda is clear*". But what underlines the agenda remained unclear.

In all fairness, the Russian delegation put forward one pathbreaking proposal. Mr. A. Dvorkovich, the presidential aide, announced that Russia was to establish a sovereign fund to co-invest public resources in Russian and foreign investors' business projects and share risks with them. One of the founders of the Fund is going to be VEB, which essentially has already exercised similar functions.

Mr. Dvorkovich's idea should be construed a fairly interesting one, providing the Fund should fundamentally differ from other public institutions, like public corporations, with information of its operations, as well as selection criteria for its prospective partners, subject to public disclosure. Respective government documents will make it clear whether this is plausible.

On 24 January 2011, Domodevovo airport in Moscow was shattered by a huge terrorist attack, which followed blasts in the Moscow subway in less than one-year span. Amid a bunch of welcomers, a terrorist committed an own goal by exploding a self-made bomb stuffed with metal projectiles equivalent of up to 7 kg TNT. As many as 35 people were killed in the blast and over 120 others were hospitalized. In contrast to the subway bombing in March 2010, North-Caucasian Islamists have not yet claimed responsibility for this terrorist act, there is small doubt it was they who staged it. The authorities also ascertained this.

The tragedy exposed visible gaps in the airport security. Procured in the aftermath of two blown up planes in 2004, metal detectors at the entrances were switched off, and quite legally, as no law or normative act provided for the obligation to service them. Mr. Medvedev for no reason accused the airport's owners of negligence and threatened with criminal charges against them. Some local police officers were dismissed. Admittedly, the market does not foresee any problems for the airport owners - a couple of years ago they had won a longstanding trial against public agencies over proprietary rights for the key asset – the long-term leasing contract on the airport site. Plus, Mr. Medvedev made a bizarre statement that the terrorists' ultimate goal was to thwart his participation in the Davos Forum.

The terrorist attack shows that the situation in the North Caucasus is far from stabilization. A certain improvement of the operating environment in Ingoushetia after the capture of leaders of the local underground is compensated by a drastic rise in terrorist activity in Kabardino-Balkar Republic (for instance, right on the eve of the New Year holidays terrorists killed a local mufti who had condemned them) and particularly in Dagestan. The situation in Chechnya has remained steadily difficult. As concerns technical security measures, they need to be improved, and the remedy often is on the surface, as it was in the case of metal detectors in the airports.

The month of January 2011 proved to be a fairly interesting one for Russian businesses. While in Davos, on January 26, the Russian public company "Rosneft" signed a framework agreement on strategic cooperation with BP. It will rest upon a swap of 9.5% of Rosneft's equity for a 5% stock package in BP. It was also announced that the companies would establish a joint venture to carry out geologic exploration and development of three promising oil-and-gas fields on the shelf of the Kara Sea. Given the FAS's approval of PepsiCo's acquisition of JSC Vim-Bill-Dann, a huge national manufacturer of juices and dairy products worth a total of USD 5.4 bln. (including stock redemption from minority shareholders on the market), the deals have become the first foreign companies' acquisitions in Russia for a long time. Before these deals, the tendency had been an opposite one: last year, Chevron sold its 20% stock in LukOil back to the Russian oil giant, while E.On sold back to Gasprom some 4% of its stock; as well, the operator of the Schtokman field, in which foreign investors have a 49% stake, halted its operations for an indefinite period.

Investing in the Russian food-processing sector with its relatively low entry barriers appears a logical move against the background of a favorable price dynamic for energy sources and the population's demand (notably, the previous large acquisition made by a foreign business in Russia was also noted in the food-processing sector: in just a few months prior to the 2008 crisis PepsiCo had bought JSC Lebedyansky, another manufacturer of juices. By contrast, the situation with the Rosneft-BP deal does not seem that bright. First, BP has encountered a hostile behavior of the Russian co-owner, AAR consortium. Spearheaded by Mr. M. Fridman, the consortium is notorious for its extremely aggressive manner of doing business and enjoys the Russian administrative and judicial systems' warm. As a reminder, back in 2008, all the executives of the BP's representative office in Russia, including the then Chairman of the Board of TNK-BP, were compelled to leave Russia, as their work permits were revoked. The compromise was reached in the autumn of 2008: BP refused its original right to nominate the Chairman of the Board of TNK-BP and it was agreed that henceforth this would be done upon both parties' consent. Two years after the conflict, however, under various pretexts AAR has not yet approved a new nomination, thus retaining operational control over the company. So, the alliance with Rosneft is not a new good-will investment for PB, but a logical consequence of the corporate conflict. Interestingly, AAR keeps braving the fortune by bringing to the High Court in London a claim to arrest the work on the BP-Rosneft deal. In so doing AAR claims the deal is contrary to the shareholder agreement between TNK and AAR. If the deal is closed notwithstanding these challenges, Rosneft would gain not only economic benefits (hardly computable at the moment, though), but political ones, as having a world-class corporation among its shareholders would diminish Rosneft's political risks in developed countries associated with YUKOS's assets and ongoing trials on the subject in different European countries.

The State Duma passed in the third, final, reading the presidential Act 'On Police". For the first time ever before its submission to the Parliament the bill had been posted for a broad public consideration, particularly on the Internet. This positive development, however, was counterbalanced by the fact that the bill initially was clearly anti-legal and totalitarian by its nature. The discussions resulted in crossing out the most notorious provisions, and the final document on the whole appears pretty similar to the former Act "On Militia", bar its title. The new Act fixed the detainee's right for a phone call, however, this does not apply to those on the wanted list. The debated provisions on the right of penetration into residence ultimately took the following form: prior to entering a residence, the policeman shall be obligated to explain on which grounds he is going to do this (except for the situation where "*the delay engenders a direct peril to citizens and police's lives and health and may result in other grave consequences*"). The list of the grounds for penetration into residence now lacks the possibility for the police to enter it "in order to establish circumstances of the offence"; however, there was retained the possibility for the police to enter residence to examine circumstances of the accident. The notorious provisions stipulating the police's right "to request and obtain" from commercial organizations any kind of information – an attempt to restore the solemnly abolished in 2008 provisions of the former Act - were crossed out. The mandate to form public councils under local police offices was re-assigned from the Ministry of Interior to the RF President (more precisely, it should be exercised following some yet unclear "procedures established by the President of RF").

On 31 January, Mr. T. Bolloev, head of the public corporation Olympstroy, announced his resignation. Meanwhile, the Investigative Committee and the Police Department of Krasnodar krai opened six criminal cases on corruption in Olympstroy (though given the corporation's budget, the alleged embezzlement of Rb. 23 mln. seems preposterous). With Mr. Bolloev in the driving seat, construction works at previously idle Olympic sites have been gaining momentum, while the government dropped some objects or cut back on the others. The Olympic construction program started appearing more realistic, albeit the city of Sochi still remains a zone of conflicts associated with the Olympic construction, as well as a very unfavorable terrain, as far as construction of Olympic facilities is concerned.

INFLATION AND CREDIT AND MONETARY POLICY

N.Luksha

As a result of December 2010, the CPI in Russia amounted to 1.1 per cent, which is considerably higher than in the previous year (0.4 per cent). As a result, the growth rate of consumer prices in general for 2010 exceeded the official government forecast, having reached 8.8 per cent, and coincided with the index of 2009. In January 2011, inflation has accelerated markedly: from January 1 to 24, the CPI stood at 1.8 per cent, thus exceeding the monthly index of January 2010 (1.6 per cent). Over a month, from mid-December 2010 to mid January 2011 the volume of Russia foreign currency and gold reserves remained unchanged, amounting to 478 billion dollars as of January 14. In 2010, the national foreign currency and gold reserves have been increased by 8.8 per cent to 480 billion dollars. In December 2010, the real effective exchange rate rose by 3.7 per cent, and as of the year results - by 7.1 per cent. In January 2011, the value of the two-currency basket has continued to decrease: on January 25, it amounted to 34.67 rubles (-0.7 per cent as compared with late December). On December 24, 2010, the Board of Directors of the Central Bank has announced the preservation of the refinancing rate at 7.75 per cent and other rates for the Bank of Russia operations to provide liquidity. At the same time, from December 27, 2010 the interest rates on deposit operations were raised by 0.25 percentage points.

In December 2010, inflation continued to accelerate: the consumer price index for the month was the highest for the past year (except January), amounting to 1.1 per cent (against 0.4 per cent in December 2009) (see Fig. 1). The main contribution to the acceleration of inflation, like a month earlier, was made by the food items, the rate of price growth for which has increased by 1.5 times to 2.1 per cent. The utmost growth once again was observed in fruit and vegetable products (+ 8.6 per cent), cereals and beans (+ 7.6 per cent) and sunflower oil (+ 6.6 per cent). Prices for meat and poultry have ceased to decline and rose by 0.8 per cent.

In the last month of 2010, the growth rate of prices for industrial goods has slowed down (by 0.5 per cent versus 0.7 per cent in November 2010). The largest price growth was observed in the same group of products that in November, but their increase was lower than before: petrol went up by 0.9 per cent, tobacco products - by 0.8 per cent, knitwear - by 0.7 per cent. Prices have fallen down for video-audio items (-0.1 per cent).

In December prices for commercial services continued their growth by 0.4 per cent. The utmost growth was noted in transport services, which have grown by 0.4 per cent. Services for heating have also increased in price (+0.7 per cent), as well as medical services (+ 0.6 per cent). At the same time, communications and international travel services have fallen down by 0.1 and 0.6 per cent, accordingly.

The basic CPI of consumer price index[1] in December 2010 has made 0.7 per cent (versus 0.7 per cent in the relevant period of 2009).

The consumer price index in Russia in the past year amounted to 8.8 per cent, remaining at the same period as in the last year. Therefore, the increase in consumer prices exceeded the upper limit of the last estimates of the Ministry for Economic Development - 8.5 per cent. We would like to remind, that in the first six months of the year of inflation slowed down, owing to the effect of the base in 2009 and the effects of economic recession, accompanied by stagnation in consumer demand. However, since August, inflation began to gain speed, having reached its peak in December. In the second half of the year the determining factors of accelerating inflation were food shock as a result of summer drought and crop failure, increasing inflationary expectations, recovery in domestic demand and money supply growth. The largest price growth in the last year were observed in the food segment, which due to the negative supply increased by 12.9 per cent

1 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

(two-fold as compared with 2009). In contrast, the rate of growth of prices for industrial goods (+5 per cent) and commercial services (8.1 per cent) in 2010 was 1.5-2 times lower than those of the last year.

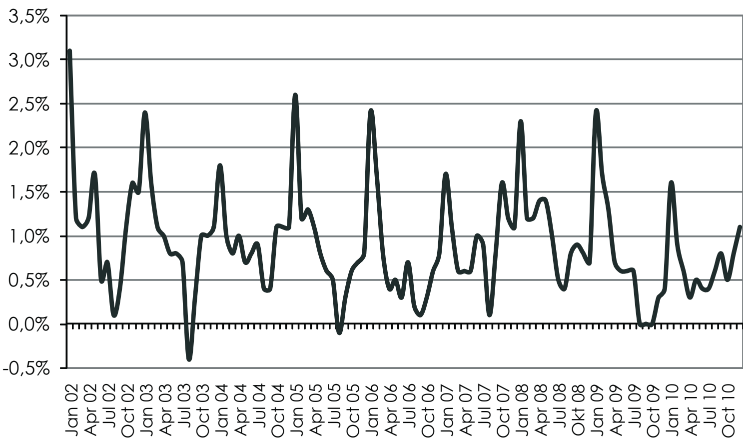
In January 2011, inflation continued to accelerate: in the first 11 days of the month consumer price index reached 0.8 per cent, having exceeded by 0.1 percentage points the level of the same period of 2010. During the second and third weeks of the month inflation slowed down the pace of growth. Nevertheless, since the beginning of the year to January 24, the rate of growth of prices amounted to 1.8 per cent, exceeding the monthly inflation rate of the last year (1.6 per cent in January 2010). Leaders of growth in consumer prices were potatoes (+15 per cent), cabbage (+11.9 per cent) and buckwheat (+10 per cent). The largest tariff increase was recorded for cold and hot water (respectively, by 9.1 per cent and 7.6 per cent) and heating (+8.1 per cent).

At the beginning of the year, inflation has traditionally gathered pace. One of the main reasons for the burst of inflation has become a seasonal rise in prices for fruit and vegetables, supported by the continuing effect of the summer food shock, as well as the worldwide increase in food prices. In addition, January is traditionally a month when rising adjustable rates for commercial services have also contributed to the jump in prices. Increased excise taxes on gasoline from January 1, 2011 have also made its contribution. According to the Ministry of Economic Development estimates, inflation in January 2011 will be 2.1-2.3 per cent[1].

The official forecast of annual inflation for 2011 is 6-7 per cent. However, according to Alexander Ulyukayev, Central Bank First Deputy Chairman, keeping this ceiling of inflation growth rate will be difficult to achieve, especially of the projected in 2011 capital inflow. Inflation risks will remain high during the first half of 2011, we believe that the implementation of the official inflation forecast for 2011 is a hardly possible task.

In December, the monetary base in broad definition has grown for the first time since August, it has increased by 17.9 per cent to RUR 8,190.3 bn. On January 1, cash in circulation with regard to the fund balances in credit organizations has reached RUR 5.8 trillion (+12.5 per cent), correspondent accounts of credit organizations with the Bank of Russia made RUR 994.7 billion (+1.7 per cent), mandatory reserves made RUR 188.4 billion (growth by 4.3 per cent), deposits of the banks with the Bank of Russia made RUR 588.9 bn (decrease by 1.5-fold) In general, the monetary base in broad definition has grown by 26.6 per cent.

In December, the excessive reserves of commercial banks[2] have significantly increased and reached by the end of the month RUR 2,216.8 bn, which is by 1.4-fold higher than the relevant indicator of November. This was due, first of all, to sharp increase of banks' deposits with the Bank of Russia, as well by one and a half times higher amount with the correspondent accounts of the Central Bank. Such dynamics is explained by a seasonal increase in budgetary expenditure in the year.



Source: RF Statistical Service.

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

According to preliminary estimates of G. Melikyan, First Deputy Chairman of the Bank of Russia, in 2010 the credit portfolio of banks in nominal terms has increased by about 12-15 per cent. Retail lending increased by over 15 per cent, while lending to non-financial sector - about 13 per cent. Therefore, the growth rate of banks' loan portfolio remained low, and with regard to inflation, the banks showed very little growth in their loan portfolio. In addition, the level of

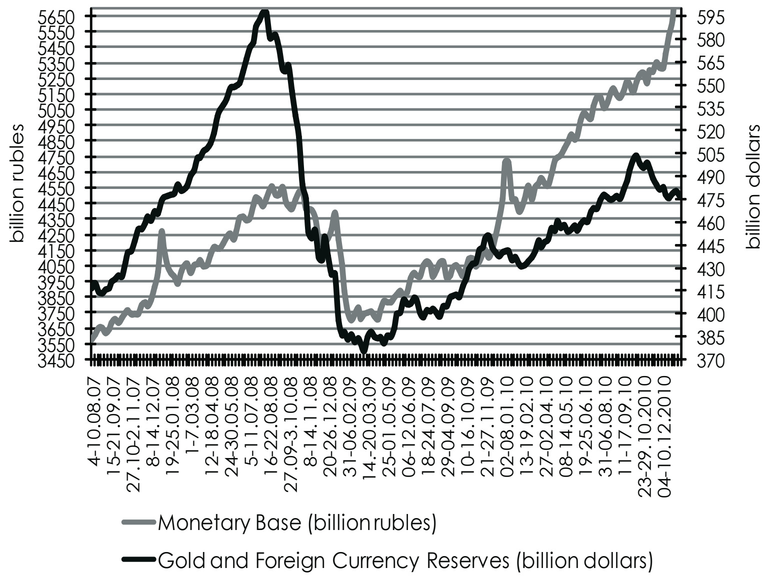
1 RBC News (http://www.rbc.ru/fnews.frame/a//top//////20101020171955.shtml?), 20.10.2010.

2 Under the excessive reserves of commercial banks in the Central Bank rating if understood the sum of correspondent accounts of commercial banks, their deposits with the CB and the CB bonds from commercial banks.

outstanding debt in banks, according to G. Melikyan, exceeded the pre-crisis level by 2-3 times.

In December the growth of the volume of cash in circulation by 12.5 increase of mandatory reserves by 1.5 per cent urged the extension of monetary base in narrow definition (cash plus mandatory reserves)[1] by 12.1 per cent to RUR 5,973.6 bn (*see Fig. 2*). Herewith, from mid-December 2010 to mid-January 2011, the volume of foreign currency and gold reserves has not changed and amounted to 478 billion dollars as of January 14. In general, over the past year, international reserves have grown by 8,8 per cent, from USD 441 billion to 480 billion.

As of 2010 results, the net outflow of capital from the country has reached USD 38.3 bn, which exceeded all earlier estimates of the Central Bank[2],.



Source: RF Central Bank.

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

According to preliminary estimates of the Central Bank, the major capital outflows occurred in the IV-th quarter, when the country lost 22.7 billion dollars. We would like to remind, that only in the II-nd quarter of the last year there was a net inflow of USD 2.8 billion. In quarters I and III there was also recorded a net outflow.

S. Ignatiev, the Head of the Central Bank Capital is concerned with the capital outflow from the country, who does not have complete information on the causes of such outflow. In addition to payments by companies on foreign debt, according to the Chairman of the Central Bank, a possible cause of leakage was the purchase of non-financial assets abroad. Some market participants also attributed the flight of capital from Russia with fears arising from investors after resigning of the Mayor of Moscow Yuri Luzhkov. We believe that a large capital outflow from Russia is due, above all, to the continuing significant economic and political risks of investing in Russia.

High oil prices contributed to the strengthening of the ruble in real terms in December, for the first time since August 2010. Accordingly, the index of real effective exchange rate for the month increased to 141.066[3] (see Fig. 3). As a result of 2010, the ruble strengthening in real terms in the two-currency basket has reached 7.1 per cent, as compared with the weakening in 2009 by 3,9 per cent.

Throughout 2010 the dollar exchange rate against the ruble fluctuated in a corridor of RUR 29-32 to the dollar. At the year-end, the exchange rate of ruble/dollar, despite the high volatility, has returned to that of the beginning of the year – RUR 30.4/USD 1

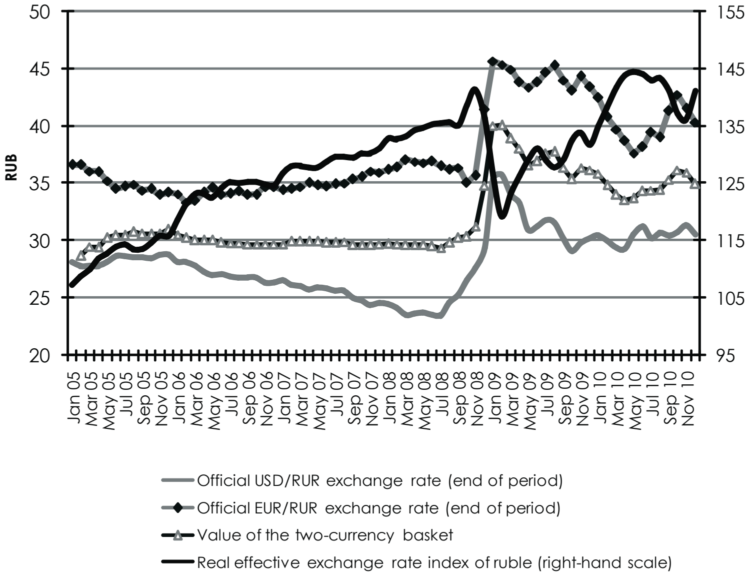
In January 2011, the dollar continued to weaken: within 25 days of the month it has lost 1.6 per cent. Since mid-January, the dollar rate has fallen down to RUR 30 to the dollar. The dollar becomes cheaper for the second consecutive month: since the beginning of December of the last year, after a month-and a half months growth, dollar was depreciated by 3 per cent. One of the main reasons for the ruble strengthening were the high world oil prices, which approached in December USD 100 per barrel.

Over the past year, the euro weakened against the ruble by 7.2 per cent. Herewith, for the first five months the Euro fell by almost 14 per cent to the ruble, then in the next five months, it has

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 RF Central Bank (http://cbr.ru/statistics/print.aspx?file=credit_statistics/capital.htm)

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



Source: RF Central Bank, author's estimates.

Fig. 3. Indicators of Ruble Exchange Rate Dynamics within January 2005 – December 2010

virtually reconquered its lost position, but in the last two months of the year again lost about 7 per cent.

In early January of the new year the dynamics, typical of the European currency in December 2010, was continued. The Euro exchange rate was falling against the dollar, as well as to the ruble in FOREX market. Depreciation of the Euro was caused by the same debt problems of some European countries. However, on January 14, negative tendency has changed, and Euro went up rapidly, having gained 2.7 per cent in the ten days of the month. Trend change was the result of successful placement of debt bonds by Italy and Spain, as well as by positive investors' expectations upon the announcement that China and Japan are going to buy government bonds in Greece, Portugal and Spain.

On January, the value of the two-currency basket has continued to downgrade: on January 25, it amounted to 34.67 rubles. (-0.7 per cent as compared to December 31, 2010).

On December 24, 2010 at a meeting of the Board of Directors there was announced on the Conservation of constant refinancing at 7.75 per cent and other operations rates of the Bank of Russia to provide liquidity. This decision was dictated by the central bank, on the one hand, the preservation of key macroeconomic trends and moderate inflationary risks, and on the other hand, by the desire to stimulate economic activity.

At the same time, from December 27, 2010 there have been increased the rates of deposit operations at 0.25 percentage points. We would like to remind, that this is the first tightening of monetary policy since June 1, 2010 The main reason for raising the rates to attract liquidity was, apparently, the acceleration of inflation that began in the last months of the past year.

The next meeting of the Board of Directors is scheduled for January 31, where the issue of raising interest rates will be reconsidered. The Bank of Russia will face a challenge of finding an adequate balance between stimulating economic activity and support of bank lending, on the one hand, and curbing rising inflation, on the other one. Sergey Ignatiev, the Head of the Central Bank does not exclude that after the meeting, the interest rates still will be changed[1]. In our opinion, the ongoing efforts of the Bank of Russia should be aimed primarily at inflation curbing.

1 RBC News (http://rian.ru/economy/20110124/325731913.html), 24.01.2011.

FINANCIAL MARKET[1]

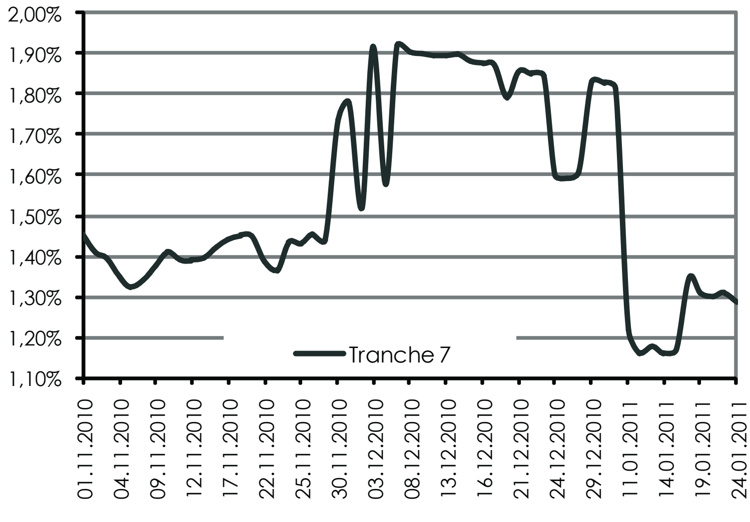
N.Burkova, E.Khudko

In January 2010, a downward dynamics in the Russian financial market was prevailing at the background of high investors' activity. Thus, the RF government securities market has demonstrated for the period from December 21 to January 24, a decline by 34%, the market of corporate bonds – a 29 per cent and futures MICEX market – by 22 per cent. However, there was observed some growth in the value of shares of the majority of the most liquid Russian companies, as well as the major financial indices of the Russian Federation (by 3–7 per cent). Moderately positive dynamics of key market indicators was continued in the domestic corporate bond market: volume of the market, index of the Russian corporate bond market, bonds yield. The major negative event in January was the aggregation of the situation with the bondholders liabilities performance.

Government securities market

At the end of December 2010 reduction in the US and Europe equity markets in view of the publications on negative macroeconomic indicators (such as reduction in orders for durable goods in the US), the international rating agencies lowered ratings of Portugal and Greece as a result of the economic problems in the countries, Christmas and New Year holidays have provoked a decrease in investors' activity in the market of government securities. Additional pressure on the market demand had been provided by the information of the Ministry of Economic Development on the inflation acceleration in Russia in November. In this background, Russian securities looked also as unappealing: prices were falling together with the basic assets. In the first half of January, the rise of oil prices in the global market, the positive macroeconomic statistics of the US (reducing the unemployment rate in December, increased sales of new homes in the US in November), China willingness to provide material support to Portugal, increasing the profitability of Russian Eurobonds have contributed to increased market demand for government securities. The peak demand was noted on January 19, when an auction on placement of OFZ in the primary market was held. Given the high level of liquidity and interest to government securities, there were placed 29.81 billion rubles in nominal terms, which amounted to about 99.7 per cent of placement. However, the decline in world oil prices and ruble liquidity in view of expected payments from January 20, has resulted in rising inflation and significant capital outflow from Russia as of 2010 result, which has resulted in a decrease in activity in the secondary market for government securities.

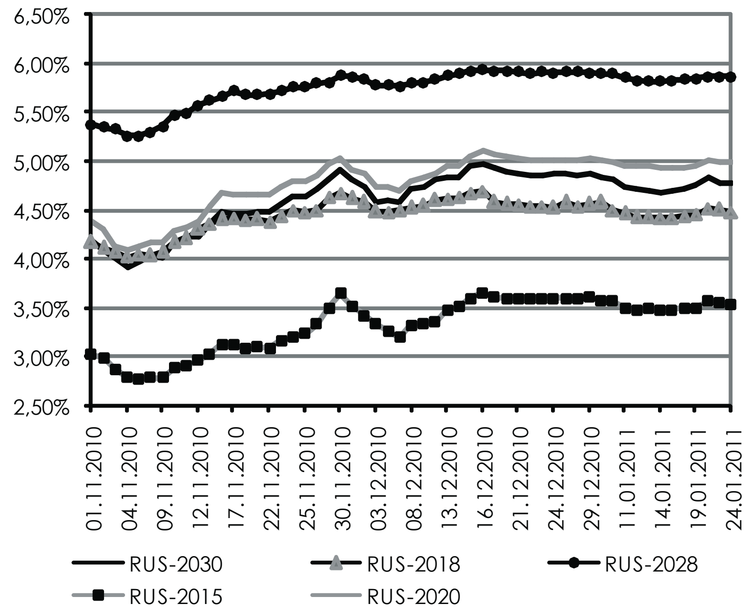
As of January 24 of the current year, the Russian Eurobonds RUS–28 yield to maturity has decreased as compared with the level of December 05 from 5.92 to 5.87 per cent per annum (by 0.88 per cent), RUS–18 – from 4.57 to 4.48 per cent per annum (by 1.95 per cent), RUS–30 – 4.9 to 4.78 per cent per annum (by 2.33 per cent), RUS–20 – from 5.05 to 5 per cent per cent per annum (by 1.8



Source: "Finmarket" Information Agency data.

Fig. 1. Minfin bonds' yields to maturity in November 2010 – January 2011

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. 2. Yields to maturity of the Russian Eurobonds with maturity in 2010, 2015, 2018, 2020, 2028 and 2030 in November 2010 – January 2011

per cent) and RUS–15 from 3.61 to 3.54 per cent (by 0.91 per cent). In the same period, a similar 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 decreased from 1.79 to 1.29 per cent per annum (by 28.24 per cent). Herewith, on the first working day of 2011 (January 11, 2011), there was observed a significant a significant decreased trend of those Eurobond yield (see *Figs 1– 2*).

Within the period from December 21 to January 24, 2011, the total turnover of the secondary market of government bonds amounted to approximately RUR 81.97 billion with an average daily turnover of RUR 4.31 billion (about RUR 111.28 billion with an average daily turnover of RUR 6.55 billion in December), which means a significant decrease of an average monthly turnover by 34 per cent.

As of January 24, the volume of government bonds market made RUR 2,042.99 bn at face value and RUR 2,053.29 bn at the market value (as compared with RUR 1,916.63 bn and RUR 1,925.39 bn accordingly as of December 20). The duration of the government bonds market portfolio was 1,339.7 days, having decreased by 37.36 days as compared with the preceding month (as of December 20).

Stock market

Stock market situation

In late December 2010 a negative USA macroeconomic statistics, the economic problems of Greece and Portugal, as well as the closure of USA and Europe equity markets in connection with Christmas holidays, have led to reduced activity of the participants and the RF stock market. With the start of trading in the new year, the stock market showed a marked increase due to the rising global commodity prices observed in the first half of January, the positive financial results of a number of major international companies, the relative stabilization of the economic situation in Portugal, the economic growth in China. In addition, the information of the Ministry of Economic Development of Russia on the Russian GDP growth in January–November 2010 by 3,7 per cent as compared with the same period of 2009, preservation of the RF CB refinancing rate at 7.75 per cent also supported the stock quotes of the majority of the most liquid Russian companies and urged their growth in the range from 3 to 13 per cent. However, inflation growth, reduction of the trade surplus of the Russian Federation, according to the RF CB within November 2010 by 5,3 per cent to USD 10.86 billion (as compared with November 2009), revocation of licenses from a number of banks, decreased credit rating of the Bank of Moscow by Moody's Investors Service by one level – from Baa1 to Baa2 with a "negative" outlook were restraining the growth of the stock market.

The maximum value within the month the MICEX index has reached on January 17, having reached – 1,771.66 points (1,676.41 points in the preceding month). The minimum value for the period the MICEX index has reached on January 11 – 1,713.97 points (against 1,601.76 points in the preceding month) (See *Fig. 3*).

In general, within the period from December 21 to January 24, the MICEX index has increased by 3.46 per cent, what makes about 57.59 points in absolute terms (within the year, from January 24, 2010 through January 24, 2011, the MICEX index has been upgraded by 21.53

per cent). Within a month, the turnover of trades in securities included in the MICEX index made about RUR 822.36 bn at an average daily turnover of RUR 43.28 bn (against about RUR 1,038.73 bn with an average daily turnover of RUR 61.1 bn in the preceding period). Therefore, the investors' average daily activity in the stock market in January has decreased as compared with the preceding period by 29 per cent. The indicators of maximum and minimum daily turnover in the market trades made, accordingly, RUR 73.04 bn (as of January 12) and RUR 48.48 bn (on January 14).

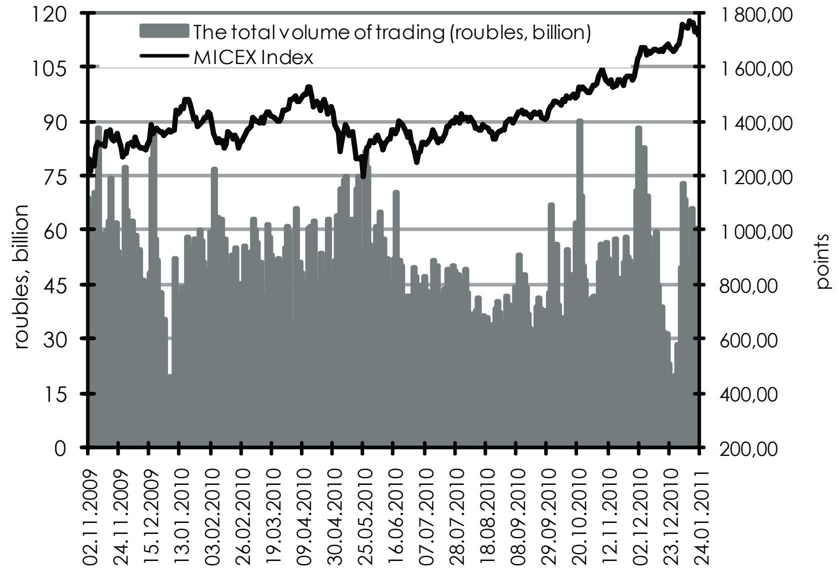


Fig. 3. Dynamics of MICEX Index and trading volume

As of the month results (from December 21 through January 24), the majority of the "blue chips" securities have shown a growing dynamics. The leaders in the growth were by Rostelecom and GMK Nornickel, having increased by 12.95 and 12.61 per cent, accordingly. They were followed by Tatneft securities, which increased by 10.6 per cent, Rosneft (+10.45 per cent), Surgutneftegaz (+10.01 per cent). Significantly lower rates of growth were demonstrated by LUKOIL (+7.59 per cent), VTB Bank (+4.8 per cent) and Mosenergo (+0.06 per cent) and Gazprom Neft (+3.07 per cent). A reverse trend was demonstrated by Gazprom, Sberbank of Russia and Mosenergo securities, the value of which has decreased by 3.31 per cent, 2.57 per cent and 2.5 per cent, accordingly (See *Fig. 4*).

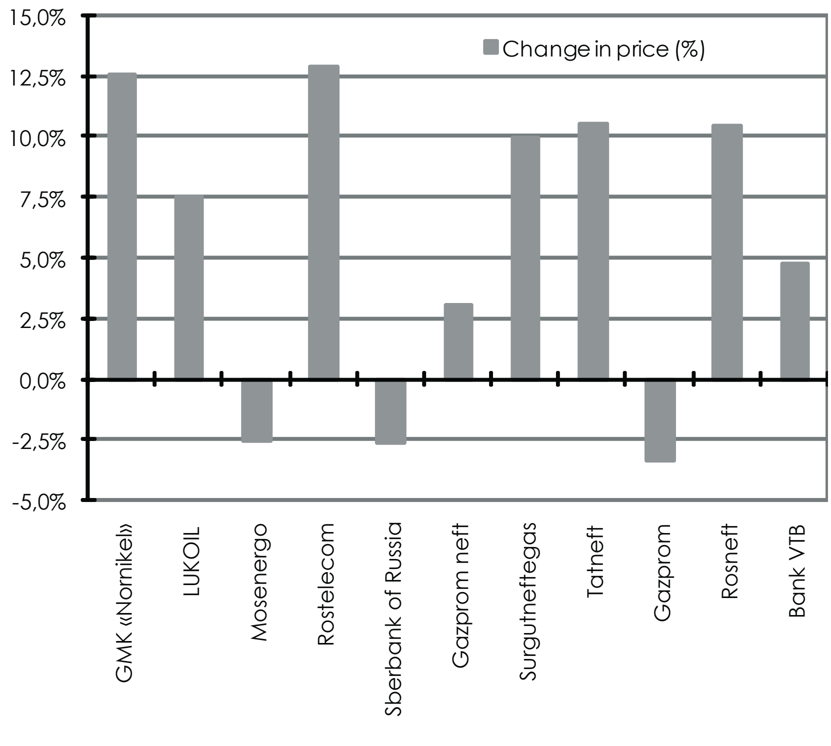


Fig. 4. Dynamics of the Russian Blue Chips from December 21, 2010 to January 24, 2011

In January of the current year the MICEX turnover leaders were: Sberbank of Russia (26.35 per cent of the total turnover), Gazprom (20.12 per cent), GMK "Nornickel" (8.57 per cent), LUKOIL (7.11 per cent) and Rosneft (6.93 per cent). The total volume of transactions with the shares of those five «blue chips» was about 75 per cent (of all «blue chips» – 69 per cent) of the total trades in shares at the MICEX stock market over the period from December 21 through January 24.

According to MICEX information, as of January 24, the top five leaders of the domestic stock market in terms of capitalization were: "Gazprom" – RUR 4,507.91 bn (RUR 4 507,91 4,587.45 bn as of December 20), "Rosneft" – RUR 2,569.1 bn (against RUR 2,328.74 bn), "Sberbank of Russia" – RUR 2,250.22 bn (against RUR 2,281.31 bn), "LUKOIL" – RUR 1,612 (against RUR 1,487.72 bn) and GMK Nornickel – RUR 1,426.2 (against 1,279.06 bn rubles).

Futures and Options Market

In January the average daily turnover in the MICEX futures market has decreased by 21.5 per cent as compared with the preceding month. Thus, in the period from December 21 through January 24 the total turnover in the MICEX (futures) market made approximately RUR 133.33 bn (484.94 thousand of transactions, 3.06 mln of contracts) with an average daily turnover of RUR 7.02 bn against about RUR 151.92 (327.94 thousand of transactions, 3.69 mln of contracts) with an average daily turnover of RUR 8.94 bn in December. The largest volume of trading in January, like a month before, was observed in contracts for futures and equity instruments, amounting to RUR 73.62 billion (454.48 thousand of transactions, 1.36 mln of contracts). Herewith, in terms of the trading volume in this section, the MICEX derivatives market after the settlement of futures contracts for the MICEX index are followed by the futures supply contracts for the shares of Nornickel, Sberbank, Gazprom, and LUKOIL. We would like to note, that the value of the MICEX index (the price of transactions) for March 2011 was at the level of 1,670 –1,770 points and for June 2011 – at 1,680–1,780 points.

The second place in terms of trading volume within the month of January was taken by foreign currency futures (RUR 56.13 bn). Herewith, contracts for Euro against US dollar were in the first place in terms of trading in the MICEX futures market, followed by futures contracts for USD rate and for Euro/RUR 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 29.9–30.9 for March 2011, and RUR/USD 30.2–31.2 for June 2011. Trading volume in futures for commodity assets within the period under review has made RUR 3.08 bn. Besides, in January there was one contract for the interest rate for the amount of RUR 500 mln.

Similar trends were observed in the RTS FORTS futures market, where the investors' average daily activity in January has decreased by 43 per cent as compared with the previous month. Thus, in the period from December 21 through January 24 the total market turnover of futures and options in RTS made about RUR 1,915.42 billion (6.17 million of transactions, 36.3 million of contracts) with the average daily turnover at the level of 100.81 bn (as compared with about RUR 2,993.74 billion (9.57 million of transactions, 58.43 million of contracts) with the average daily turnover of RUR 176.1 in December. The greatest demand among the market participants, as before, was demonstrated in futures: trading volume in them during the period under review amounted to RUR 1,802.46 billion (6.02 million of transactions and 34.76 million of contracts). Herewith, in the first place in terms of futures trading volume were the futures contracts for the RTS index, which were followed with a significant margin by the futures contracts for the dollar–ruble rate and for Euro/USD rate and for the shares of Sberbank of Russia and Gazprom shares. It should be noted that prices of the latest transactions, concluded in the RTS FORTS on futures contracts RUR/USD rate for the date of execution on March 15, 2011, were within RUR 30–30.9 /USD, and for June 15, 2011 – RUR 30.3–31.2/USD. The value of futures contract for the RTS index (based on the prices of recent contracts) with the execution date on March 15, 2011 made 1,750 – 1900points and for June 15, 2011 was estimated on average at 1,750–1,890 points. Options enjoyed far less demand, the turnover made about RUR 112.96 bn (154.81 thousand transactions and 1.54 of contracts). The maximum daily turnover in the short–term RTS futures market in the period under review made RUR 185.99 billion (as of January 20), and the minimum was RUR 61.07 (as of January 11) .

External factors behind the Russian stock market dynamics

In January 2011 the Russian financial market dynamics, as a month earlier, was largely dependent on the situation in the global financial markets. Among the basic factors of positive global market indicators, affecting the Russian market from December 21, 2010 trough January 24, 2011, one should mention:

– preservation of the Central Bank of Japan's key rate at the level of 0.1 per cent;

– growth of U.S. GDP in III quarter 2010, according to the final data, by 2.6 per cent (2.4 per cent – by tentative data) as compared with the previous quarter, in annual terms;

– increase in sales of new homes in the U.S. in November 2010 as compared with the previous month by 5.5 per cent;

– reducing unemployment in the U.S. in December 2010 as compared with the previous month to 9.4 per cent;

– loans attraction by insurance company American International Group Inc. (AIG) totaling to USD 4.3 billion dollars to the return of public funds;

– allocation by Portugal in the world financial market the government short–term treasury bonds for the amount of Euro 500 million for the period of 6 months;

– reducing the budget deficit of Portugal as of 2010 results up to level below the planned 7.3 per cent of GDP;

– growth of Chinese economy in 2010 (10 per cent) and gold reserves of the country (nearly by 450 billion dollars);

– China willingness to buy government bonds of Spain amounting for Euro6 billion in support to combat the debt crisis;

– slowdown in inflation in the US as of 2010 results up to 1.5 per cent (2,7 per cent in 2009);

– increase in net profit of U.S. bank JPMorgan Chase & Co as of the 2010 results by 1.5 times to USD 17.4 billion, of Citigroup – to USD 10,6 billion (USD 1.6 billion net loss a year earlier), of IBM – by 10.5 per cent to USD 14.8 billion.

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

– international rating agency Moody's Investors Service long–term and short–term sovereign credit ratings of Portugal establishment at the level of A1/Prime–1 for review with the possibility of lowering;

– lowering by the rating agency Fitch Ratings of the long–term rating of Hungary foreign currency debt from BBB to BBB–, long–term rating of Hungary local currency from BBB to BBB + with a "negative" outlook, the country ceiling rating – from A to A–and the Hungary short–term rating on foreign currency debt was affirmed at F3;

– reduction of long–term rating of Portugal by rating agency Fitch Ratings in the local and foreign currency from AA–to A + rating outlook "negative", and short–term foreign currency rating – from a F1 + to F1;

– decrease the rating agency Fitch Ratings rating Greece BBB–to BB +, outlook – "negative";

– decrease of Greece rating by the rating agency Fitch Ratings from BBB–to BB +, outlook – "negative";

– reduction of the trade surplus of Japan in November 2010 by 55,4 per cent in annual terms;

– increase of the UK budget deficit to GBP 23.3 billion in November 2010 (by GBP 5.9 billion more than in November 2009);

– decline in orders for durable goods in the US in November 2010 as compared with the previous month by 1.3 per cent, as well as the decline in the construction of new homes in the US in December 2010, as compared with the previous month by 4.3 per cent ;

– decision of the People's Bank of China to tighten monetary policy to fight with inflation in 2011, as well as raising key lending rate by 0.25 percentage points up to 5.81 per cent from 26.12.2010;

– growth of the UK GDP in the III–rd quarter of 2010, according to final data by 0.7 per cent (by 0.8 per cent – according to tentative estimates) compared to the previous quarter, the GDP of France – by 0.3 per cent (by 0.4 per cent – as per initial data);

– decrease of Goldman Sachs net income by 38 per cent as of 2010.results , and net losses of the Bank of America in the amount of 3.6 billion dollars.

All those factors have generally resulted in the increased dynamics of the global stock indices in January (by 1–4 per cent) and volatile dynamics in developing countries, as of the month results. Thus, the markets of the developing countries were demonstrating both, a general increase in the indices by 1–3 per cent over the month, as well as decline by 1–5 per cent. Compared to the beginning of January 2011, the majority of stock indices of developed countries, as well as emerging markets have shown a similar volatile trend (See *Table. 1* and *Fig. 5*).

Table 1

DYNAMICS OF THE GLOBAL STOCK INDICES (AS OF JANUARY 24, 2011)

Index	Ticker	Value	Dynamics within the month(%)*	Dynamics from the year beginning (%)
MICEX (Russia)	MICEXINDEXCF	1 720.70	3.46	1.94
RTS (Russia)	RTSI	1 861.66	7.01	5.16
Dow Jones Industrial (USA) Average (USA)	DJI	11 980.52	4.38	3.48
NASDAQ Composite (USA)	NASD	2 717.55	2.57	2.44
S&P 500 (USA)	SPX	1 290.84	3.51	2.64
FTSE 100 (UK)	FTSE	5 943.85	0.89	0.74
DAX–30 (Germany)	DAX	7 067.77	0.70	2.22
CAC–40 (France)	CAC	4 033.21	3.81	6.00
Swiss Market (Switzerland)	SSMI	6 603.80	1.27	2.61
Nikkei–225 (Japan)	NIKKEI	10 345.11	1.26	1.14
Overpay (Brazil)	BUSP	69 426.57	3.22	0.18
IPC (Mexico)	IPC	37 667.90	–0.81	–2.29
IPSA (Chile)	IPSA	4 882.97	–2.20	–0.90
Straits Times (Singapore)	STI	3 185.76	1.69	–0.13
Seoul Composite (South Korea)	KS11	2 082.16	3.06	1.52
ISE National–100 (Turkey)	XU100	65 201.71	2.68	–1.22
BSE 30 (India)	BSE	19 151.28	–3.71	–6.62
Shanghai Composite (China)	SSEC	2 695.72	–5.51	–4.00
Morgan Stanley Emerging Frontier Markets Index	EFM	901.07	2.37	–1.17

* – Versus index indicator valid on December 20, 2010.

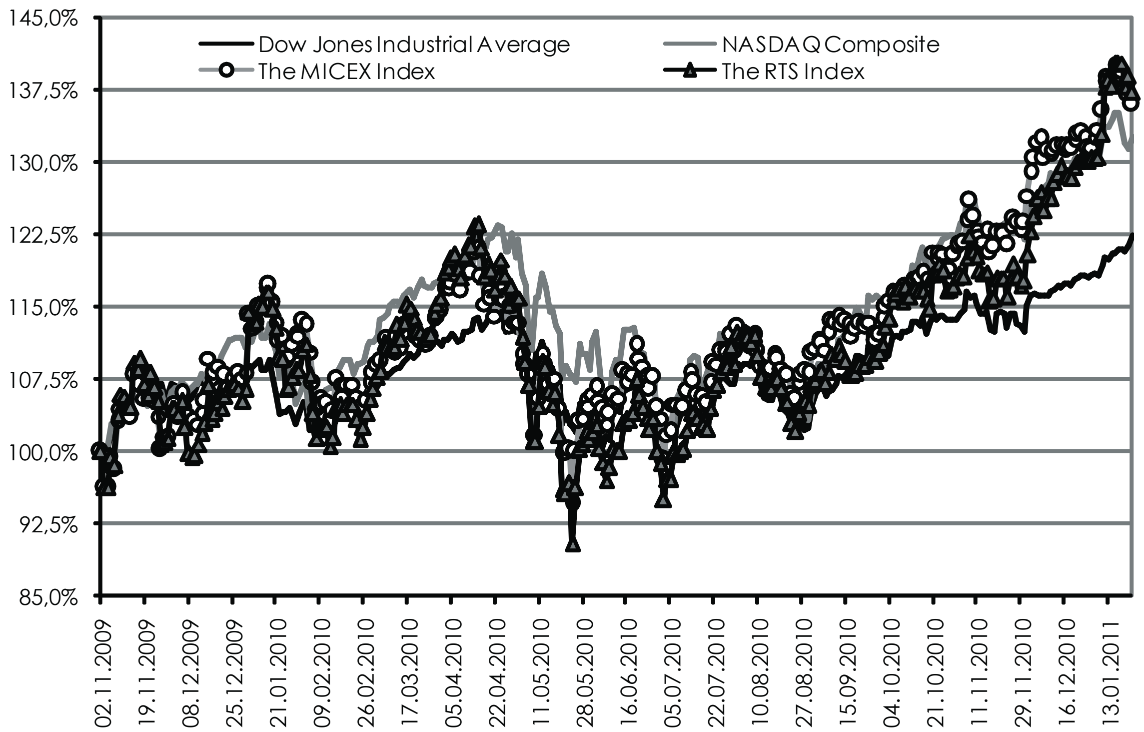


Fig. 5. Dynamics of the main USA and Russian stock indexes (in % to the date 01.11.2009)

Corporate News

OAO "VTB Bank"

On January 13, 2011, OAO "VTB Bank" and MICEX have announced a strategic partnership in the development of electronic auctions of government and municipal orders.

NC «Rosneft»

On January 14," Rosneft" and BP have announced a global strategic alliance – a joint venture that will involved in exploration and development of three licensed sites – East Prinovozemelskie –1, –2, –3, and also provides for cooperation on other projects. "Rosneft" will receive 5 per cent of ordinary voting shares of BP in exchange for 9.5 per cent of its shares.

Sberbank of Russia

On December 24, 2010 Sberbank has signed a loan agreement for the purposes of trade financing in the amount of USD 250 million with Oversea–Chinese Banking Corporation Limited, Singapore. On January 25, 2011 the Sberbank of Russia has disclosed its unconsolidated financial results of 2010 without the results of the events after the reporting date under RAS: net profit amounted to RUR 183.6 billion against RUR 21.7 billion in 2009, the bank's assets grew by 20.3 per cent to RUR 8,547 billion. Russian enterprises were granted more than RUR 4.35 trillion of credits; capital adequacy ratio was at the level of18 percent.

Corporate bonds market

The volume of the Russian domestic corporate bonds market (as per nominal value of shares in circulation, denominated in national currency) in January 2010 continued its growth and at the end of the month made RUR 2,848.7 bn, which exceeds the relevant indicator of preceding month by 2.0 per cent[1]. It is remarkable, that the number of emitters and emissions in circulation, denominated in national currency remained the same as in preceding month: 716 corporate bond issues against 714 at the late–December of the last year, 358 emitters against 357 in the last month. The constancy of the above characteristics at the background of growth in the bond market indicates an increase in the nominal volume of a single issue of bonds on average. .There is still one emission of bonds in circulation, denominated in US dollars and one in Japanese yens.

Turnover in secondary trades of the stock market in January has significantly increased as compared with December of the last year, despite the fact that the number of trading days in the analyzed period was less than in the last year. Thus, in the period from December 21 to January 24, the total volume of transactions in the MICEX Stock Exchange amounted to RUR 121.5 billion. (For comparison, from November 26 to December 20, the volume of transactions was equal to RUR 100.3 billion), approaching the high rate of turnover in October–November of the last year. There were 28.8 thousand of transactions with securities, which is the highest indictor since March 2010 (in previous month the number of transactions was 21,000)[2].

Index of the Russian corporate bonds market IFX–Cbonds was continuing its growth at the beginning of 2011, having increased from December 23 through January 25 by 2.7 points (by 0.9 per cent). Average effective yield over the period under review showed a decrease (from 7.51 per cent at the end of December to 7.33 percentage points at the end of January (Fig. 6).Despite the reduction in yield, the rate of portfolio duration of corporate bonds for the month fell down again by 25 days, having returned to the level of March of the last year.

The most liquid bond issues in this period under review demonstrated a declining dynamics of the average weighted yield, having rendered to null the growth of December of the preceding year. The maximum growth from December 21 to January 24 was recorded for the bonds emissions of the major financial–credit institutions: in particular, the yield of bonds of the "Agency for Housing Mortgage Lending", Commercial Bank "Petrocommerce" (JSC), "MDM Bank", "Renaissance Capital" (OOO), OJSC "Bank Zenit", the Bank "Avangard" (JSC) in some emissions declined by 1 percentage point and more, while in December some of those institutions have become leaders of increasing yield. Bond yields of most other large banking institutions has decreased by 0,3–0,7

1 As per Rusbonds information
2 As per " Finmarket"Information agency.

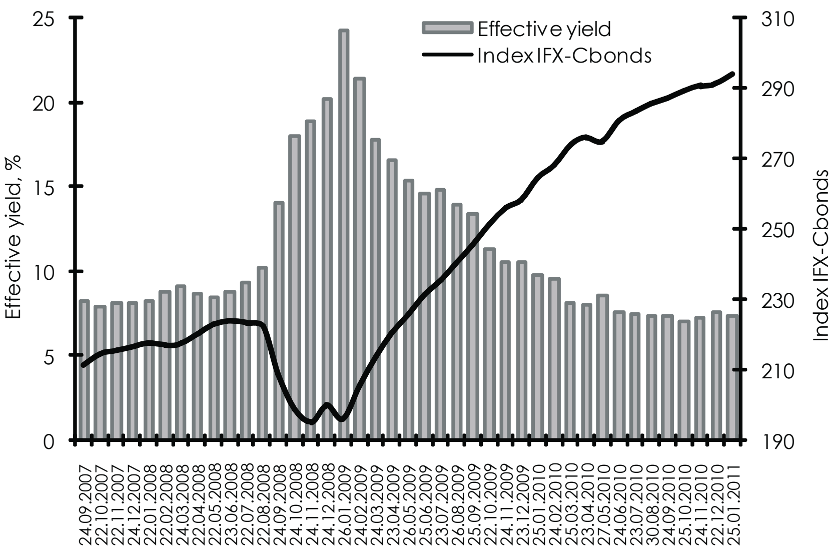
percentage points, while “Rosbank” and “Russian Agricultural Bank” demonstrated growth yield of about 0.2 percentage points in some of their emissions[1]

The dynamics of bonds yields of the major industrial companies was volatile. Most significantly decreased the yield of bonds of OAO “Gazprom Neft” (series 04 −1.4 percentage points), OAO “Mechel” (series 02 and BO−01 −1 p.p.), OAO “Mosenergo” (Series 02 − 0.9 percentage points), OAO “Lukoil” (Series BO−07 −0.8 percentage points), OAO “Magnitogorsk Iron and Steel Works” (BO−02 and BO−03 −0.8 p.p. and −0.7 percentage points, respectively), OAO “Gazprom” (Series 08 −0.7 percentage points), OAO “Russian Railways” (series 08 and 12, − 0.8 percentage points and −0.7 percentage points, respectively). Herewith, the yield of securities of OAO “Novolipetsk Steel Works” has significantly increased (Series BO−05 0.7 pp).

Among the telecommunications companies there was a sharp decline in the yield of bonds of OAO “North−West Telecom” (ten−year bonds of 06 Series −3.2 percentage points), OAO “VolgaTelecom” (Series 04 −2 percentage points), OAO “Mobile TeleSystems” (Series 04 −1.1 percentage points). Herewith, there was an increase in bond yield of the “North−West Telecom” (series 04 − +0.6 percentage points), OAO “Dalsvyaz” (series 02 − +0.4 percentage points), OAO “Mobile TeleSystems” (Series 01 and 0.2 − + 02 percentage points).

In January this year, there were significantly fewer bond issues as compared with the previous month, which, however, was due to fewer working days in the period under review. Thus, in the period from December 24, 2010 to January 25 this year eight emitters have registered 19 bond issues totaling to RUR 86.1 billion (for comparison, from November 25 to December 23, sixteen emitters have registered 42 issues of bonds amounting to 169.5 billion rubles), and there were 15 exchange bonds issues. The major amount of registered emissions fell on a series of exchange bonds of OAO “Uralkaliy” for the volume of 50 billion rubles and four series of exchange bonds of CB “Loko−Bank “(ZAO) for the total amount of 10 billion rubles. Also of particular note is the new issuer − OAO “Mortgage specialized organization GPB−Mortgage Two”, which has issued two series of mortgage−backed bonds maturing in 2041.

The total volume of outstanding issues in the period from December 24 to January 25 totaled to 45 billion rubles (against the previous corresponding period − 83,6 billion rubles.), and the amount of emissions − 8 (in late November − December, there were placed 30 bond issues). Thus, the performance of IPOs were significantly lower than the averages, but in January such dynamics is quite common (Fig. 2). During the period under review, the largest bond issues were placed by SC “Rosnanotech” (three series of seven−year bonds totaling to 33 billion rubles.) and OAO “Agency for Housing Mortgage Lending” (one series of bonds amounting to 5 billion rubles, maturing in 2027, and for the “Agency for Housing Mortgage Lending” this was the second placement in December of the last year).



Source: Rusbonds data

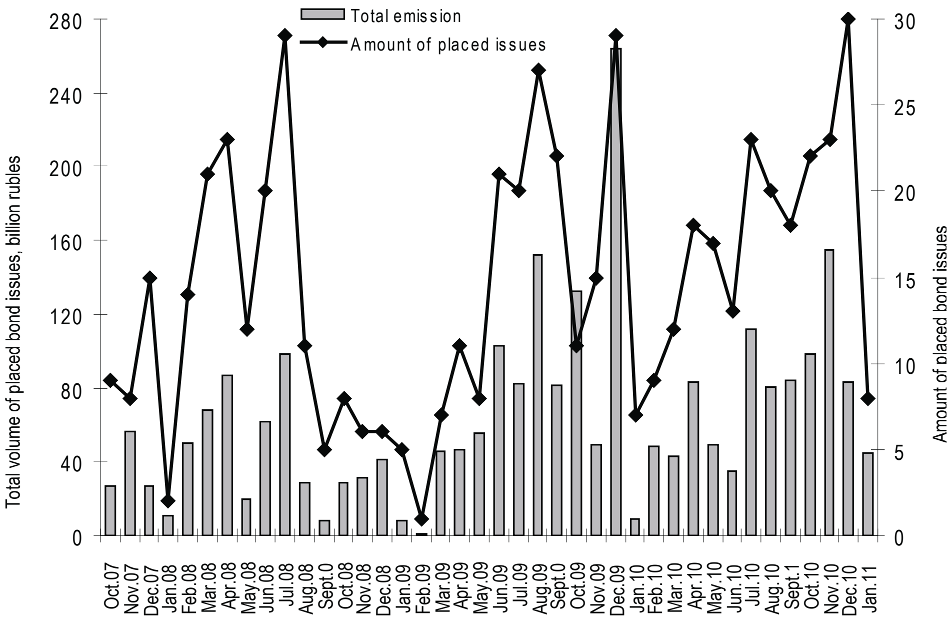
Fig. 6. Russian corporate bonds index dynamics and average weighted yield

Within December 24 – January 25, the Russian Federal Financial Markets Service has not canceled any issues of bonds, though in late November that was the reason for canceling the bond issues of OAO “Nuclear Power Complex” and OAO “VTB−Leasing Finance”[2].

In the period from December 24 through January 25, twenty two bond issues were to be redeemed

1 *Source:* Rusbonds data.
2 Data of the Russian Federal Financial Markets Service

(for the total nominal value of 5.3 billion rubles), but two issuers have announced a technical default on redemption of their bonds with the total nominal value of 0.6 billion rubles (against seven issuers who have announced a technical default on redemption of their bonds with the total nominal value of 6.7 billion rubles). In February 2011, 12 corporate bond issues totaling to 40.1 billion rubles are expected to be redeemed[1].



Source: Rusbonds data

Fig. 7. Dynamics of corporate securities primary placement, denominated in national currency.

The majority of technical defaults on repayment of bonds in December last year turned into reality at the beginning of this year. As a result, from December 24 through January 25, six emitters were unable to repay the investment to investors. Two more emitters failed to comply with its obligations under the offer (bonds redemption), although one of them managed to reach an agreement with bondholders on the debt restructuring. The situation with the performance of current debt liabilities by emitters was still not easy: within the period under review the real default on bonds coupon yield redemption was announced by for four emissions (from November 25 to December 23, the real default on bonds coupon yield redemption was announced by six emitters six emitters[2].

1 Rusbonds data.
2 Cbonds data

THE REAL SECTOR OF THE ECONOMY: FACTORS AND TRENDS

O.Izryadnova

According to preliminary estimates, GDP growth in 2010 was 4.0 %, while investments in fixed assets rose 6.1 %, and retail turnover – 4.2 % against the previous year. The industrial production index was 108.2% against its previous year's level, including 111.8 % in the processing industries. The revival of economic growth was followed by a normalization of the situation on the labor market. The overall number of unemployed dropped in 2009 by 10.9 %.

The macroeconomic situation in 2010 was marked by a rather instable dynamics of its main indices throughout the year. Growth during the first half-year, which was sustained by the favorable conditions on the world raw materials market, in the second half-year gave way to a slower rate of economic development due to the effect of certain domestic factors.

According to *Rosstat*'s data, over January - September 2010, GDP growth was 3.7 % against the same period of the previous year. In Q III 2010, GDP growth dropped to 2.7 % against 5.2 % in Q II and 3.1 % in Q I. In Q IV 2010, the positive effects produced by an expanding investment and consumer demand proved to be sufficiently strong to compensate for the diminished volumes of agricultural output, and so the growth rate of GDP, according to the preliminary estimated published by the RF Ministry of Economic Development, rose by nearly 5.0 % on the same period of last year. As demonstrated by *Rosstat*'s reports, in 2010 investments in fixed assets increased by 6.1 %, and retail turnover – by 4.4 %, as compared to their 2009 indices. The industrial production growth index in 2010 rose to 108.2 % of its previous year's level, including that for the processing industries – to 111.8 %, for the extracting industries – to 103.6%, and the production and distribution of electric energy, gas and water – to 104.1 %. The agricultural production volume amounted to 88.1 % of its 2009 level. As a result, GDP growth – according to the preliminary data for the year 2010 – may turn out to be 4 %, against the initially expected 3.8 %.

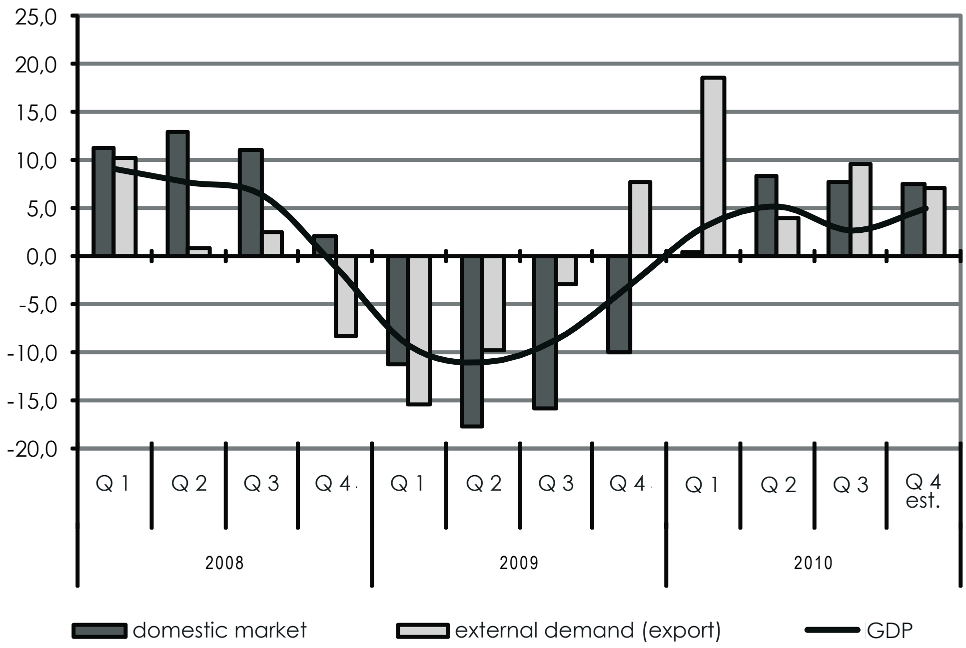
Table 1

MAIN MACROECONOMIC INDICES FOR 2009 – 2010, AS % OF A PREVIOUS YEAR'S LEVEL

	2009					2010				
	Per annum	Q				Per annum	Q			
		1	2	3	4		1	2	3	4
Gross domestic product	92.1	90.7	89.0	91.4	97.1	104.0*	103.1	105.2	102.7	105.0*
Investments in fixed assets	83.8	82.7	77.2	81.8	90.6	106.1	95.9	105.3	107.2	112.8*
Housing put in operation	93.5	102.5	99.7	98.8	86.4	97.0	91.7	107.5	85.9	100.5
Production volume in construction	84.0	80.7	80.7	82.8	89.3	99.4	91.9	99.9	102.2	105.6
Industrial production volume	89.2	84.5	86.4	90.4	101.8	108.2	109.5	110.9	106.4	106.5
Extraction of mineral resources	99.4	94.9	97.3	99.9	105.4	103.6	106.7	104.8	101.3	102.0
Processing industries	84.8	76.1	79.3	85.0	100.0	111.8	112.1	116.3	109.5	109.9
Production of electric energy, gas and water	96.1	94.9	94.5	94.0	101.4	104.1	107.7	102.6	103.9	101.6
Agricultural product	101.2	102.3	100.8	99.0	105.2	88.1	103.6	102.3	81.4	91.8
Cargo turnover in transport	89.8	82.8	82.2	93.1	102.0	106.9	111.6	113.0	101.7	102.4
Retail turnover	95.1	100.4	94.9	91.4	94.5	104.4	101.7	105.3	105.9	104.1
Commercial services to the population	95.8	99.1	95.3	93.6	95.6	101.4	99.9	101.6	101.5	101.5
Foreign trade turnover	64.9	56.2	55.4	59.9	91.0	130.5*	144.1	139.0	125.9	119.9*
Real disposable money incomes	102.3	100.7	103.4	96.6	108.2	104.3	107.4	103.2	104.4	102.4
Real wages	96.5	99.2	96.1	94.8	99.3	104.2	103.1	106.1	105.1	102.4
Total number of unemployed	131.7	134.8	152.1	132.2	112.3	89.1	96.3	86.7	87.2	85.3
Number of unemployed, officially registered	148.9	126.5	157.4	163.0	152.3	90.0	114.2	91.1	81.0	91.2

**) preliminary data* *Source*: Rosstat.

This specific combination of the rates of domestic and external demand had a decisive effect on the peculiarities of the post-crisis development of the national economy observed in 2010. From Q IV 2009, the dynamics of exports (external demand) once again became positive, while the domestic market was gradually growing throughout the year 2010.



Source: Rosstat.

Fig. 1. GDP Changes, by Domestic and External Demand Components in 2008 – 2010, As % of the Same Quarter of a Previous Year

An analysis of the dynamics of economic development broken up by component of external and domestic demand can serve as an illustration of its very high dependence on foreign trade. Over the first three quarters of 2010, the rate of growth on the domestic market was 5.8 %, while exports rose by 10.3 % on the same period of the previous year, and the domestic production of commodities for domestic consumption - by 1.5 %. Given the existing difference in the growth rates of the output of commodities for export and for domestic consumption, the balance of demand and supply on the domestic consumer and investment markets was sustained at an adequate level due to the revival, from Q II 2010 onwards, of the trend towards an accelerated growth of imports by comparison with exports and domestic production.

Table 2

SHARES OF CONSUMER, INTERMEDIATE AND INVESTMENT COMMODITIES IN THE RF'S TOTAL IMPORTS (BASED ON BALANCE OF PAYMENTS), AS % OF RESULT

	Type of commodity		
	Consumer	Investment	Intermediate
2008			
I Q	45.0	22.6	32.4
I QI	41.3	23.9	34.8
III Q	43.6	24.2	32.2
IV Q	37.8	24.4	37.8
Per annum	41.8	23.8	34.4
2009			
I Q	46.8	18.6	34.9
II Q	44.0	18.1	38.4
III Q	42.9	20.6	36.5
IV Q	43.9	19.5	36.6
Per annum	44.3	19.7	36.0
2010			
I Q	43.5	16.8	39.7
II Q	39.5	18.7	41.8
III Q	42.1	19.8	38.1

Source: Rosstat.

At the same time, in 2009 – 2010 there occurred some negative shifts in the overall structure of imports, when the share of imports in investment commodities was rapidly shrinking against the backdrop of a reorientation toward the other two types of commodities intended to satisfy consumer and intermediate demand.

The emergence of this trend was followed by an increasing share of imports in the retail commodity resources. The opposite trend observed in 2009, when the share of imports in retail commodities was shrinking, had disappeared. The share of imports throughout 2010 was systematically increasing, having achieved by Q III the level of 47 %.

Table 3

THE STRUCTURE OF RETAIL COMMODITY RESOURCES IN 2009 - 2010, %

	Retail commodity resources	Including	
		Domestic production	Imported
2009			
I Q	100	55	45
II Q	100	60	40
III Q	100	59	41
IV Q	100	61	39
Year	100	59	41
2010			
I Q	100	56	44
II Q	100	58	42
III Q	100	53	47

Source: Rosstat.

When the dynamics of economic development is analyzed by the components of external and domestic demand, one may notice that it very strongly depends on external factors. Lack of any significant structural changes, the development by inertia of both exports-oriented and end-demand production (based on extensive use of basic factors), and a high share of imports in the resources available on the domestic market were determining the low competitive capacity of the Russian economy in conditions on the post-crisis growth in 2010.

The dynamics of the processing industries was rather significantly differentiated by type of economic activity, while the strongest impact was made by the ratio of production rates of capital and consumer commodities.

Table 4

PRODUCTION INDICES, BY TYPE OF ACTIVITY, IN THE PROCESSING INDUSTRIES IN 2008 – 2010, AS % OF THE SAME PERIOD OF A PREVIOUS YEAR

	2009					2010				
	Per annum	Q				Per annum	Q			
		I	II	III	IV		I	II	III	IV
Processing industries	84.8	76.1	79.3	85.0	100	111.8	112.1	116.3	112.6	109.9
Production of foodstuffs, including beverages and tobacco	99.4	97.5	97.5	97.8	103.9	105.4	103.8	106.4	105.4	105.9
Production of textiles and garments	83.8	79.1	78.0	82.6	95.9	112.1	110.2	115.6	111.4	111.3
Production of leather, leather products and footwear	99.9	85.8	97.3	104.5	112.3	118.7	126.3	120.0	111.4	118.4
Timber processing and timber products	79.3	71.7	74.7	79.8	92.4	111.4	111.1	112.6	111.4	110.5
Pulp and paper production, publishing and printing	85.7	78.1	82.9	86.3	96.5	105.9	106.7	109.3	106.7	97.8
Production of coke and petroleum products	99.4	95.8	99.8	100.2	101.6	105.0	104.7	105.3	103.5	106.4

Table 4, cont'd

	2009					2010				
	Per annum	Q				Per annum	Q			
		I	II	III	IV		I	II	III	IV
Chemical production	93.1	77.9	86.4	91.9	123.1	114.6	123.8	115.7	112.5	108.1
Production of rubber and plastic products	87.4	72.7	84.7	89.3	101.4	121.5	122.8	119.2	121.9	122.4
Production of other non-metal mineral products	72.5	63.5	66.6	75.0	85.1	110.7	104.9	114.2	109.1	113.2
Metallurgy production and production of finished metal products	85.3	70.0	75.2	86.3	114.4	112.4	118.8	119.6	107.3	104.8
Production of machinery and equipment	68.5	56.5	62.5	70.7	87.8	112.2	109.1	130.5	101.4	110.5
Production of electrical, electronic and optical equipment	67.8	56.8	61.3	69.9	82.4	122.8	130.4	127.5	117.3	119.3
Production of means of transportation and transport equipment	62.8	61.0	59.2	56.7	74.3	132.2	113.3	141.2	138.1	135.9
Other industries	79.3	67.3	70.7	82.7	98.5	117.7	130.7	135.4	117.1	114.1

Source: Rosstat.

While the rate of growth varied rather significantly depending on a specific type of activity across the processing industries, the dramatic drop in the machine-building output in 2009 was the leading negative factor that became responsible for the changes in the business activity in the allied industries (construction materials and other types of intermediate commodities). The level of growth achieved in these sectors in 2010 so far has failed to compensate for the losses in production incurred during that time.

Our analysis of the main macroeconomic trends has led us to the conclusion that, although in 2010 the acute phase of the crisis was already a thing of the past for the Russian economy, there existed certain limitations to development in the medium term, namely the instable dynamics displayed by the main macroindices, the low indices observed in the investment and crediting spheres, and the complicated situation on the labor market. On the other hand, the dynamics of investments in fixed assets and the construction industry during the last two quarters and the investments in construction materials and machine-building over the past year have given rise to some hopes that the 'investment complex' is going to 'wake up'.

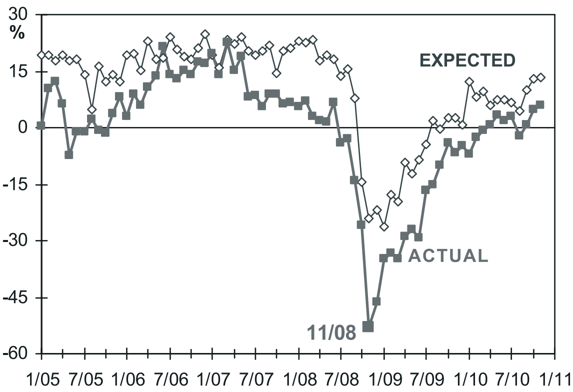
The national economy continues to be dominated by the same factors that determined both the speed and the depth of the decline during the crisis, and the speed of the subsequent rehabilitation: the dependence on the movement of the world prices for raw materials; low domestic demand and the lax attitude of domestic producers to intervening on the markets for consumer, investment and intermediate commodities; a weak financial system and absence of long-term financial investments in the economy.

RUSSIAN INDUSTRIAL SECTOR IN DECEMBER 2010

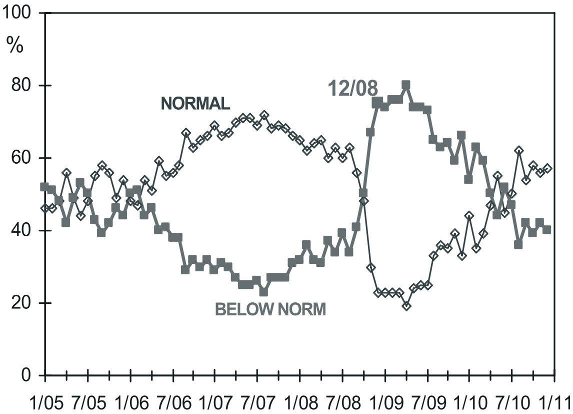
S.Tsukhlo

In the end of the year, the state of affairs in the Russian industrial sector unfolds under the impact of conflicting tendencies. The surveys run by the Gaidar Institute[1] show that, on the one hand, the data on the dynamics of demand and output, less seasonality, hit regular post-crisis record-breaking values, while the situation with employment has not aggravated (against expectations). On the other hand, assessments of finished products inventories speak for corporations being uncertain about renewal of demand and still planning head cutting. The rise in loans availability rates discontinued.

Demand for Industrial Products



Graph 1. Changes in Effective Demand Cleared from Seasonality (Balance=% Growth -% Decline)



Graph 2. Dynamic of Main Assessments of Effective Demand

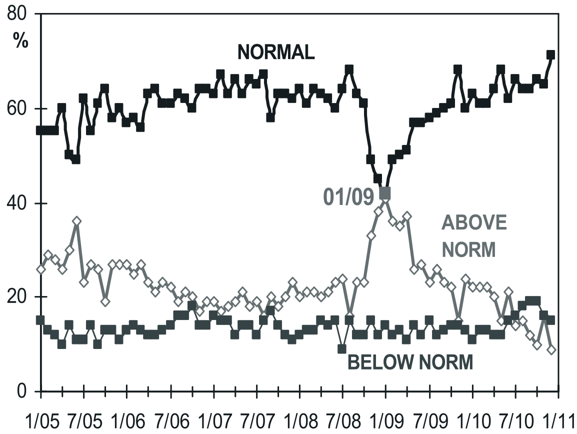
The original data on the dynamic of demand remained unchanged in the end of the year, with the indicator's growth rate (assessed by the difference between responses "growth"-"decline" remaining in the zero zone. So, in the five past months the proportion of responses on growth in sales across the industrial sector on the whole has been counterbalanced by the proportion of responses of their decline. Meanwhile, as in prior years the December growth rate would usually decline vs. the prior months, the formal methods of clearing from seasonality showed increase in the demand growth rates in December 2010. As a result, this indicator hit its crisis maximum and matched its pre-crisis values (*Graph 1*). The demand forecasts had plummeted prior to the January holidays of course, but their clearing from seasonality equaled them to the forecasts of the prior months and held them at the crisis maximum.

An evident improvement of the dynamic of demand in December has not yet told on assessments of its volumes. Satisfaction with demand remained at the level of the prior months (*Graph 2*). This is not bad, either, though, for the proportion of normal assessments in Q2 and Q3 was prone to strong oscillations, which evidenced corporations' uncertainty about which sales volumes should be considered adequate to the current economic conditions. Presently, enterprises seem to have come to better appreciate the state of affairs. In Q4 2010 it is metallurgical corporations that demonstrated the best adaptation to the situation (75% of them believe demand is "normal"), followed by chemical (72%), food-processing and forestry enterprises (67% each).

1 The Gaidar Institute has run monthly surveys on corporate heads by the European harmonized methodology since September 1992. The surveys cover the whole territory of the Russian Federation. The panel's size is some 1,100 corporations that employ over 15% of industrial labor. The panel is biased towards large corporations by each individual sub-sector, with the questionnaire return rate making up 65–70%.

Finished Products Inventories

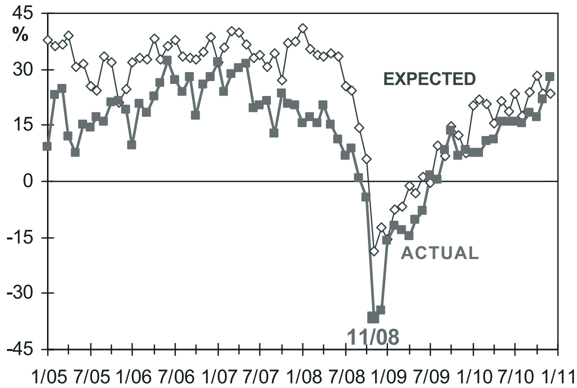
That said, corporations retain a great deal of pessimism in their understanding of the "current situation", which is evidenced by assessments of finished products inventories (*Graph 3*). In December, as far as deviations from the norm are concerned, they were back to visible prevalence of the "below norm" assessments, with the proportion of such responses currently standing at 17%, while the "above norm" responses made up just 9%. The latter rate became an absolute minimum one for the indicator in question over the whole 18 years of monitoring. Corporations clearly do not wish to replenish their final products inventories in reliance to new customers and prefer holding the volume of their products at storages at a level far smaller than the one typical of the month. That is to say, the industrial sector has not yet gained solid ground to believe in renewal of the former sustained growth rates. The "below norm" responses prevail in all the industries, bar the construction sector.



Graph 3. Dynamic of Finished Products Inventories

Industrial Output

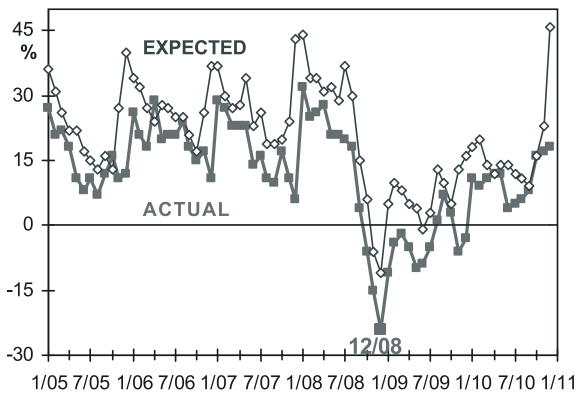
Judging by corporations' original responses, the output growth rates have demonstrated a stunning stability in the 2nd half-year of 2010 by oscillating within the range between +13…+20 points since last May. Cleared from seasonality, the data on the dynamic of actual output demonstrate an increase in the production growth rate and the indicator hitting a new crisis maximum (*Graph 4*). Plans of output likewise retain a great optimism, albeit not a record-breaking one in the context of the current crisis, but fairly praiseworthy, nonetheless.



Graph 4. Changes in Output, less Seasonality (Balance=% Growth - % Decline)

Producer Prices

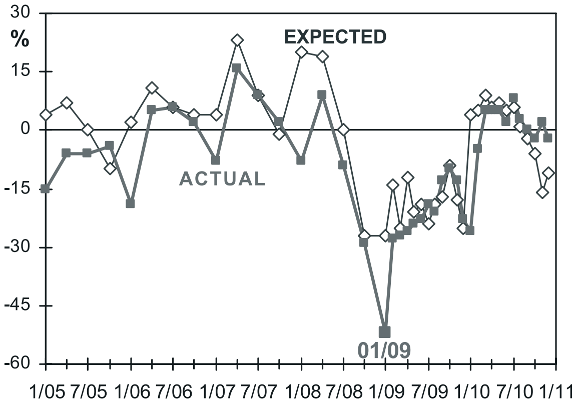
Since the beginning of the last quarter 2010 the industrial sector has fundamentally changed its pricing policy and transited to a steady increase of producer prices. While in Q3 the balance of price changes was 6 points, in Q4 this indicator accounted for 17 points on average (*Graph 5*). It was the light and chemical industry branches that held leading positions in terms of intensity of price increases in the last three months 2010, while the construction sector was the only one to report reduction in prices.



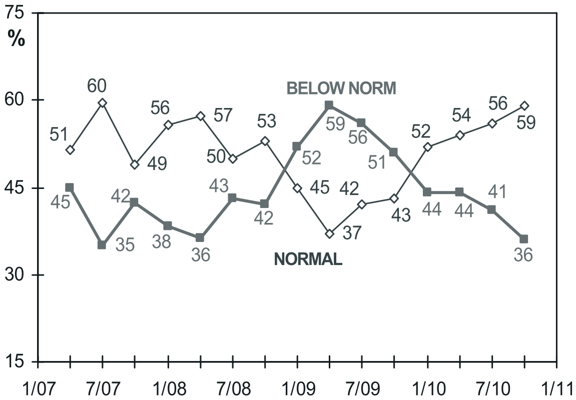
Graph 5. Changes in Producer Prices (Balance=%Growth - % Decline)

The corporations' December price plans changed fundamentally, too. Like in the pre-crisis period, the industrial sector plans a considerable increase in prices in the first months of the new year, perhaps even to the detriment of sales volumes. It looks like the rise of the tax burden leaves enterprises with no other strategic options. There has been no such drastic revision of price plans in the Russian industrial sector since September 1998.

Dynamic and Plans of Actual Lay-Offs



Graph 6. Changes in Employment (Balance=%Growth - % Decline)

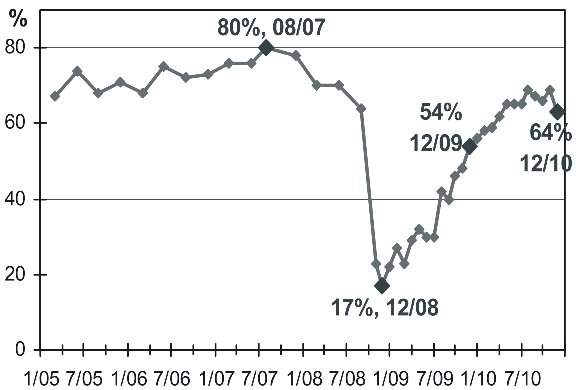


Graph 7. Corporate Heads' Assessments of Workers and Specialists' Salaries

Despite an explicit intent to downsize noted in the prior months, in the end of the year, the industrial sector basically held employment at the same level, with no sizeable hiring or mass layoffs (Graph 6). In December, pessimism of the plans discontinued to surge. While in November it hit its annual (2010) peak (i.e. expectations of the most considerable layoffs were reported), in December the balance of the plans improved by 5 points, but remained negative, nonetheless: the industrial sector still expects head cutting. New job opportunities may continue to appear only in the non-ferrous metallurgy and the food-processing sector.

In Q4 2010, estimates (not absolute values!) of workers and specialists' salaries hit the pre-crisis level. Currently as many as 59% of enterprise executives believe the level of their employees' labor compensations is normal, while another 36% ones consider it to be "below norm". An analogous ratio was noted in 2007 and in the early 2008. At the peak of the crisis the estimates traded places: at the time, 37% of enterprise heads consider their subordinates' salaries to be normal, while another 59% of executives thought it was "below norm".

Lending to the Industrial Sector



Graph 8. Proportion of Enterprises with Normal Loans Availability Rate

The rise in availability of loans discontinued in the late 2010 (*Graph 8*). The proportion of normal estimates of the indicator in question in the 2nd half-year stabilized at the level of 66%. So, in the conditions of the continuous uncertainty banks discontinued to soften their lending terms for the real sector. This conclusion is also proved by the stabilization of the interest rate on Rb.-denominated loans at the level of 13% across the industrial sector as a whole. Interestingly, the interest rate for SMEs was frozen at the level of 15.0-15.5% annualized, while that for large corporations – at the level of 11-12% annualized.

FOREIGN TRADE

N.Volovik, K.Kharina

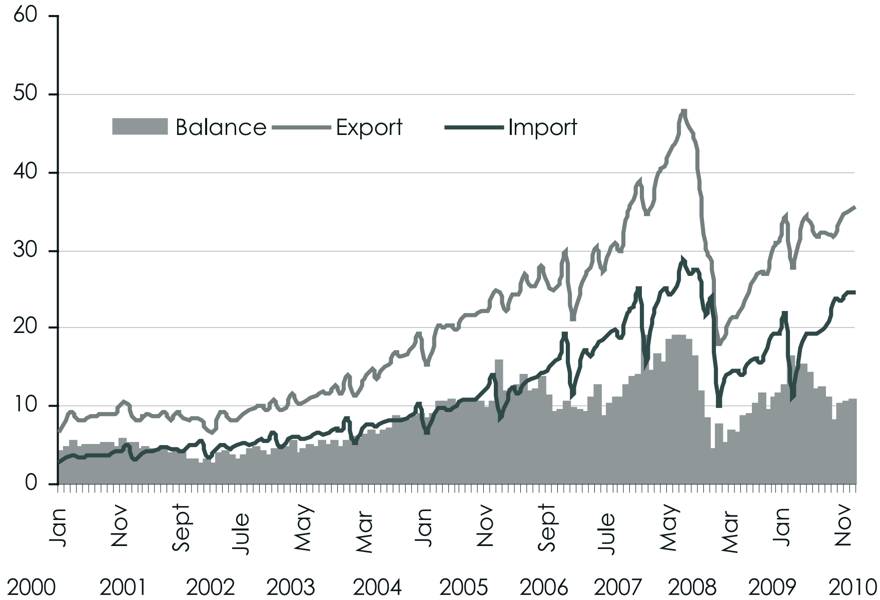
Fueled by a favorable state of affairs on the world markets and growth of the national economy, Russian foreign trade continued to restore its volume. The RF Government extended the moratorium on increase in timber duties and restored zeroed in 2009 export duties on copper and nickel, abolished duties on oil supplied to Belarus and made the planned step towards equalizing duties for dark and light oil products.

According to the World Bank's preliminary data, the global economy posted a 3.9% growth in 2010. The World Bank experts suggest that the 2011 growth should make up 3.3%. It is envisaged that the emerging nations' GDP would increase by 6%, while that of the developed nations – by meager 2.4%. China, as the largest emerging economy, should grow by 8.5%, or at 1.5 p. p. down vs. the 2010 figures. In 2012, the global economy's growth should accelerate up to 3.6%. The volume of global trade is envisaged to post a 8.3% growth in 2011 and 9.6% in 2012. This is far smaller a growth vs. the astounding 15.7% posted in 2010. In 2009, this indicator plummeted by 11%[1].

In November 2010, Russia's foreign trade turnover calculated by the balance-of-payments methodology was USD 59.8 bln. and was up by 0.5% vs the prior months and 19.1% vs. November 2009.

In November 2010, the volume of Russian export was USD 35.3 bln., or up by 1% vs. the prior months and 14.6% vs. November 2009. The growth in the value volume of the nation's export was fueled by favorable prices for Russia's exports on the global markets. More specifically, the average price for Urals in November 2010 was USD 84.39/bbl (+10.9%) vs. 76.11/bbl in October 2009. The averaged over the 11 months of the year price was USD 77.19/bbl, while between January and November 2009 it was 59.92/bbl. So, its year-on-year growth rate made up 29%.

According to the price monitoring data, between 15 January 2010 and through 14 January 2011 the average price of Urals was USD 91.901/bbl. So, in compliance with the effective law, since 1 February 2011 the export duty on oil will make up USD 346.645/t vs the January figure of USD 317.5/t. The duty on light oil products will be increased up to USD 232.2/t (USD 226.2/t in January), while that for dark oil products – USD 161.8/t (USD 121.9/t). The preferential oil duty set for 24 domestic oil fields will be raised from USD 117.5/t in January to 137.6/t. The duties on dark and light oil products were calculated according to a new methodology adopted by Resolution of the RF



Source: the CBR

Graph 1. Main Indicators of Russia's Foreign Trade (as USD bln.)

1 http://web.worldbank.org/WBSITE/EXTERNAL/NEWS

Government №155 of 27 December 2010. The document reads that since February 2011 duties on dark oil products should make up 46.7% of the oil duty, while on light ones – 67%.

According to the LME, in November 2010 copper, aluminum and nickel prices increased by 26.9%, 19.7% and 34.8%, respectively, on a one-year basis.

Table 1

AVERAGE WORLD PRICES IN NOVEMBER OF RESPECTIVE YEARS

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Oil (Brent), USD/bbl	32.14	21.45	27.2	29.6	49.8	58.2	57.9	81.4	79.63	77.42	86.17
Natural gas, USD/MMBTU	5.767	2.649	4.144	5.162	7.7	12.2	12.76	7.47	6.824	5.215	4.19
Gasoline, USD /gall	0.895	0.603	0.801	0.841	1.43	2.056	1.484	2.13	4.195	2.01	2.16
Copper, SD/t	1838.6	1405.1	1519.0	1916.4	3012.0	4060	7500	8008	4925.7	6675.6	8469.9
Aluminum, USD/t	1473.5	1280.8	1313.2	1474.8	1822.8	1929	2659	2442	2121.4	1949.3	2333.1
Nickel, USD/t	7353.2	4836.8	6840.9	11030	14,483	12403	32348	30999	12140	16991	22909

Source: calculated on the basis of the LME and IOE data (London).

According to FAO, in November 2010 the world prices for food stuffs hit their peak values since July 2008. The FAO index, whose calculation covers 55 kinds of food stuffs, had been rising for the fifth straight month by November 2010. The price rise was driven by prices for grain, sugar and oil, while the cost of meat remained unchanged vs. the prior month.

According to the CBR, between January and November 2010 Russian export posted a 32.9% growth (up to USD 357.7 bln.) on a one-year basis. It is fuel and energy commodities that still formed the bulk of the nation's exports – during the period in question, their specific weight in the commodity structure of Russian exports accounted for 68.3% (vs. 66.7% reported for the period between January through November 2009).

Calculated upon the same one-year basis, Russia's oil revenues in the 11 months of 2010 soared by 38.5% - from USD 83.5 bln. to 115.6 bln., while in physical equivalent the growth accounted for just 2.6% and made up 212.1 mln. t.

The proportion of export of machinery and equipment between January and November 2010 accounted for 5.4% (vs. 5.7% reported over the period between January and November 2009). On a one-year basis, the value volume of export supplies of machinery and equipment soared by 2.3%. The physical volume of export of passenger cars rose by 7.4% thanks to a 18% surge in their supplies to the CIS countries against a 21.6% contraction of those to Far-Abroad countries.

A poor grain harvest in 2010 did not enable Russia to retain a decent position among major grain exporters – by results of the 2009/20010 agricultural year the country was in the group of Top Three leading wheat and flour exporters and among TOP Four barley suppliers, with export of grain and grain products forming over 40% of the nation's agrarian and food export.

Because of a sharp price rise on the world market, the Government ruled to impose embargo on grain export, effective as of 15 August 2010. Its deadline was initially set for 31 December 2010 and was subsequently extended through 1 July 2011. Consequently, the share of export of food stuffs in the commodity structure of the nation's export slid to 2.3% between January and November 2010 vs. 3% in January-November 2009, with the value volume of these exports plummeting by 9.8% on a one-year basis.

The volume of imports to RF in November 2010 accounted for USD 24.5 bln., or by 0.3% down vs. the prior month, but up by 26.3% vs. November 2009. Meanwhile, import supplies from the CIS countries surged by 34.3% and those from Far-Abroad countries – by 25.1%. Imports to Russia have been growing steadily through the whole year. Between January and November they soared by 30.2% vis-a-vis the same period of 2009 and accounted for USD 221.5 bln. A notable rise in imports should be ascribed primarily to the post-crisis renewal of Russia's economy.

As concerns commodity structure of import, the proportion of machinery and equipment accounted for 44.3% (43.4% - between January and November 2009). The value volume of import of machine-building products grew by 39.5% on a one-year basis. Import of passenger cars surged by 29% vs. the same period of 2009 and accounted for 6,193.000 pcs.

The nation's balance of trade remained positive during the whole year and accounted for USD 10.8 bln. in November alone, while over the 11 months of the year it made up USD 136.2 bln. (vs. 99.0 bln. in the respective period of 2009).

Since 18 December 2010 Russia imposed the 10% duty on copper export, and since 19 December the export duty on nickel supplies was increased from 5 to 10%. As a reminder, in the early 2009, on the request of JSC GMK Norilsk Nickel, the Government zeroed export duties on nickel and cathode copper that had earlier accounted for 5% and 10%, respectively. At the time, the national ferrous metals producers faced a dramatic decline in demand and prices on the world markets, with copper prices falling to USD 3,000-3,200/t., or 2.5 times down vs. their respective values of the early 2008. Nickel prices fell nearly 3-fold, under USD 10,000/t.

In the spring of 2009, to create its public inventories, China vehemently started shopping for raw materials, including non-ferrous metals, and the economic environment began improving shortly thereafter. That is why in December 2009 the RF Government issued a Resolution on introducing a 5% duty on export of unalloyed nickel.

A subsequent return of copper duties was expectable – Russia is one of the biggest copper producers. According to the Federal Customs Service, its 2008 copper export supplies to Far-Abroad countries accounted for 201,000 t. worth a total of USD 1.22 bln. These figures practically doubled in 2009, making up 507,200 t. and USD 2.5 bln., accordingly. The figures for the ten months 2010 are: 375,200 t. worth a total of USD 2.6 bln.

The lion's share of Russian copper production falls on the "Big Three"- that is, Norilsk Nickel, Ural Mining-Refinery Company and JSC Russian Copper Company, with Norislk Nickel exporting 75% of its copper production, thus securing a half of Russian export supplies.

The MinFin calculations suggest that thanks to the newly introduced export duties on copper, the 2011 federal budget should gross another Rb. 8.8 bln. in revenues, while another 6.5 bln. in revenues should be collected from the increased export customs duties on nickel.

With its Resolution of 29 December 2010 №1190, the RF Government ruled to retain the 2011 export duties on round timber – they will be at the level of 25% of the customs value, but no less than Euro 15/cubic meter. The duties on Russian timber supplies to Finland have recently formed one of major hurdles to Russia's accession to WTO, with EU demanding their reduction since 2004. But, as the process of accession procrastinated, Russia took a course towards development of its own wood-working industry. In February 2007, the RF Government decided on a stage-by-stage increase of export duties on unprocessed timber. Since 1 July 2007 the duties rates were increased up to 20% of the cost of supplies and further to 25%, effective as of 1 April 2008. Export duties on round timber were envisaged to reach the protection level of 80% since 1 January 2009; however, under the EU's pressure coupled with the unpreparedness of the nation's own wood-working sector, in 2008 Russia set moratorium on the move and froze the duties on the level of 25% of the customs value. The moratorium was set to expire on 1 January 2011, and the duties might have reached the noted 80% level. However, at the Russia-EU summit held in early December 2010 the parties reached an agreement on extension of the term of the moratorium and a subsequent reduction of the duties upon Russia's accession to WTO. Meanwhile, the Russian side does not refuse the right to increase the duties rates since 2012, should the accession to WTO fail.

Since 1 January 2001 Russia abolished duties on crude oil supplies to Belarus, per an intergovernmental agreement on distribution of export duties, which the countries signed on 9 December 2010.

According to the document, in exchange for duty-free oil supplies Belarus shall transfer to the RF budget the whole volume of export duties on oil products exported from its territory to beyond the borders of the Customs Union, with export duties on the locally produced Belorussian oil (some 1.7 mln. t.) subject to collection to Belarus's budget.The bilateral carbohydrate agreement does not apply to Belarus's prospective oil procurements from Venezuela and other third countries, with respective duties on petroleum derivatives produced from that oil being likewise subject to collection to Belarus's budget.

This arrangement shall remain in effect for three years until the three countries design another mechanism for distribution of export customs duties. As concerns the amount of the export duty on oil products Belarus is bound to transfer to Russia's budget in 2011, the respective rate on light oil products shall account for 67% of the oil duty, while that on dark oil products shall be 46.7%.

STATE BUDGET

E.Fomina

According to tentative estimates. the federal budget deficit for 2010 amounted to 3.9 per cent of GDP against 5.3 per cent of GDP. approved in the original version of the budget law. This significant reduction in the budget deficit relative to the initial estimates was due to favorable foreign trade conditions. which contributed to outrunning revenue in the budget. At the same time the year 2010 was characterized by curbing government spending: total for the year was fulfilled 98 per cent of the annual budget plan. and in terms of cash budget execution around 17 per cent of annual expenditures were made in December. However. in view of the growing deficit in the pension system and adopted by the Russian government expenditure commitments. the budget expenditures will only increase.

Analysis of the main parameters of the expanded government budget execution in January–November 2010

According to the available statistics on the execution of the *budget* of the *expanded government* over the eleven months of 2010. the volume of the budget revenues has exceeded the level of the relevant period of 2009 by 0.6 percentage points of GDP[1]. Herewith. the expenditures in relative terms has been reduced by 2.2 p.p. of GDP. whereas in absolute terms they have grown by approximately RUR 1.170 bn. As a result. as of December 1. 2010. the budget of the expanded government has been executed with the surplus of 0.3 of GDP. whereas in the relevant period of 2009 the budget balance was negative and made 3.1 per cent of GDP (See *Table 1*).

Table 1

EXECUTION OF THE BUDGET OF ALL LEVELS IN TERMS OF REVENUE AND EXPENDITURES IN JANUARY–NOVEMBER 2009–2010

	January–November 2010		January–November 2009		Change. against GDP. p.p.
	RUR. bn	% of GDP	RUR. bn	% of GDP	
Federal budget					
Revenues	7431.7	18.1	6445.9	18.2	–0.1
Expenditures	8323.4	20.3	8178.8	23.1	–2.8
Deficit (–) /Surplus (+)	–891.7	–2.2	–1732.9	–4.9	+2.7
Consolidated budgets of the RF Subjects					
Revenues	5909.2	14.4	5267.8	14.9	–0.5
Expenditures	5484.7	13.3	5157.3	14.6	–1.3
Deficit (–) /Surplus (+)	424.5	+1.1	110.5	+0.3	+0.8
The budget of the expanded government					
Revenues	14064.9	34.2	11871.7	33.6	+0.6
Expenditures	14165.1	34.5	12995.1	36.7	–2.2
Deficit (–) /Surplus (+)	–100.2	–0.3*	–1123.5	–3.1	+2.8
For reference: GDP. bn rubles	41 103.4		35 386.8		

* A significant surplus of the budget of the expanded government as against the deficit/surplus of the federal budget and budgets of the RF Subjects can be explained by the change in procedure for crediting of funds to extra–budgetary funds. bypassing the federal budget as it was done before.

Source: The Ministry of Finance of the Russian Federation. assessments of Gaidar Institute for Economic Policy (IEP)

1 When analyzing the volume of revenues to the budget of the country one should consider revenue from investment income from funds management of oil and gas assets in 2009–2010 in the amount of 275.2 billion rubles. and 134 billion rubles. respectively.

Growth in revenues of expanded government budget in relative terms against the negative dynamics of growth in federal budget revenues was due to changes. introduced since 2010 in the order of crediting premiums to non–budgetary funds. by redistributing funds directly into the budget. bypassing the federal budget.

Consolidated budget of the Subjects of the Russian Federation over January–November of the current year was also executed with a surplus of 1 per cent of GDP against 0.3 per cent of GDP over the same period of 2009. Herewith. the amount of expenditure for the 11 months of 2010 decreased by 1.3 p.p. of GDP. while revenues of budgets of the Federal Subjects have decreased in relative terms by 0.5 per cent of GDP as compared with 2009. However. the share of donation from the federal government in the total regional income still remains high – about 20 per cent of all revenue of the RF Subjects.

In 2011 and in subsequent years. regional authorities should be prepared to tighten fiscal conditions in order to restore balance in the budget system of the country and reducing the federal budget deficit. to which the financial assistance is addressed to the lower levels of budgets.

Therefore. in the medium term budget policy in the sphere of intergovernmental relations will focus on: adjusting mechanisms to provide financial support to regions in order to enhance its effectiveness. creating incentives to increase own revenue base of the RF Subjects; improved delineation of expenditure commitments of state and local governments[1].

Exploring the structure of the formation of expanded government revenues (*Table 2*) it may be noted that their volume largely depends on revenues from profit tax. tax on mineral extraction (MET) and the value added tax (VAT). as well as contributions to mandatory pension insurance. Herewith. the dynamics of budget revenues in January–November of 2010 was largely based on revenue from foreign trade.

Revenue from *mineral extraction tax (MET) and income from foreign economic activity* over the 11 months of 2010 increased by 0.4 percentage points of GDP for each of those taxes. The grounds for high tax collection level were provided by the growth of global oil prices against the relevant period of 2009 (USD 75.9 per barrel against USD 56.7 per barrel). The positive effect of growth of global energy prices has been backed up by increase in the physical volume of production and export of hydrocarbons (average price of crude oil Urals from January to November reached 77.2 dollars per barrel. or 1.3 times higher than in the last year; in November compared with October 2010 price for Urals oil grew by 3.5 per cent to 84.4 dollars per barrel due to the heating season and the onset of cold weather in Europe)[2].

Growth in world energy prices in 2010 contributed to the sustainable increase in export duties on crude oil and petroleum products. except for their slight decline in July and October 2010. however. reduction of the duties paid in those periods did not lead to a marked reduction in revenue of the expanded government budget in January–November 2010.

Table 2

THE DYNAMICS OF THE LEVEL OF THE TAX BURDEN AND REVENUES FROM THE MAIN TAXES TO THE BUDGET OF THE EXPANDED GOVERNMENT OF THE RUSSIAN FEDERATION IN JANUARY–NOVEMBER 2009 AND 2010. % OF THE GDP

	11 months of 2010	11 months of 2009	Change. percentage points of the GDP
Level of tax burden (1+2+3)	31.4	30.1	+1.3
Revenues from taxes (1). including:	19.6	20.3	–0.7
Corporate profits tax	3.9	3.2	+0.7
Individual income tax	3.7	4.1	–0.4
Single social tax*	0**	2.0	–
VAT	5.4	5.3	+0.1
Excise duties	1.0	0.9	+0.1

1 http://bujet.ru/article/107963.php

2 Report of the Ministry of Economic Development of Russia "On the current economic situation of the Russian Federation in January–November 2010".

Table 2, cont'd

	11 months of 2010	11 months of 2009	Change. percentage points of the GDP
Severance tax	3.1	2.7	+0.4
Insurance contributions for mandatory pension insurance (2)	4.9	3.3	+1.6
Revenues from foreign economic activity (3)	6.9	6.5	+0.4

*without taking into account insurance contributions for mandatory pension insurance.
** Starting from 2010. the single social tax has been transformed into insurance contributions which are credited to extra–budgetary funds.
Source: The Ministry of Finance of the Russian Federation and Rosstat; Gaidar Institute assessments.

In January 2011 the rate of export duty continued to grow and amounted to 317.5 dollars per ton against its December value of 2010 (303.8 dollars per ton). Export duty on crude oil from 22 fields in East Siberia and the two fields in the Northern Caspian Sea has risen from January 1. 2011 to 117.5 dollars per ton to 108 dollars per ton in December 2010. export duties on light oil products from January 1. 2011. increased from 217 dollars per ton to 226.2 dollars per ton. while heavy oil – from 116.9 dollars per ton to 121.9 dollars per ton. A further increase in export tariff rates will contribute to the replenishment of the revenue component of the budget[1].

Following a tangible increase of oil and gas revenues. both in absolute and relative terms. other than oil industries also demonstrate a trend of revenue growth (*Table 2*).

The share of revenue from *corporate profit tax* in the expanded government budget within eleven months of 2010 has increased by 0.7 percentage points of GDP as compared with the relevant period of preceding year. Over January–March 2010 the dynamics of revenue from that tax was less than the indicator of the relevant period of 2009. but in April the trend has changed. Most likely. this dynamic has developed under the influence of the relative improvement of the RF general economic background. Thus. for 11 months of 2010 the real sector has received the financial result of 5.5435 trillion rubles. which is 50 per cent higher than its value for the corresponding period in 2009. whereas the share profitable organizations in the total number of organizations in comparison with the period of 2009 increased by 3.4 percentage points and amounted to about 70.3 per cent[2].

The volume of revenue from the *VAT* in the eleven months of 2010 amounted to 5.4 per cent of GDP. which is by 01. p.p. higher that in the relevant period of 2009. This dynamics is associated with improvement of tax administration and the gradual revival of business activity of economic agents. However. despite the stability of VAT collection indicators in relative terms. it should be noted that in absolute terms its indicator is somewhat lower than in pre–crisis indicator of 2008.

In January–November of 2010 there was a sustained increase in *excise tax* revenue to the budget of expanded government. The increase in revenue was 0.1 percentage points of GDP as compared with the indicator of 2009. The reason for this growth was the rapid increase in tax rates on a number of excisable goods from 2010.

In general it can be noted that the level of the *tax burden* on the economy in 11 months in 2010 has increased by 1.3 percentage points of GDP as compared with the same period in 2009 and reached 31.4 per cent of GDP. To a large extent the increase of this indicator is due to the influence of external factors. In the long run we should expect some increase in the tax burden. which is necessary to reduce the budget deficit in view of impossibility to reduce government liabilities during pre–election period. In particular. since 2011. the rates of contributions to the extrabudgetary funds are increased (total increase in rates was 8 per cent). In addition. there was increased a number of excise rates. Also increase affected MET and the rates of export customs duties on certain types of raw materials. At the same time rates of the main types of taxes. presumably. will not grow.

It should be noted that an increasing tax burden may negatively affect the recovery of economic growth and investment into the country. In order to offset the growth rates of certain types of taxes

1 http://top.rbc.ru/finances/15/12/2010/515391.shtml
2 According to the Federal State Statistics Service "On the financial performance of organizations in January–November 2010 "

and levies. it is expected to expand the list of tax benefits for certain categories of taxpayers. In general. it is expected that in future tax system will become neutral by reducing the total number of benefits.

It may be noted that throughout 2005–2010. the amount of benefits has been growing with the greatest amount of benefits provided by the federal budget. Using different kinds of tax benefits leads to the loss of a significant amount of budget revenues – in 2009 this sum amounted to about 2.7 trillion rubles (about 7 per cent of GDP)[1]. This amount could be credited to the budget system and reduce the deficit.

Against the background of growing revenue of the budget of expanded government within eleven months of 2010. relative level of expenditures demonstrated an explicit reduction. Budget expenditures decreased by 2.2 percentage points of GDP (*Table 3*).

Table 3

EXECUTION OF THE BUDGET OF THE EXPANDED GOVERNMENT IN TERMS OF EXPENDITURES IN JANUARY–NOVEMBER 2009 AND 2010. % OF THE GDP

	January–November 2010		January–November 2009		Change. percentage points of the GDP
	RUR bn	p.p. of GDP	RUR bn	p.p. of GDP	
Total budget expenditures	14165.1	34.5	12995.1	36.7	–2.2
Among them					
Federal issues	1191.7	2.9	1072.5	3.0	–0.1
Including expenditures associated with the servicing of federal and municipal debt	241.7	0.59	211.0	0.60	–0.01
National defense	952.0	2.3	923.1	2.6	–0.3
National defense and law enforcement	1096.1	2.7	1052.4	3.0	–0.3
National Economy	1710.2	4.2	2161.1	6.1	–1.9
Housing and public utilities	840.9	2.1	782.5	2.2	–0.1
Environmental protection	22.2	0.05	23.4	0.07	–0.02
Education	1549.7	3.8	1470.9	4.2	–0.4
Culture. cinematography and mass media	287.9	0.7	268.0	0.8	–0.1
Health care and sports	1395.1	3.4	1368.4	3.9	–0.5
Social policy	5119.2	12.5	3871.4	10.9	+1.6

Source: RF Treasury. Gaidar Institute estimates.

In varying degrees of reduction in relative terms. nearly all budget lines of expanded government were reduced. excluding "Social policy", the growth of which reached 1.6 per cent of GDP as compared with the same value in 2009.

The worst decline in public expenditures in relative terms was based on the reduced funding for «National Economy» budget line – by 1.9 percentage points of GDP, for «Health Care and Sports» and «Education" – by 0.4 – 0.5 percentage points of GDP. In addition. lower rates in spending are noted in the direction of «Federal issues». "National defense" and "National Security and Law Enforcement" – by 0.1 – 0.3 percentage points of GDP lower than in the corresponding period of 2009 for each of those areas.

RF federal budget execution within January–December 2010

According to the tentative estimates of the RF Ministry of Finance of the federal budget execution in 2010. *budget revenues* amounted to 18.2 per cent of GDP. which is by 0.6 percentage points of GDP lower than the indicator of the relevant period of 2009 (*See Table 4*). In absolute terms. the growth of federal budget revenues during the period under review mounted to 962 bn rubles. The key sources of revenue were increased proceeds of fuel and energy complex as a result of sustained relatively favorable market prices and demand for the Russian exports. as well as the resumption of the physical volume of production of hydrocarbons. as well as general improvement

1 http://www.keycomments.ru/news/450861/

of the economic background. To the factors that caused the slowdown in revenue growth one can attribute the transformation of the UST. as well as lower revenues from investments of oil funds allocation.

Tentative assessments of federal budget expenditures in 2010 demonstrate significant decrease – by 2.6 percentage points of GDP against the level of the corresponding period of 2009. at their nominal growth rate by about 460 billion rubles.

As a result. according to tentative assessments. the federal budget was executed with a deficit of 3.9 per cent of GDP against 5.9 per cent of GDP in 2009. However. according to tentative assessments. the amount of non–oil deficit has decreased by 1.2 p.p. of GDP as compared with the indicator of the preceding year and reached 12.3 p.p. of GDP. Such a large amount of non–oil deficit shows again a significant scope of the accepted state obligations not secured by non–oil budget revenue.

Table 4

BASIC INDICATORS OF THE RF FEDERAL BUDGET IN JANUARY–DECEMBER 2009–2010

	January–December 2010		January–December 2009		Budget execution in % versus 2010 year estimates	Change	
	RUR. bn	% GDP	RUR. bn	% GDP		RUR. bn	% of GDP
Revenues. including:	8298.9	18.2	7336.8	18.8	105.4	+962.1	–0.6
Oil and gas	3830.6	8.4	2984.0	7.6	102.5	+846.6	+0.8
Contributions to the Reserve Fund and National Welfare Fund (Stabilization Fund)	26.5	0.1	770.3*	2.0	–	–743.8	–1.9
Revenues. including:	10094.1	22.1	9636.8	24.7	98.4	+457.3	–2.6
Interest expenditures	194.8	0.43	176.2	0.45	88.6	+18.6	–0.02
Non–interest expenditures	9899.2	21.7	9460.6	24.2	98.6	+438.6	–2.5
Deficit / Surplus of the federal budget	–1795.2	–3.9	–2300.1	–5.9	75.4	+504.9	+2.0
Non–oil deficit	–5625.8	–12.3	–5284.0	–13.5	91.9	+341.8	+1.2
GDP estimates	45 722.0		39 063.6				

* Including investment income of funds for 2009

Source: RF Ministry of Finance (tentative assessments). Gaidar Institute estimates

The key source of funding for the federal budget deficit financing remains the Reserve Fund (*Table 5*). According to preliminary estimates. in 2010 there wasspent about 1 trillion rubles from the Reserve Fund. At the same time. in early 2010. it was assumed that the expenditures of the Reserve Fund will reach 1.5 trillion rubles. A part of the money saved will be directed at reducing the federal budget deficit in 2011. The total amount of reserve fund planned to finance the federal budget deficit in 2011 is 285 billion rubles.

Table 5

DYNAMICS OF FEDERAL BUDGET OIL AND GAS REVENUE AND EXPENDITURE WITHIN JANUARY–DECEMBER 2009 – 2010. RUR BN.

Indicators	Balance as of late 2009	Estimated for 2010 budget	Revenue within January – December 2010	Utilized over January–December 2010		Balance as of January 1. 2011
				Support of the federal budget balance	Support to oil and gas transfer	
Oil and gas revenue of the federal budget	X	3737.2	3830.6			x
Areas of oil and gas revenues expenditure:	X	x				x

Table 5, cont'd

Indicators	Balance as of late 2009	Estimated for 2010 budget	Revenue within January – December 2010	Utilized over January–December 2010		Balance as of January 1. 2011
				Support of the federal budget balance	Support to oil and gas transfer	
• Oil and gas transfers	X	2531.1	3830.6			
• Reserve Fund	1 830.5	5147.5	0	994.0	0	775.2
• National Welfare Fund	2 769.0	x	26.5	2.5	–	2695.5
Total	4599.5	x	3857.1	996.5	0	3470.7

* balances are calculated at the rate of January 1. 2011
Source: Federal Treasury

The greater amount of the deficit will be funded through government borrowing and the funds received from privatization of federal property. It is assumed that the privatization program will replenish the budget by 900 billion rubles in 2011–2013.

As of Jnuary 1. 2011 the volume of the National Welfare Fund (NWF) has reduced to 2695.5 billion rubles. and this reduction was due to exchange rate fluctuations during the reporting period.

Table 6 shows the dynamics of the cash execution of the federal budget for the eleven months of the current year. according to the functional classification of budget expenditures. It should be noted that in general the dynamics of federal budget expenditures over January–November 2010 is less (by 1.4 per cent) against the rate of the cash budget execution for the relevant period of 2009.

The utmost decelerated rates are noted in the funds expenditures under the line of "Healthcare and Sports" and "National Economy" – by 6.7 and 4.6 per cent respectively lower than in 11 months of 2009. It should be noted that exercised in the previous months of 2010 in excess of the last year dynamics for "Intergovernmental transfers". is reduced as of 11 months results versus the rates of 2009 by 36 percentage points. Financing of the "enforcement" budget line is also carried out at lower rates against the parameters of 2009 approximately by 3.0–3.7 per cent for each article.

Table 6

CASH EXECUTION OF THE FEDERAL BUDGET WITHIN JANUARY–NOVEMBER 2009–2010
(% VERSUS BUDGET ESTIMATES FOR THE YEAR)

	January–November 2010	January–November 2009
Total Budget Expenditures	81.01.4	82.4
Including		
Federal issues	74.3	70.4
Including expenditures associated with the servicing of federal and municipal debt	84.9	79.1
National defense	73.4	76.4
National defense and law enforcement	80.8	84.5
National Economy	66.9	71.5
Housing and public utilities	80.7	66.7
Environmental protection	81.2	75.3
Education	74.2	78.5
Culture. cinematography and mass media	80.6	82.8
Health care and sports	67.2	73.9
Social policy	82.9	79.8
Interbudgetary transfers	91.1	94.7

Source: RF Ministry of Finance. Gaidar Institute estimates.

However. contrary to the general trend of a slowdown in spending pf the federal budget. there was observed an acceleration in some budget lines funding. Among the articles of the functional classification. accelerated transfer of funds to recipients may be noted in expenditures for “Housing and public utilities”. “Environmental Protection” and “Federal issues”.

Tentative results of budget execution for 2010 indicate that the approved by the budget law limits of funds for 2010 are used by 98 per cent. In addition. approximately 17 per cent of them were transferred to performers only in December 2010. which demonstrates irregularity of budget funds within the year. The right to use unspent funds will not be transferred tor 2011. excluding the assets related to the activities of the Investment Fund and Road Fund[1].

1 http://www.openbudget.ru/video/index.php?ELEMENT_ID=3371

RUSSIAN BANKING SECTOR

S.Borisov

In November 2010, the banking sector's assets grew by 2. 4%. The increase was fueled chiefly by the volume of interbanking lending and loans to the real sector. The structure of the banking sector's investments is still dominated by investments to the RF bonds, corporate bonds, and the CBR's papers. The proportion of investment to the RF Subjects' bonds has surged substantially since the early 2010. The share of idle assets remained steadily at the level of 8.3%. The banking sector's profits rose by Rb. 56 bln. in November.

Table 1

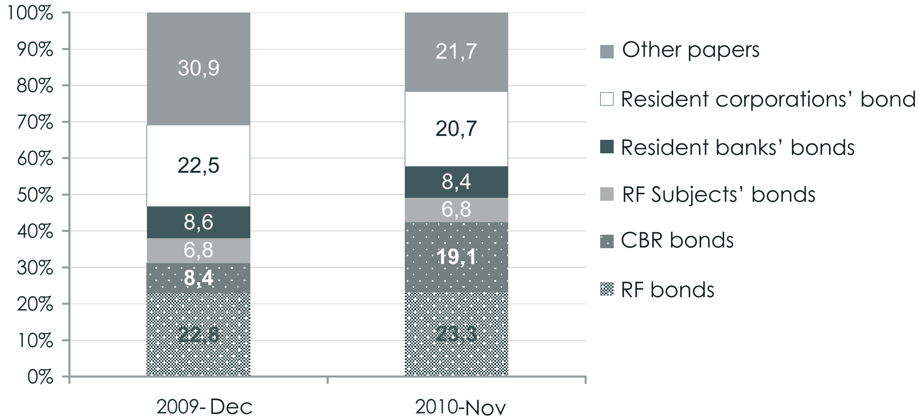
MAIN INDICATORS OF RUSSIAN BANKING SYSTEM. AS RB. BLN.

	As of 01.12.2009. Rb. Bln..	As of 01.01.2010. Rb. Bln.	As of 01.12.2010		
			Nominal	Growth since the start of the year. as %	Year-on-year growth. as %
Assets	28 691.9	29 430.0	32 671.8	11.0%	13.9%
Loans to non-financial organizations	12 697.8	12 541.7	13 904.0	10.9%	9.5%
Loans to private individuals	3 586.2	3 573.8	3 997.7	11.9%	11.5%
Loans to banks	2 823.0	2 725.9	3 283.4	20.5%	16.3%
Investments in bonds	3 121.6	3 379.1	4 516.7	33.7%	44.7%
Deposits with the CBR	1 238.6	1 423.1	362.9	–74.5%	–70,7%
Banks' deposits	3 262.3	3 117.3	3 685.6	18.2%	13.0%
Corporate deposits	5 227,3	5 466.6	5 620.0	2.8%	7.5%
Private deposits	6 998,8	7 485.0	9 250.4	23.6%	32.2%
Impairment	1 959,9	2 050.6	2 279.7	11.2%	16.3%
Profit (in the respective year)	96,4	205.1	495.3		413.8%

Source: the Bank of Russia.

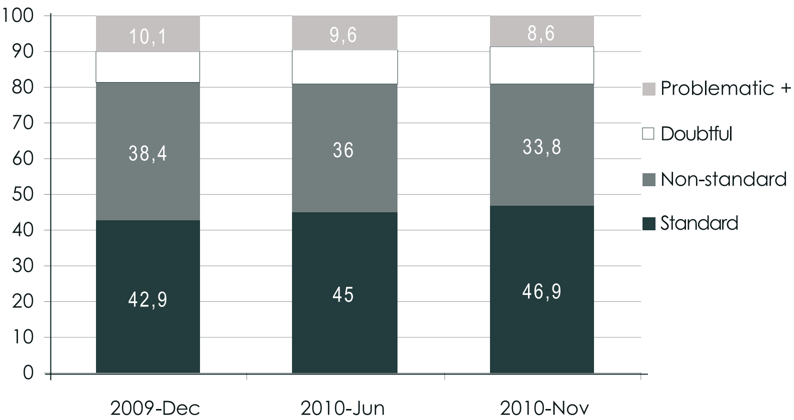
In November, the Russian banking sector's assets increased by Rb. 765 bln. The main factors propelling the growth in the balance-sheet total were increase in loans banks extended to other credit organizations (up by 11% over the month, or by Rb. 328 bln.) and loans to non-financial organizations (up by 1.6% over the month, or by Rb. 213 bln.). Interestingly, since the beginning of the year the proportion of idle banking assets (cash, fixed capital, use of profits, other assets) has remained stable and even slid from 8.6% in the aggregate volume of assets as of 1 January 2010 to 8.3% as of 1 December 2010. The trend to banks boosting investments to the corporate and government papers was still there. In our reviews, we repetitiously referenced to a substantial increase in the volume of the banking sector's investment in the bonds: as of 1 December the growth rate made up already 33.7% compared with the beginning of the year (for reference: the corporate credit portfolio posted a 11% growth over the 11 months of the year). During the period in question, the structure of investments in the bonds underwent certain changes: the proportion of investments in T-bonds rose from 8.4% in the beginning of the year to 19.1% as 1 December, while the proportion of investments in the CBR's bonds climbed up from 8.4% to 23.3%, and the proportion of investments in corporate bonds plummeted from 22.5% to 20.7% (*Graph 1*). In search for a guaranteed risky-free income, the banking sector vigorously invests free liquidity in government papers, while, being a more liquid and less risky instrument, investments to corporate bonds often form a substitute for loans.

The growth in the credit portfolio in tandem with a gradual improvement of its quality continues exerting a positive influence on values of key indicators of the national banking system's turnaround. More specifically, the proportion of delinquencies in loans to non-financial organizations in November slid by 0.3 p. p. and fixed at the level of 5.6% (vs. 6.1% as of 1 January 2010). As for loans to private individuals, the situation with the quality of the credit portfolio has remained stable for several straight months: in November, the proportion of arrears plunged by 0.1 p.p., while overall since the beginning of the year the arrears increased 0.7 p.p. (6.8% as of 1 January 2010, 7.3% as of 1 December). According to the CBR, in November the share of standard loans (the 1st category of quality) in the credit portfolio held by the Top 30 largest banks surged by 1.3 p.p., while the share of problematic and bad debts (the 4th and 5th categories of quality) sank 0.4 p.p. Meanwhile, the proportion of non-standard loans shrank consistently (-1.2 p.p.), while the share of doubtful loans rose by 0.3 p.p. This fact is an indirect proof to a recent re-classification of a part of the largest banks' credit portfolio, which is associated with improvement of their' borrowers financial standing (*Graph 2*).



Source: Bank of Russia

Graph 1. Structure of Banks' Investments in Bonds, as %



Source: Bank of Russia

Graph 2. Dynamics of Loans By Categories of Quality in the Credit Portfolio of Top 30 Largest Banks, as %.

As for liabilities, the main factor propelling the November growth of the balance-sheet total became an unprecedented rise of balances on legal entities' current accounts, which accounted for Rb. 376.5 bln., or19.6% over the month. The rise can be ascribed chiefly to corporations concentrating their funds on banking accounts prior to the upcoming payments of annual staff bonuses and compensations and the traditional December increase in administrative and economic costs. Private individuals' deposits surged by Rb. 170 bln. in November, while the banking sector once again posted growth in profits in November. According to the CBR, in November banks grossed Rb. 56 bln., while the aggregate accumulated profit already hit Rb. 495.3 bln., or four times the 2009 figure. The main factors fueling the banks' profits remain cutting rates of growth in expenses on formation of additional loan loss provisions, coupled with a surging accrued income. In November, the volume of the national banking sector's capital increased by Rb. 32.1 bln. and made up Rb. 4,613.1 bln. The share of profit in the banking sector's capital rose by 1 p.p. in November, while the H1 rate dropped slightly from 18.4% to 18.2%.

Below, we cite the most significant developments in the banking sector between December 2010 and January 2011.

• Since 1 January 2011 the Bank of Russia has lost the right to cap deposit rates. The regulator had had been deprived of this right several years ago, but regained it during the crisis, albeit as a temporary measure effective through the end of 2010.

• In pursuance of consolidation of its Russian assets, Rosbank, one of the Top 30 Russian banks and subsidiary to Societe Generale, acquired the 100% stake in Delta Credit and Rusfinans Bank.

• The CBR proposes to increase requirements to minimum capital for Russian banks up to Rb. 300 mln. since 2015.

• The sale of the Bank of Moscow has become a hot potato in December 2010 - January 2011. VTB, previously the unrivaled buyer, has now been challenged by Alfa-Bank , which is keen ready to acquire a controlling stake in the Bank of Moscow.

MORTGAGE IN RF

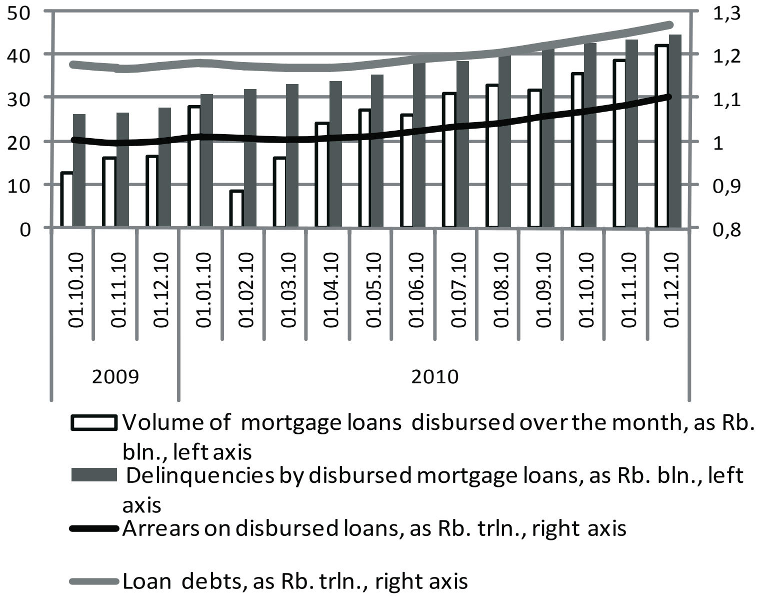
G.Zadonsky

The volume of mortgage loans disbursed over the 11 months of 2010 accounted for Rb. 315.1 bln. and exceeded 2.5 times the respective 2009 volume. As of 1 December 2012, the average weighted rate of Rb.-denominated mortgage loans plummeted to 12.6%. The proportion of delinquencies continues to grow against residual debt.

According to the CBR, as of 1 December 2010, Russian banks disbursed as many as 252,072 mortgage loans worth a total of Rb. 315.1 bln., with delinquencies accounting for Rb. 1, 105.02 bln. As of 1 December 2009, the amount of disbursed mortgages was 2.53 times less than the above figure . The volume of disbursed housing loans as of the same date was Rb. 364.3 bln., or 333,158 loans, with delinquencies standing at Rb. 1, 270.8 bln. The month of November 2010 (*Graph 1*) saw disbursement of mortgage loans worth a total of Rb. 42,25 bln., or up by 8.87% vs. the prior month's figures. Mortgage loan delinquencies grew by 2.89% on a month-on-month basis in November and accounted for Rb. 44.68 bln. Meanwhile, the proportion of delinquencies in residual debt by mortgage loans soared by 0.02 p.p. in November both across both Rb.- and forex- denominated loans and accounted for 2.84% of the residual debt by Rb.-denominated loans and 9.98% of the respective debt by forex-denominated loans.

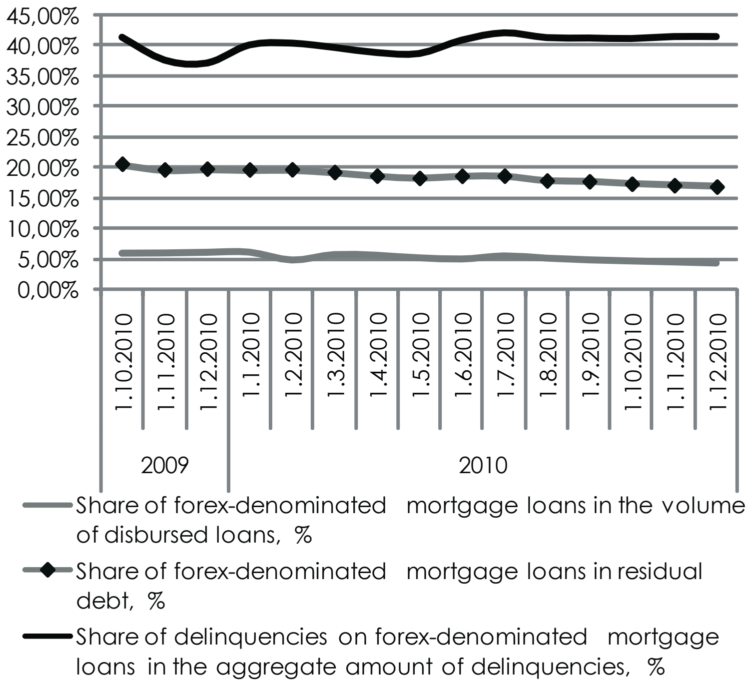
According to the CBR, in November 2010 the proportion of debt by mortgage loans less overdue payments in the aggregate amount of the mortgage-related debt was down by 0.42 p.p. and accounted for 86.29%. The proportion of debt by defaulted loans (with overdue payments over 180 days) in the overall amount of mortgage-related arrears slid by 0.07 p.p. and made up 5.65%.

The proportion of forex-denominated housing loans in the volume of loans disbursed in November 2010 was 4.38%. As of 1 December 2010, the proportion of such loans in the residual debt was 16.88% (*Graph 2*).



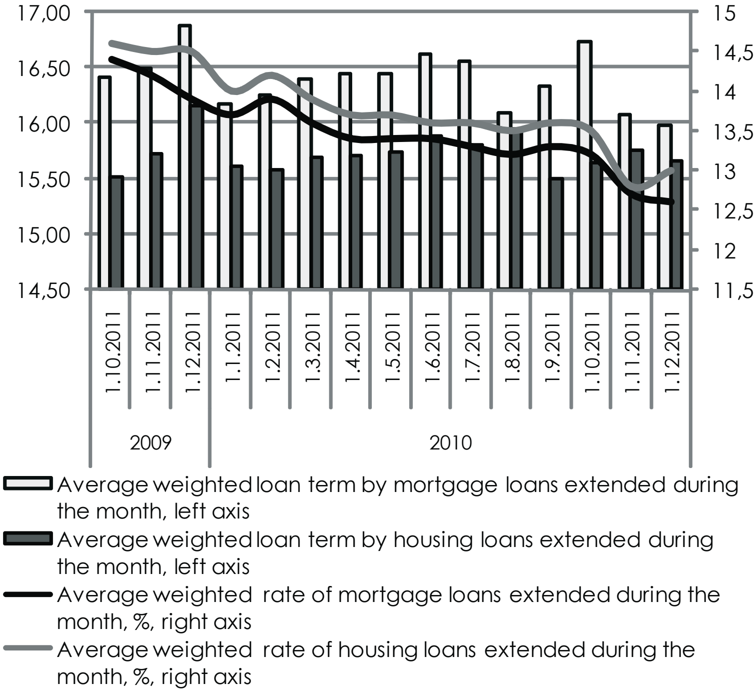
Source: CBR

Graph 1. Dynamic of Disbursement of Mortgage Loans



Source: CBR

Graph 2. Dynamic of Forex-Denominated Mortgage Loans



Source: CBR

Graph 3. Average Weighted Terms and Interest Rates on Rb.-Denominated Loans

The average weighted rate on Rb.-denominated mortgage loans extended in November 2010 was 12.6%, down by 0.1 p.p. vs. the prior month, while the one on Rb.-denominated housing loans disbursed over the same month surged by 0.2 p.p. compared with the October 2010 figures and accounted for 13.0% (*Graph 3*). The average weighted rate on loans refinanced by JSC Housing Mortgage Finance Agency (HMFA) in November 2010 rose by 0.05 p.p. up to 11.78% on a month-on-month basis.

According to Creditmart, in December 2010 the average market rate on mortgage products surged by 0.15 p.p. and hit 15.34% (vs. 15.19% in November 2010). Compared with the December 2010 figures (17.58%), the decline rate of the average market rate on Rb.-denominated loans made up 2.24 p.p.[1]. In December 2010 to October 2010 the average market rates of Rb.-denominated loan offers for house pruchases on the secondary market slid by 0.45 p.p. by their minimal value and by 0.41 p.p. by a maximal one (*Table 1*)

Table 1

AVERAGE MARKET OFFER RATES BY RB.-DENOMINATED LOANS

Credit product	October 2010		November 2010		December 2010	
	Min	Max	Min	Max	Min	Max
Loan on buying a flat on the secondary housing market	12.31%	18.40%	11.86%	17.72%	11.86%	17.99%
Target loan against real estate collaterals	15.18%	20.97%	14.92%	20.68%	14.75%	20.64%
Loan on buying housing and land on the secondary market	13.06%	19.15%	13.05%	18.75%	13.05%	19.10%

Source: Kreditmart data.

Rusipoteka's data suggest that the most affordable rates at the stage of housing construction are offered by: Sberbank (11.65-14% annualized in Rb. and 11.7-13.7% annualized in forex equivalent), Svyaz-bank (12-12.5% and 11.7-13.7%), Gazprombank (starting from 13% and from 12.5%), Delta Credit (14.75- 16.75% and 13-11%).

By the early December 2010 HMFA had refinanced 200,997 mortgages worth a total Rb. 171.1 bln. (as of the date of their refinancing). During the three quarters 2010 the Agency refinanced a total of 34,176 mortgages equivalent of Rb. 37.1 bln vs. 28,450 mortgages (Rb. 28.77 bln.) in 2009. The volume of mortgage loans refinancing commitments contracted by the Agency for the first half of 2011 accounted for Rb. 22.5 bln.

HMFA had completed the government program on restructuring sub-prime lenders' mortgage loans. All the contracts and agreements between the Agency and the lenders shall remain in effect through the term of a contract. Two years in operation, HMFA restructured 7.500 lenders' loans worth a total of Rb. 11.7 bln.

1 Calculated by Creditmart analysts on the basis of offers by 25 banks – the largest players on the national mortgage market

ON THE CONCEPT OF SUSTAINED DEVELOPMENT OF RURAL TERRITORIES

R.Yanbykh

With its Resolution of 30.11.2010 №2136-p, the RF Government adopted the Concept for sustained development of rural territories until 2020 (hereinafter referred to as the "Concept"). The Concept failed to establish assessment criteria of efficacy of development of rural areas, size and sources of funding the sustained development of rural territories, and to identify priority measures. This necessitates a broader discussion on the matter.

Adopted by the RF Government in November 2010, the Concept once again compels one to think of whether Russia has a rural development policy.

The term "rural development" has been coined recently with regard to the most advanced nations, while it had originally been used in the economic and sociological literature in respect to aid policies towards the least developed countries wherein the role and specific weight of the agrarian sector was prevalent both in formation of the national income and in utilization of main resources. The problem of rural territories' development was fairly well substantiated theoretically and had a system of developed aid measures in the frame of leading international organizations on cooperation (such as FAO, the World Bank, OECD, UNESCO, ILO, etc.). In Western Europe, the concept of rural development has been employed since the 1970s, and it has constantly evolved ever since.

It is possible to single out three most frequently debated concepts of this kind[1]:

1. Sectoral (identification of rural development solely with the general modernization of agriculture and agri-food complex);
2. Equalization concept, which links rural development solely to bridging the gap between the most depressed rural areas and those with more advanced economies;
3. Territorial concept, which identifies rural development with development of rural areas on the whole by means of employment of all the resources at hand in a given area (human, physical, natural, historical, landscape, etc) and integration of all the components and sectors at the local level.

It can be asserted with confidence that until 2000 Russia has been employing the sectoral concept. At the onset of the new decade, however, alongside the debate on the traditional matter of the rural social development there began to unfold the issue of sustained development of rural territories. So what is understood under the notion of sustained development, as far as rural areas are concerned? The 2002 Johannesburg Summit on sustained development defined sustained development through the demand "to root out poverty, change unsustainable models of production, consumption, conservation and rational use of the natural-resource base of economic and social development"[2]. The World Bank experts consider main components of a sustained rural development strategy to be "renewal of economic growth in the agrarian complex…, encouragement of private initiative in the non-agricultural sphere of the rural economy…, combat against poverty… and support of local initiatives and self-governance"[3].

The new Russian Concept defines sustained development of rural territories as "a stable socio-economic development of rural territories, increase in the volume of agricultural and fishery production, boosting efficiency of the agriculture and forestry complex, ensuring a complete employment of the rural populace and improvement of their living standards, and a rational use of land". So, once again the focus is on developing agriculture and fishery, while the rural populace's quality of life is viewed only through the prism of their employment and incomes.

1 Mantino, Francesco. Selskoye razvitiye v Evrope. Politika, instituty i deystvuyuschie litsa na mestakh s 1970-kh godo do nashikh dney, FAO, Russian transl. 2010, p. 315

2 Doklad Vsemirnoy vstrechi na vyshem urovne po ustoychivomu razvitiyu.-OON, Yokhannesburg, 2002, p.9

3 Strategiya selskogo razvitiya: region Evropy i Tsentralnoy Azii.- Vsemirny Bank, 2000

Is this approach correct? Presently, as many as 38 mln. Russians (27% of the country's total population) reside in rural areas, but just 5.1% is employed in the agrarian sector, and this share is to shrink with advancement of new technologies and modernization of the agrarian production. In Canada, for instance, just 1.4% of the employed fulfill the mission of ensuring the nation's food safety. Meanwhile, economically developed nations also put rural development atop the list of main current priorities, having it incorporated in their economic context, sitting of their production forces, equalization of the populace's living conditions.

The authors of the Concept hold the view that rural territories, as a socio-territorial societal subsystem, exercise 6 critical nationwide functions. These are: production, demographic, labor-resource, housing, spatial-communication, and the function of social control over the territory[1].

While the three first functions appear absolutely sound, the others need to be clarified. More specifically, the housing function "is aimed at placement in rural territories of housing for citizens that have an income-generating business in an urban area, as well as at provision them with objects of the rural social and engineering infrastructure for use". The spatial-communication function should ensure "placement and servicing of roads, electricity transmission lines, water supply lines and other engineering communications, as well as creation of conditions for provision of residents of rural territories with communication services". As concerns social control over the rural territory, the task is to "render assistance to government administrative and local self-governance bodies with securing public order and safety in thinly populated territories and rural settlements, as well as with securing borderlands"[2].

Russia indeed is undergoing the rural development crisis, which manifests itself in most rural residents being impoverished and in the social desertization of rural territories.

An illustrative evidence of the above assertion are results of the typology of rural administrative districts built upon the 20o2 Russian Census[3]. Proceeding from the specific weight of children and the elderly in the age structure of the rural population, districts were classified into progressive, stationary and regressive types of demographic development. Most districts (69%) are regressive, including 53% of them facing depopulation processes. Depopulation is typical of most of the European part of Russia (and it is particularly intense in its North-Western areas) and in the southern part of Western Siberia. While in the early 1990s the natural loss of the rural population was compensated by the migration flow therein, this source has exhausted by now. The proportion of rural settlements without permanent residents in the residence structure has been on the upsurge, with the Central and North-Western economic areas having particularly numerous settlements of this kind.

Such statistics is usually used to substantiate retaining and development of the existing settlement network for the sake of maintaining social control over the territory. Meanwhile, some experts have a perspective that "conservation of the emerged settlement system in any instances equals preservation of an archaic rural economy and traditional lifestyle. Meanwhile, "points of growth" represented primarily by cities transmit innovation impulses onto territories around them, thus drawing into their orbits urban agglomerations first and, subsequently, a remote periphery… Clearly, maintenance of numerous budget institutions, an extensive road network requires sizeable budget funding, which inevitably affects the quality of services, primarily in rural areas"[4].

Having agreed that there are certain grounds for this approach, let us examine rural development costs against the general backdrop of funding the agricultural sector. Since 2008 all the budget funding administered by the RF Ministry of Agriculture is provided under the auspices of the State program on development of agriculture, regulation of markets for agricultural products, raw materials and food for 2008-2012 (the State program). The planned appropriations for the State program over the period of 2008-2010 were[5]: out of the federal budget – Rb. 296.3 bln.; out of regional budgets – Rb. 290.1 bln.; out of extrabudgetary sources – Rb. 311 bln. Rural development was among undisputable priorities (20% of all the above funding). But because of the crisis, in 2010,

1 Rasporyazheniye Pravitelstva RF on 30.11.2010 №2316-p "Ob utverzhdenii Kontseptsii ustoychivogo razvitiya selskikh territoriy Rossiyskoy Federatsii na period do 2020 goda"

2 Ibid

3 Ustoychivoye razvitiye selskikh territoriy: regionalny aspect. M.: VIAPI im. A.A. Nikonova: ERD, 2009

4 Problemy selskogo razvitiya v usloviyakh munitsipalnoy reformy v Rossii/Starodubrovskaya I., Mironova N.- M.: Gaidar Institute, 2010.-p. 116

5 In the version of Resolution №446 of 14.07.2007

the State program's funding was axed one-third vs. the 2009 figures, with rural social development programs having been sequestrated in the first place (*see Table 1*).

Table 1

CHANGE IN RESOURCES PROVISION OF THE STATE PROGRAM IN 2008–2010AS RB. BLN.

Names of measures	2008			2009			2010		
	Planned	Actual	Budget variance, %	Planned	Actual	Budget variance, %	Planned	Actual	Budget variance, %
I. Sustained development of rural territories	7335	8 138	10,9	17 913	8 965	–50,0	25 124	7 720	–69.3
II. Creation of general conditions of agriculture's functioning	9863	17 720	79,7	12 917	17 819	38.0	13 781	10 191	–26.1
III. Development of priority agrarian sub-sectors	13733	9 144	-33,4	15 412	16 443	6.7	14 110	10 585	–25.0
IV. Attainment of agriculture's financial sustainability	44004	82 642	87,8	51 284	112 270	118.9	65 622	76 623	16.8
V. Regulation of markets for agricultural products, raw materials and food	1360	640	-53,0	1 360	9 637	608.6	1 363	5 578	309.2
On support of agriculture in the frame of the State program, TOTAL	76296	118 283	55,0	100 000	165 133	65.1	120 000	110 697	–78

Source: data of the RF Ministry of Agriculture.

Formally, sustained development of rural territories has lately formed one of main national agrarian policy objectives, which is stipulated in the statute on the RF Ministry of Agriculture and in the State program. As much as Rb. 112.4 bln. was to be earmarked from the federal budget on the respective measures. It was planned that they should form the most vigorously developing element of the State program: its implementation in 2012 was envisaged to be fueled by a volume of funding 5.7 times greater than the 2007 figures.

The main measures, which should ensure sustained rural development in the frame of the State program, are:

– subsidized construction or purchase of housing by rural residents, including young specialists and families (30% - from the federal budget and 40% - from the RF Subject's budget);

– subsidized measures on development of water supply and gasification;

-other measures, as per the federal target program on social development of rural territories (development of the general education institutions network in rural areas, the one of institutions of primary medical-sanitary assistance, physical culture and sport, trade and consumer services, power and telecommunication networks).

The State program's measures aimed at development of small businesses in rural areas, including non-agrarian ones, promotion of the services sphere, etc. can be provisionally attributed to rural development, too.

The year of 2009 was to see implementation of measures on support of a complex compact house building and municipal development of rural settlements in the frame of pilot projects. As much as Rb. 847 m. was allocated for these measures. It was envisaged that the funding will be provided in the form of grants on a tender basis. But the respective appropriations were suspended in 2010, too.

In 2010, the per-capita (rural residents only) budget spending on rural development measures under the State program accounted for Rb. 203 (Euro 4.95). Is this big or small a figure? For example, in 2009 the EU countries allocated on rural development out of their agrarian budget Euro 185 mln., or 0.66 in per capita terms[1] (rural residents only). It should be noted, though, that the EU funded absolutely different directions of support (subventions to young farmers, an early

1 http://ec.europa.eu/agriculture/fin/finrep09/annexes_en.pdf

retirement program, grants to finance local communities' initiatives, etc.). It seems that in this context it is worth discussing efficacy of spending, rather than volumes of financing.

Regretfully, the adopted Concept fell short of setting assessment criteria for development of rural areas, nor it determines amounts and sources of funding of their sustained development. The Concept even failed to identify priority measures, which makes it another castrated, declarative document. The authors did not factor into regional and inter-regional peculiarities in terms of territorial development, while the differences between periphery and suburban areas within a given RF Subject often appear far greater than the ones between them and similar areas in neighbor regions[1]. From our perspective, it would be appropriate to regulate sustained development of rural territories in the frame of an individual program, like in the EU, where problems of support of competitiveness and investment in agriculture, on the one hand, and support of territories with unfavorable conditions for development paired with encouragement of local initiatives, on the other, fall under different blocs and are financed with the use of special vehicles.

That the Concept gives no answers to fundamental questions means a kick-off of a broad discussion on what future for the Russian territories we would like to see.

1 See, for example: Nefedova T.G. Proshloye, nastoyaschee i buduschee periferiynykh rayonov Nechernozemya (na primere Kostronskoy oblasti). Voprosy gosudarstvennogo i municipalnogo upravleniya. 2008. №1. Pp. 166- 183

INNOVATION RUSSIA – 2020: WHITHER EFFICIENCY?

I.Dezhina

On the last day of December 2010, the RF Ministry of Economic Development released the draft Strategy of innovation development of RF for the period to 2020. Analysis of the document evidences that it constitutes an attempt to bundle, in the context of the need in innovation–based development, objectives and measures of the educational, scientific, technological, and innovation policies. The employed approach (scenarios, stages, and set of implemented and new measures) in many ways appears reminiscent of the previous documents. The strategy is an array of develope to different degreemeasures.

The draft Strategy of innovation development of RF for the period to 2020, which the RF Ministry of Economic Development released on 31 December 2010, is yet another document in the string of concepts and strategies that outline avenues of the nation's innovation development. Its peculiarity lies in an attempt to bundle together the educational, scientific, technological, and innovation policies. Equally important is the fact that the Strategy was not designed from scratch, as the document comprises references to some provisions and results of the preceding document – that is, the Strategy of development of science and innovation in Russian Federation to 2015. While the new Strategy states that the nation has fallen behind most indicators set by the Strategy–2015, regretfully, there is no at least general analysis as to why it is occurred so – whether because of wrongly set objectives, or unduly implemented measures, or erratically picked indicators, or mistakes in calculations of values of target indicators. That said, it is worth noting that it is not the authors' fault. Rather, it is the result of the absence of both research into, and basic indicators of, a number of recently implemented scientific and innovation policy measures. The absence of the data of evaluation of results of earlier adopted government decisions makes developing a new Strategy a particularly daunting task, for such a document concerns both the direction of movement and what should be done, as well as where one should not go and what one should discontinue to do in the light of, say, the global climate change, exposed inefficiency, changing priorities, etc.

The Strategy comprises a statistical description of the status of the innovation sphere, albeit it presents bare bones without any interpretation. As well, it rests exclusively upon the official statistical data, which appears absolutely wrong, as far as a number of spheres are concerned, for not only does it fail to portray the reality, but miscolors it. A typical and already broadly known example in this regard is the level of the corporate innovation activity. All qualitative and quantitative surveys held in the past five years have been registering it at a level far greater than Rosstat's data suggested. Accordingly, the problem does not lie with a low investment activity, but in its substance and magnitude. Meanwhile the Strategy asserts that, "The structure of statistical indicators in many ways reflects objectives facingthe public administration of the industrial age and appears not quite adequate to today's challenges. A real concept of the status and trends of progress in the innovation sphere today can be drawn largely from results of surveys and polls, which are not conducted systematically atpublic organizations and private corporations' instigation". The strategy, however, failed to take stock of the survey results. Plus, as many of the latter are commissioned by federal ministries (the RF Ministry of Science and Education, the RF Ministry of Economic Development), one falls under impression the customers do not care to familiarize themselves with their outputs, so much for existence of any information exchange between the agencies concerned. Ultimately, the new Strategy is built upon the understanding of what the government has already launched, but it was not adjusted with account of good practices and causes for failures.

The document comprises three innovation strategy options, each complemented with analysis of its prospects, benefits, challenges, and risks. They are followed by the assertation that the optimal strategy option is a "combined" one. It was taken as a basis for the present Strategy, though the document contains no parameters of the "combined" option. Meanwhile, the "combined strategy option" does not imply a mechanical integration of benefits and risks of thus combined scenarios. Accordingly, there is no detailed description of the selected innovation strategy option.

Sections in the document appear very unevenly developed: the most eclectic ones is the section defining what an innovation state should look like and the section on innovation infrastructure (the latter comprises the least data on effectiveness of numerous technological infrastructure objects established with the government's participation). The section named "Efficient science" looks fairly logical, and its content is linked to main stages of the Strategy implementation, which is what all other sections lack. Throughout the document there are references, though with various degrees of specification, to practically all known instruments of encouragement of innovation activities – from public procurement and technological platforms to technical regulation to tax measures. The Strategy emphasizes the problem of selection of development priorities which should become the focal point for the government, research and business communities' joint efforts. Surprisingly, among critical directions of creation of technological platforms this section of the document embraces concepts of different order: from industry branches (airspace technologies, information technologies, nuclear energy) to specific technologies that form technology subgroups or a part of a certain direction (composition materials and even "production of LEDs"). Perhaps, the content of the Strategy was notimmune to the lobbyists' pressure, and they partially succeeded in promoting certain topics and businesses.

The Strategy identifies a number of priorities in the area of development of science.

The first priority whose implementation is already underway is a set of measures on beefing up research in universities. Meanwhile, the issue of integration of universities with other organizationswas voiced, albeit it was not accentuated, nor was it further specified. The text of the Strategy implicitly suggests that over time universities are to replace the Russian Academy of Sciences and grow into main centers of fundamental science in the country. More specifically, the authors argue that research universities, "Should emerge as a nucleus of a new integrated research–and–educational complex which provides for …implementation of a sizeable share of fundamental and applied research".

The second priority concerns the sphere of applied research and implies creation of national research centers that should borrow the pattern designed for the National Research Center "Kurchatov Institute". Provisions that emphasize the need for creation of centers of excellence (their tentative number was earlier set at the level of 5–7 centers) appeared in a whole series of previous conceptual and strategic documents, but NRC "Kurchatov Institute"has so far beenthe only center. The existing NRC has been consistently building its capacity by obtaining extra budgetary funding and incorporating into itself high–profile research institutions. Meanwhile, its operational efficiency and, accordingly, the need for replicating the model, have triggered a furious row among the research community, whosecomments,as a rule, werenot particularlyfavorable. At the same time, it is hard to understand how the NRC progresses, for there are no objective operational data, but concerns that the NRC model is a mere monopolization of specific directions of research, which is hardly to form an incentive to boost up efficiency.

Notably, the authors of the Strategy seem to realize the perils monopoly bears and are even going to combat it by supporting "as a minimum, several competing research organizations of the global scientific level within the frame of each direction with substantially overlapping areas of research". This is the most expensive way to combat monopoly.The USSR used to employ this method in itslavishlyfundedMIC–related research projects.Employing this approach today is more complex a task, and this is the very sphere to try new tender procedures and mechanisms of organization of public procurement, as per the Strategy, as well as attraction of foreign expertise, particularly for the sake of enhancing operational transparency of centers of excellence.

The third priority is cadres policy. The Strategy enumerates quite a number of measures in this regard, including a few absolutely groundbreaking ones, such as introduction of a "federal researcher" status or implementation of a pilot program on attraction specialists with the university executive management record in leading universities overseas to fill in respective positions in the federal and research universities, among others. The respective subsection comprises many right words on the necessity to link salaries to research outputs, get rid of inefficient personnel, introduce age qualification with regard to executive positions, and to create conditions to ensure the rise of young researchers. The "human resources" subsection appears the most developed one vis–a–vis other subsections.

The fourth priority is improvement of financial mechanisms, focus on priority avenues of the scientific and technological development, optimization of grantor organizations' operations. This direction is not new either – it was postulated many times, with novisible progress so far. In this context, the issue of improvement of public research foundations' performance is worth a special notice. The Strategy enumerates a whole series of intents to improve research foundations' operational activities – from traditional mantras about the need to boost their budget funding to importance of attraction of foreign experts to assess projects. However, it is this particular subsection that conveys the suggestion that the Strategy and the real life of the nation's research complex co–exist in some parallel universes, for what the Strategy outlines fully conflicts with the actual budgeting that suggests cuts in the respective funding by 2013.

So, perhaps, for the first time for a document of this kind, the section "Efficient science" conveys the government's fairly clear, though not bold, vision on the national scientific complex by 2020. The vision appears disputable and lacking substantiated reasoning. One thing is for certain, though, – that is, there will be science in the country by 2020, butwhether it is going to be efficientstill is a big question.

THE ROLE OF FREE TRADE AGREEMENTS IN RUSSIA'S CURRENT FOREIGN TRADE POLICY

A.Pakhomov, K.Muradov

In 20010, Russia drastically bolstered its activities in the area of integration processes. That primarily concerned creation of the Customs Union (including Russia, Belarus, and Kazakhstan) and the start of shaping on its basis a Single Economic Space, as well as Russia's initiative on creation a free trade zone in the CIS. In addition to its steps towards intensification of centripetal trends in the post-Soviet zone, the country announced its intent to launch negotiations on concluding free trade agreements (FTAs) with Far-Abroad countries, too.

Russia's integration in the global economy, which should bolster efficacy of the nation's contribution to the international labor division and engender greater opportunities for realization of its comparative advantages on external markets, constitutes one of Russia's major foreign economic policy objectives. The country relates attainment of this objective to its contribution to the multilateral process of regulation of economy and finance, activities in the frame of regional economic unions, and development of various forms of trade relations with individual countries or group of nations.

The decision to try such a bilateral instrument as conclusion of FTAs with Far-Abroad countries allows an assumption of the rise in 2010 of a new trend in the nation's foreign economic policy, which in the past 10-15 years was regarded as a hypothetical direction,- that is, integration into the global economy. The change of the course seems to be driven by a series of domestic and external reasons.[1]

The popularity of FTAs has not plummeted, even despite the global crisis. As of the early 2011, there were at least 205 effective bilateral agreements of this kind, albeit only 5 of them provided for creation of a customs union. Another 17 FTAs were signed, but have not come into effect as yet. Customs unions are more widespread among regional economic alliances, with no less than 10 out of 18 regional alliances being formally aimed at, as a minimum, this particular form of economic integration.

REGIONAL AND BILATERAL FREE TRADE AGREEMENTS IN INDIVIDUAL NATIONS' FOREIGN ECONOMIC TIES

Country (group of countries)	The number of signed FTAs (effective FTAs in brackets), as of January 2011	Aggregate export, as USD mln. 2009	Proportion of exports to FTA partner countries *,as %, 2009	Average-weighted import tariff, as %, 2009	
				MFT**	Inclusive of all preferences
EU	31(29)	1 588 647	27.4	3.15	2.09
Switzerland	25(21)	172 474	71.3	3.02	1.79
Norway	24(20)	117 901	87.4	2.00	1.47
Iceland	24(20)	4 057	86.7	2.60	1.09
Chile	20(18)	53 732	87.7	5.70	0.66
Singapore	20(18)	269 832	66.4	0.04	0.01
Turkey	16(15)	102 139	60.0	4.20	1.84
USA	14(11)	1 056 712	40.1	1.92	1.25

1 For a more detailed analysis of necessary and sufficient conditions of Russian Federation conducting negotiations on conclusion of free trade agreements with foreign states, see A. Pakhomov "Vozmozhnosti uchastiya Rossii v preferentsialnykh torgovykh soglasheniyakh so stranami dalnego zarubezhya"// Ekonomiko-politicheskaya situatsiya v Rossii, January 2009, pp. 67-70

Table, cont'd

Country (group of countries)	The number of signed FTAs (effective FTAs in brackets), as of January 2011	Aggregate export, as USD mln. 2009	Proportion of exports to FTA partner countries *,as %, 2009	Average-weighted import tariff, as %, 2009	
				MFT**	Inclusive of all preferences
Russia	12(12)	301 796	15.6	12.34	11.00
Japan	11(11)	580 719	16.3	3.11	2.82
Mexico	11(11)	229 712	93.2	8.84	1.69
Malaysia	10(9)	157 195	59.6	4.76	4.76
Costa-Rica	10(8)	8 711	45.2	4.33	2.51
Israel	9(9)	47 935	69.0	3.01	1.15
Thailand	9(9)	152 497	52.1	…	…
China	9(8)	1 201 647	24.0	4.56	4.22
Canada	9(6)	315 424	77.6	3.72	1.74
New Zealand	8(8)	24 933	44.7	2.51	1,93
Peru	8(7)	26 738	54.3	2.68	2.04
Australia	7(7)	153 767	19.9	5.21	4.47
Moldova	7(7)	1 288	32.3		
South Korea	7(5)	363 531	14.6	7.05	7.05
India	6(6)	176 765	20.0	6.65	6.46
MERCOSUR	5(5)	184 503	8.6	9.74	6.44
Taiwan	4(4)	203 494	0.2	2.34	2.34
Croatia	4(4)	10 492	84.9	4.49	1.25

* including regional FTAs – NAFTA, EACT, etc.

** under the most favored treatment regime (MFT), inclusive of ad-valorum equivalents of non-advalorum duties (the 2008 data are given in italics)

Source: calculated and compiled with the use of the *UN COMTRADE and World Bank World Trade Indicators 2009/2010 data bases.*

Russian leadership came to acknowledge the fact that FTAs can be an efficient vehicle for promoting trade, economic and investment relations, ensuring greater access to partners' markets, and they spoke in favor of talking stock of best practices in the area[1].

Presently, the most fundamental element of Russia's foreign trade policy is the international treaty framework of the Customs Union (CU) between Russia, Belarus, and Kazakhstan, within which the bulk of the customs tariff regulation functions was mandated to a supranational body – namely, the Commission of the Customs Union. In connection with this, devising FTAs in the conditions of application of the CU's Customs Code and the Uniform Customs Tariff first provides for evaluation of two main groups of problems.

1. Analysis of effects the conclusion of an FTA with a given state (or group of states) might have on the CU economies, including its impact on individual industrial sectors, the agrarian sector, and the one for services. In other words, this is an examination of the CU nations' competitiveness level vis-a-vis potential counterparts under a planned FTA.

2. Examination of practical effects such an FTA might have on increase in trade and investment between the CU nations and a third country (or their group), primarily from the standpoint of prospective advancement of Russia's, as well as Belarus and Kazakhstan's, economies.

Typically, such an evaluation is conducted in the frame of the respective feasibility study and comprises a detailed analysis of the background and the current state of respective trade and economic relations, and an assessment of envisaged effects from elimination of barriers.

1 See Minutes of the meeting with participation of Pres. Dmitry. Medvedev on socio-economic development of Far East and co-operation with the Asia-Pacific nations on 2 July 2010 - http://www.kremlin.ru/transcripts/8234

In parallel with that, the nations concerned are holding bilateral consultations in the format of special task forces. The purpose of such consultations is to adopt a fundamental decision on appropriateness (or vice versa) of entering into such an agreement. At this point, it should be stressed that modern agreements of this kind not only provide for a reciprocal axing of import duties but liberalization of trade with services, investment movements, as well as agreements on so-called systemic matters, too.

As a model research, suffice it to reference to the US International Trade Commission's report on effects for the US economy from an FTA with South Korea[1]. Making such research with the use of mathematical methods has proved a standard practice at the preliminary stage of crafting an agreement[2].

Of all the Far-Abroad nations Russia used to have an FTA only with Yugoslavia. The agreement was concluded, primarily due to political reasons, back in 2000. But the FTA was applied on the temporary basis and embraced a limited circle of commodities. On November 23, 2010, Geneva saw the official ceremony of the start of negotiations on free trade between the **EACT** nations (Iceland, Lichtenstein, Norway and Switzerland) and the **CU** states (Russia, Belarus, Kazakhstan)[3]. The parties signed a joint declaration on the beginning of the negotiations on a comprehensive free trade agreement between the CU states and the EACT nations[4].

In her address at the ceremony, Elvira Nabiulina, the RF Minister for Economic Development ascertained that, 'The novelty of the project of free trade with EACT for Russia manifests itself both in the comprehensive subject of the agreement and in its format. The entering of the CU between Russia, Belarus and Kazakhstan into full-fledged negotiations on free trade *per se* constitutes an important step in advancement of our fresh integration structure and its integration into the international trade and economic system"[5].

On 11-13 January 2011, the first round of the negotiations took place in Geneva. The parties considered approaches to building future sections of the Agreement: on trade with industrial and agricultural goods, sanitary and phytosanitary measures, technical barriers, protective measures in trade, customs procedures and the ones of identification of the goods' country of origin, simplification of trade procedures, and intellectual property rights. In addition, at the EACT level the parties discussed investment and public procurement movements. The next round of the negotiations is scheduled for April 2011 in Kazakhstan[6].

That said, picking EACT as a counterpart, or, even more so, as a partner in the groundbreaking Russia - Far-Abroad negotiations on FTA appears fairly questionable. On the one hand, once a 10-nation structure, EACT has been losing its key members and, subsequently, its influence on the global and even European economy, ever since. On the other hand, EACT has already concluded 10 (!) such agreements, with another 4 to come into effect soon. In addition, EACT is in negotiations with another six prospective counterparts. All the above evidences the EACT negotiation team's great practical record in the area.

While picking counterparts, EACT mostly focuses on the EU's partner network, but in some cases proves to be outrunning the EU. More specifically, EACT concluded FTAs with Canada, Ukraine and - far earlier than Ukraine- with South Korea. Meanwhile, being the most pragmatic and consistent EACT nation, Switzerland was a pioneer among developed nations to conclude an

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1 U.S. International Trade Commission. U.S.-Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects \\ Investigation No. TA-2104-24. Corrected printing, March 2010, Washington DC, 393 p.

2 Other instances which might be of special interest to Russia: India – New Zealand Joint Study for a Free Trade Agreement/Comprehensive Economic Cooperation Agreement. – http://www.mfat.govt.nz/downloads/trade-agreement/india/nz-india-joint-study-report.pdf; Trade Sustainability Impact Assessment of the Negotiations on a Free Trade Area between the EU and Ukraine: Position Paper. – http://trade.ec.europa.eu/doclib/docs/2009/may/tradoc_143165.pdf.

3 Executive update of the RF Ministry for Economic Development of 23 November 2010. - http://www.economy.gov.ru/minec/press/news/doc20101123_04.

4 The step was preceded by establishment of the joint research group (JRG), to study prospects for a closer trade and investment cooperation. The respective agreement was reached at the level of Russia and EACT nations' foreign trade/foreign affairs ministers in Moscow in December 2007. Upon completion of its work in November 2008, the JRG submitted its report with the recommendation to conclude a comprehensive FTA between Russia and the EACT nations.

5 Brief outline of the Min. E. Nabiullina's address at the ceremony of the beginning of negotiations on free trade between EACT and the Customs Union nations, Geneva, 23 November 20010 http://www.economy.gov.ru/wps/wcm/connect/e3c3718044cab7359083f5af753c8a7e/tezisi.doc?MOD=AJPERES&CACHEID=e3c3718044cab7359083f5af753c8a7e.

6 http://www.efta.int/free-trade/free-trade-news/2011-01-14-efta-rubeka-fta.aspx

FTA with Japan[1] and embarks on negotiations with China (with the respective news broken at the 2011 Davos Forum).

That said, it is worthwhile noting the existence of a fairly close integration between EACT and EU. In addition to being located in the same common European economic space and the Shengen zone, these unions are cemented by the system of trade and economic treaties, including the 1972 pioneer FTA.

Meanwhile, Russia is going to continue the dialogue with EU on signing a new Partnership and Cooperation Agreement with the Union, which potentially provides for creation of a free trade zone and even Russia's accession to the EU's united economic zone. That is why the start of the CU-EACT negotiations should be coordinated, conceptually and time-wise, with the forthcoming Russia-EU dialogue.

Consensus on negotiations on FTA between the **Customs Union and New Zealand** was reached in Moscow in May 2010 by Minister E. Nabiulina and T. Grosser, the *Aotearoa*'s Minister of Trade. In October 2010, in what became the follow-up of its work, the joint expert group submitted to the Ministers a roadmap comprising a recommendation to launch negotiations on a bilateral FTA with a prospect of covering not only trade with goods, but trade with services, investment movements, private individuals' movements, intellectual property rights, dispute resolution mechanisms, public procurements, and other matters, should the parties so wish.

As a result, at their meeting on 9 November 2010 Ministers of Trade/Foreign Affairs of the Customs Union and New Zealand, announced the beginning of negotiations in 2011 on conclusion of the bilateral FTA and even specified the desired timeline for their completion - that is, by the late 2011.[2]

As a reminder, New Zealand enjoys a stable reputation of the staunchest proponent of liberalization of global trade, and its negotiation team can boast a huge and, most importantly, successful record in this respect. As of today, the nation has already bagged 8 effective FTAs, with another 5 ones being negotiated. The kiwi nation's major achievement to date has been an AFT with China effective since 2008. New Zealand vigorously pursues negotiations of new treaties with a focus on its partners in the APR.

At this point, it should be noted that both the EACT nations and New Zealand appear relatively minor trade partners to Russia. According to Russian customs statistics, in the 2000s the EACT's proportion in Russia's commodity export was 2-4%, while in import – 1-2%. During the period in question, New Zealand's respective shares were in the region 0.1% each[3]. As concerns trade with commercial services, EACT's specific weight was slightly greater - up to 5% in export and 4% - in import[4]. Between 2004 and 2009 the share of EACT (de-facto of Switzerland) in FDI in Russia roughly averaged 2%, while in direct Russian investments to overseas – slightly over 3%[5].

From the perspective of trade statistics, Russia's place in the EACT and New Zealand's systems of foreign economic relations is practically the same. Russia's share in these partners' commodity export and import structure in the 2000s was oscillating within the range of 0-4%[6]. Between 2005 and 2009 Switzerland, as the most active investor among the group of nations in question, channeled to Russia an average of 1% of direct investment, with a faction of those FDI being repatriated Russian capital[7].

As already noted above, both New Zealand and Switzerland (the latter - as Russia's principle counterpart in EACT) fall under the category of fairly liberal economies[8]. It would be fair to note,

1 At this point, it should be noted that prior long-standing consultations at the EACT-Japan level and conduct of the respective research have ultimately resulted in a decision on inappropriateness of conclusion of an agreement in such a format.

2 The update of the RF Ministry for Economic development of 13 November 2010.- http://www.economy.gov.ru/minec/press/news/doc20101113_010

3 According to the FCS's data, in 2010, New Zealand ranked 81st in the list of Russia's trade partners by volume of goods turnover

4 The Bank of Russia: statistics of the external sector. – http://www.cbr.ru/statistics/?Prtid=svs

5 Rosstat – http://www.gks.ru/wps/wcm/connect/rosstat/rosstatsite/main/enterprise/investment/foreign/#

6 The UN Comtrade's data. Meanwhile, one needs to factor into Russian re-export from Switzerland which forms a sizeable faction of the mutual goods turnover.

7 Swiss National Bank. Swiss direct investment abroad: By country - capital outflows – http://www.snb.ch/ext/stats/fdi/pdf/en/1_1_CH_Direktinve_Kapitalexporte.pdf.

8 See: The Heritage Foundation. Index of Economic Freedom, World Rankings – http://www.heritage.org/index/Ranking.

though, that the Swiss liberal economic policy does not embrace agricultural goods, which are excluded from FTAs the nation ever entered into together with its EACT partners or solo. By contrast, being a large exporter of agricultural products, New Zealand is keen to increase their access to Russia's market.

At such a juncture the reciprocal liberalization of trade and related spheres of foreign economic activity will likely to be asymmetric – Russia will have to open substantial segments of the national market for the unrestricted competition with the said countries' goods (fishery products in particular), services and capital. In certain cases, this may become a staggering blow to Russian producers, even notwithstanding relatively small volumes of trade[1]. Meanwhile, access to the EACT and New Zealand's domestic markets has long been opened, but those are highly competitive markets and Russian economic agents will find it challenging to win a niche therein.

The agreement with New Zealand appears not just a pilot project for Russia, but the demonstration of it being serious about getting engaged in economic integration processes in APR, which became a zone of the most intense spread of good FTA-wise practices. It is the APEC participants that have been particularly active in promoting economic integration by means of FTAs. Notably, Russia is to chair the Forum in 2012.

Today, as many as 38 bilateral and one quadruple FTAs are effective within APEC, with the latter treaty (*aka* the Trans-Pacific Strategic Economic Partnership), should it ever expand, being potentially capable of forming the basis for a region-wide free trade zone[2]. Russia has de-facto remained the only APEC nation which so far has failed to create an FTA with its Forum counterparts[3].

This juncture put Russia, as the only APEC economy that has not yet joined WTO, in a somewhat ambiguous position on the eve of its chairmanship. The APEC's discussion format has been lately used vigorously to draw attention to the need for channeling the FTA expansion process in order to ensure uniform standards of conclusion of such treaties. In this context, the APEC's ultimate goal is to keep building an integrated community in the APR.

It will be impossible to dodge discussions on the issue in 2012, but Russia will find it fairly hard to lead or moderate them.

In the meantime, it is important for Russia and its fellow nations under the Customs Union to identify strategic objectives of the FTA exercise. Mass media in this case report just on "creation of favorable conditions of cooperation both in trade and in the sphere of services, investment, competition, and protection of intellectual property rights". Information partly is confidential, perhaps, as the negotiations have kicked off just lately.

Besides, a country's negotiation stand rests on the national businesses' commercial interests. From this perspective, chances for Russia to articulate an adequate stance appear pretty unlikely, as our business circles have not clearly voiced their views. That said, it can be ascertained that negotiations in the Customs Union's frame would result in lowering or abolition of import duties, simplification of customs procedures, etc., as well as liberalization of access for foreign companies to some segments of Russia's domestic market.

Judging by the national leadership's statements, Russia centers on saving FTAs as an alternative foreign economic policy vehicle, should negotiations on accession to WTO stall. It is suggested to conduct analogous negotiations with other countries, too[4]. However, the record of such nations as China and Vietnam, which engaged in the APR integration process in the 2000s through FTAs,

1 As much as 70% of largest Russian imports (value-wise – at the six-figured level of the Harmonized Commodity Description and Coding System) from New Zealand is formed by meat and dairy products. Russia's partners may gain significant benefits in the investment sphere and in a number of sectors of the services sphere which has not earlier been regulated by Russia's international obligations.

2 The TPSEP members currently are Brunei, New Zealand, Singapore, and Chile. Negotiations are under way on re-signing of the Treaty, due to the US, Australia, Peru, Vietnam, and Malaysia joining in.

3 Taiwan does not have effective agreements with the Forum nations, either, which can be ascribed to political reasons.; however, Taiwan concluded similar treaties with Latin American countries that do not hold membership in APEC.

4 More specifically, Russia has already held first rounds of negotiations with Vietnam, Syria and Algeria on the issue of foreign trade with the Customs Union, completed the respective negotiations with Serbia and nearly finished those with Montenegro. http://news.open.by/economics/39815, 4 November 2010

shows that negotiations on FTAs take place already upon the base of obligations fixed under WTO and comprise new obligations WTO+[1].

The actual coincidence in time of completion of negotiations on accession to WTO with fine-tuning of the fresh Customs Union and building a single economic zone with a series of negotiations on bilateral FTAs has mounted pressure on the Russian negotiator team, for which, in all fairness, this was the first encounter with the above challenges ever. At the end of the day, the price for gaining the much-needed negotiation skills can become assumption of a number of permanent international obligations.

It seems that success in the process of bilateral negotiations with Far-Abroad countries on liberalization of trade and other forms of foreign economic activity necessitates their strict synchronization, in time and content-wise, with the process of accession to WTO, the dialogue with EU, and integration processes in the post-Soviet space.

1 An analysis of conclusion of FTAs in the context of Russia's joining WTO will require a separate study.

THE NEW PRIVATIZATION POLICY TWIST

Yu.Simachev

In the autumn of 2010, the RF Government announced a new large–scale program of "big privatization". The ultimately approved Forecast plan of privatization of the federal property and main directions of privatization of federal property for 2011–2013 were developed with account of extension of the planned effective date of the Forecast plan of privatization, identification of a broader circle of government policy objectives in this area, and results of the federal executive bodies' current work on optimization of the structure of federal property.

In the autumn of 2010, the RF Government announced a new large–scale program of "big privatization". The distinctive marks of the program became a unique for the history of Russian privatization time horizon of 5 years (2011–2015) and an impressive magnitude (some 900 corporations and enterprises, including the largest ones).

Generally speaking, the beginning of the new stage of privatization can be associated with the previous Forecast plan (program) of privatization of federal property for 2010 and main directions of privatization of federal assets for 2011 and 2012[1].

The discussion at the government level on objectives of privatization and its necessary instruments with emphasis on structural reforming and modernization of the economy had been quite vigorous until the spring 2010. Later, since the second half of the year in particular, however, the focus was increasingly shifting towards the privatization's role in formation of additional budget revenues. That became a consequence of growing doubts regarding prospects of Russian economy's rapid post–crisis growth, increase in budget expenditures, including social ones in particular, and, as a consequence, the aggravation of the problem of budget deficit in the years to come.

The ultimate Forecast plan (program) of privatization of federal property and main directions of privatization of federal assets for 2011–13, which were approved by the RF Government's Resolution of 27 November 2010 №102–r, were designed with account of the planned effective date of the Forecast plan (program) of privatization of federal assets (from one to three years), proceeding from recent amendments to the effective Act on privatization and results of the federal executive bodies' current work on optimization of the federal property structure.

The document tags privatization as one of instruments of "*attainment of objectives of the transition towards innovation socio–oriented advancement of the economy*".

The document also sets main government policy objectives in the sphere of privatization, as follows:

– creation of conditions for attraction of extrabudgetary investments in development of joint–stock companies on the basis of new technologies;

– reduction of the public sector of the economy for the purpose of promotion and encouragement of private investors' innovational initiatives;

1 The objectives of the public policy in the sphere of privatization of federal property comprise both traditional tasks and the conduct (continuation) of structural transformations in the economy's sectors (previously, this objective was cited thrice in privatization programs – namely, in forecast plans (programs) of privatization of federal assets for 2003, 2004 and 2009), shaping integral structures in strategic sectors of the economy (this particular objective was cited in the 2009 Forecast plan (program) of privatization), and creation of conditions for attraction of extrabugetary investments for development of joint–stock companies.

As in the similar documents for 2007 and 2008, there likewise appeared a reference to the largest (backbone budget–wise) federal property objects being subject to privatization, along with an 1.5 times increase in the volume of respective budget revenues whose aggregate amount in the 2010 Forecast plan (program) of privatization was set at the level of Rb. 18 bln., vis–a–vis 12 bln. set in the similar documents for 2008 and 2009.

The list of sectors (industry branches) in the frame of which privatization is planned was extended substantially. That was coupled with a large–scale reduction of the list of backbone corporations and organizations (more specifically, at the expense of sea– and river port terminals, and airports).

– improvement of corporate governance;
– encouragement of the stock market's advancement;
– formation of integrated structures in the backbone sectors of the economy;
– formation of the federal budget revenues.

Once compared with the previous Forecast plan of privatization of federal property for 2010–12, the recently approved privatization program comprises such tasks as (1) reduction of the state–owned sector of the economy for the sake of promotion and encouragement of private investors' innovational initiatives; (2) improvement of corporate governance; (3) encouragement of the stock market's advancement.

The adopted privatization program comprises two sections.

The first section lays out the government's fundamentals and premises, and privatization plans with respect to 10 largest companies that hold leading positions in respective sectors.

The group of companies wherein the Government is going to reduce its share in their capital by selling stakes of different size over next 5 years (2011–2015) comprises Rosneft, Rusgydro, FSK, Sovkomflot, RZHD, Obyedinennaya Zernovaya Kompaniya (OZK), Rosagroleasing, as well as VTB, Sverbank, Rosselkhozbank. At this point, it should be noted that the government must retain corporate control in nearly all of the above companies, and it is going to be mostly blocking and minority stakes that will be put on the market.

Concrete timelines and means of privatization of these companies will be set at the Government's level with account of the market juncture, coordination of the sales with processes of privatization of equity of companies of the respective sectors, and leading investment consultants' recommendations.

Alongside the aforementioned largest companies that will likely to be privatized following "bespoke" patterns, other large privatization objects included in the Forecast plan became stakes in 8 companies (Apatit (Mrumansk oblast), Prosveschenie Publishers, Sibir aircompany, Arkhangel trawler fleet, Ulyanovsk automotive plant, Murmansk sear fishery terminal, Vostochy port (the city of Nakhodka), Almazny mir (Moscow).

The second section comprises the list of objects planned for privatization in a "routine" order (114 SUEs, 844 JSCs, including 35 closed–end ones, 10 Ltds, and 73 other federal property objects, including real estate, sea and river vessels) inn the same vein as it was done in the recent years.

The Forecast plan estimates the 2011–13 privatization proceeds at a maximum level of some Rb. 1 trln., with account of the market situation and providing the RF Government makes individual decisions on privatization of the largest companies with a high investment appeal. Without regard to the above, the 2001 privatization gains are estimated to make up just Rb. 6 bln, while those in 2012 and 2013 – Rb. 5 bln. in each year.

In the meantime, it is fairly difficult to discuss soundness of the pre–set landmarks with regard to a concrete amount of privatization revenues to the federal budget. At the same time, it is worth noting that it was just once (in 2003) in the whole period of economic growth that the value in question nearly hit the Rb. 100 bln. mark , while thrice (in 2003–04 and 2007) this value was in excess of the volume of aggregate revenues from privatization (sales) and use of public property (ie. with account of dividends on state–woned stakes, rental payments, etc.). Plus, as it was earlier announced, the government might channel a faction of privatization gains in the form of investment to privatized companies, albeit so far it has not been clear to what companies and under which terms.

The problem is, how to make sure public assets are not sold at give–away prices, for here lies a certain contradiction: in the times of economic downturns, the government indeed is tempted to get rid of its assets; however, adequate proceeds can be collected only under a favorable economic situation, while privatization gains are not a particular desideratum once the budget enjoys a surplus.

That is why, should the macroeconomic situation aggravate seriously (for instance, due to the a second wave of the crisis of the global recession), the implementation of the privatization program would be one big question mark. In any rate, privatization (due to the "unrenewability" of the source and once–and–forever–gone nature of respective transactions) is capable of ensuring just a temporary relief to the budget system.

The new privatization program for 2011–13 sounds very ambitiously as far as the structural component of privatization is concerned, with the declaration of it trumpeting an explicit innovation– and modernization–oriented tune in the context of the task of reducing the public sector's share.

That said, it is necessary to bear in mind that identification of landmarks in terms of the degree of government's participation both in the economy on the whole and individual sectors is by itself a non–trivial exercise, given the public sector's small specific weight, as the official statistics suggests, its presumable concentration on lower levels of "agent chains" within concrete corporations, and a formally non–government nature of property rights for public corporations' assets. As well, the fact that it is structures that had been the government's agents in implementation of anti–crisis measures during the peak of the crisis which are viewed as probable privatization objects.

As noted above, the formation and implementation of the public privatization policy has recently seen the rise of two systemic priorities – namely, "*structural*" and "*budgetary*".

The former priority focuses on the medium term, is associated with creation of conditions for advancement of privatized companies, their reforming, and a substantial reduction of the state's share in the economy.

The latter priority suggest a greater openness of privatization, attraction of a broader circle of potential buyers, including those from overseas, lowering barriers to participation in privatization, a substantial reduction of the magnitude of the "no–cash" privatization (in the form of contributing with federal assets to joint–stock companies, public corporations, other organizations' authorized capital). In the light of implementation of this priority it is not that important to what degree the government really eases its control over large corporations (at least, in the short run) and whether they really receive investment resources for their development.

While appealing on the surface, implementation of the "structural" priority can see substantial risks as its concomitant, including, in particular:

– Expansion of conditions for an "bespoke" approach to privatization of large state property objects, particularly due to the nascence of respective legislative procedures[1];

– Imposition of substantial formal and informal restrictions on "outsider" investors' participation, creation of preferences for individual buyers[2];

– Retaining the governmental participation in managing large, formally private companies[3] and, as a consequence, yet a greater opacity of government's interests with respect to them, the rise of yet a greater number of preconditions for substitution of public interests with narrowly specialized (whether departmental, or private) ones;

– Giving boost to public and quasi–public structures in the course of privatization on the basis of such a method of privatization as contribution with state–owned assets into open–end joint–stock companies' authorized capital;

– New owners and managers restricting attraction of private resources, narrowing the "horizon of planning", indirect use of budget funds and state–owned banks' capital, including the funds earmarked in the course of implementation of anti–crisis measures[4];

– Competition between government agencies with respect to different approaches to privatization and broader conditions for a "shadow" fight of interests.

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1 We reference, first and foremost, to the most disputable and ambiguous novelty that appeared in the Act on privatization in May 2010. It enables the RF Government to make respective decisions with regard to federal property in pursuance of creation of conditions for attraction of investments, encouragement of the stock market's development, as well as the economy's modernization and technological advancement beyond the framework of the "standard" procedures set forth by the Act on privatization

2 This may rest upon the aforementioned provision the framework of whose effect appears unconstrained, due to a very broad formulation. We can so far just assume a possibility for direct sales of state–owned stakes to already existing shareholders in these or those companies.

3 In the event of discontinuation of the state's participation in large companies' (including infrastructural ones) capital, the lack of the legislative regulation of their operational peculiarities will be inevitably replaced by government representatives' interference in economic decisions, while the companies themselves will be perceived of as being in need for an undisputable government's relief and continuous guardianship.

4 A fairly serious matter is the format of participation in privatization of corporations and banks that have become recipients of the government anti–crisis financial relief. In this context, there inevitably arises the question about the target nature of use of those funds, which, as it can be easily assumed, might spark a serious negative resonance in the society with all quite predictable consequences that might affect Russia's business image, the socio–political backdrop and investment climate in the country, like the 1990s privatization processes did.

It is the absence of long–term and transparent rules of the game in the interaction between the government and businesses that will form the most significant hurdle to a successful implementation of the structural approach. Meanwhile, the "budgetary" approach appears more balanced in terms of the short run benefits and risks. Emergence of real prerequisites for solidification of the structural focus of privatization is possible only in the medium term, given substantial progress in shaping the institutional environment has been secured. This requires development and implementation of a set of measures that embrace a broader spectrum of issues, including corporate governance, regulation of foreign investment in the backbone sectors, limiting the public sector's expansion on the basis of corporations subject to retaining under the government's ownership, improvement of the quality of regulation of operations of economic agents of all property forms in the frame of specific sectors, if so provided for by the law with regard to respective spheres of activity.

Meanwhile, one needs to acknowledge a poor transparency of processes of shaping the public policy in the privatization sphere. As far as individual large companies are concerned, the interdepartmental struggle was, and still is, underway with regard to timelines and magnitude of their privatization. Notwithstanding the articulated principle of openness of privatization at all the stages, the discussion processes on the list of large corporations scheduled for privatization and means of their privatization have remained loosely transparent, while the government does not care to sufficiently and/or often officially reinforce decisions made in this regard.

Meanwhile, due attention is not paid to analysis of appropriateness of privatization, comparable economic and allocation–wise efficacy of the public and private sectors. This engenders additional risks in the case of privatization of large corporations that enjoy a power sufficient to dictate the situation on the market and boost own yields by abusing their position. For the sake of lowering the risks of latent lobbying of various decisions, it is critical to ensure a greater openness of the ministries and agencies' stance on these matters, while ultimate decisions should be reinforced in a fairly detailed and public manner.

Alongside a vigorous push for processes of privatization of public property, it is critical to continue undertaking consistent efforts on improvement of corporate governance in companies with government participation. There exists a persistent need for further engagement of independent directors in processes of managing corporations with state participation, articulation of requirements to such directors, identification of strategic objectives and main target operational benchmarks for key public corporations, and a substantial normative promotion of such a means of privatization as sales of stock by results of trust.

EU EXPERIENCE IN MUTUAL ASSISTANCE IN THE RECOVERY OF TAX CLAIMS

E.Velikova

In 2010, a new EU Directive was adopted concerning mutual assistance in claims enforcement in respect of taxes, duties and other measures. This directive specifies the number of effective and newly introduced supplementary provisions on mutual assistance between EU member states tax arrears enforced collection, in particular the execution of requests for information and recovery of tax claims. These changes are appropriate for inclusion in the relevant international agreements of the Russian Federation, especially with Kazakhstan and Belarus due to the closer cooperation of these countries not only within the CIS, but also the integration of such entities in the Customs Union (CU) and the Common Economic Space (CES) .

Enforced collection of tax arrears from foreign legal entities, as well as the execution of requests for recovery of tax arrears, coming from abroad, with respect to Russian taxpayers is significantly difficult in Russia.

In the first place, according to the Federal Tax Service, this is due to the lack of specific implementation mechanisms of interaction on the subject between the competent authorities of the Russian Federation and foreign countries. In the EU over the past few years there observed a significant increase in the amounts levied on the tax requirements of foreign authorities, the mechanism for enforcement is continuously developing, which makes the experience of the EU, a strategic economic partner of Russia, useful for the RF in improving the mechanism for tax arrears collection enforcement from foreign debtors.

EU member countries provide mutual assistance in collection enforcement in regard to a wide range of taxes, fees and charges, and the scope of collections is constantly increasing. In 2007, there was collected almost 5 times more in taxes than in 2003, and in 2008 that amount was already more than 6 times[1]. The first legislative initiative in enforced collection became EES Council Directive 76/308 of March 15, 1976, related to the mutual assistance between the countries in enforced collection of customs duties and certain kinds of agricultural levies[2]. Later on, the list of taxes, fees and charges in respect of which mutual assistance was provided in collection enforcement was significantly extended. Directive of 15 March 1976 has been expanded by the introduction of Articles of the VAT (EU Council Directive 79/1071[3] of December 6, 1979), Articles on Excise Taxes (Council Directive 92/108/EES[4] of December 14, 1992), Articles on direct taxes and taxes on insurance premiums (Council Directive 2001/44/EC[5] of June 15, 2001).

Council Directive 76/308 / EEC on 15 March 1976 and its supplementary acts have been codified by Council Directive 2008/55/EU[6] of May 26, 2008 In accordance with the Directive, mutual assistance is provided on a wide range of taxes, levies and duties. In particular, the Directive applies to the following taxes: VAT, excise duties on tobacco, alcohol, mineral fuels, taxes on income and capital, taxes on insurance premiums.

To date, another Directive is adopted, Council Directive 2010/24/EU of March 16, 2010, which aims to improve the provision of the Directive with regard to the practice of mutual assistance between the two countries to of enforce collection of taxes, fees and other measures. Its entry into force is expected in 2013.

We are going to consider certain provisions of Council Directive 2008/55/EU and Council Directive 2010/24/EU that can be used in the improvement of mechanisms for cooperation on tax claims

1 http://ec.europa.eu/taxation_customs/resources/documents/common/whats_new/com(2009)451_en.pdf
2 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31976L0308:EN:HTML
3 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31979L1071:EN:HTML
4 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31992L0108:EN:HTML
5 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32001L0044:EN:HTML
6 http://eur-lex.europa.eu/Notice.do?val=471986:cs&lang=en&list=471986:cs,&pos=1&page=1&nbl=1&pgs=10&hwords=&checktexte=checkbox&visu=#texte

recovery between the competent authorities of the Russian Federation and foreign countries. Most interesting are the new provisions of Council Directive 2010/24/EU and introduced clarifications and supplements to the provisions of currently effective Directive.

In the currently effective Directive, there is a provision that prior recourse to collect the tax claims to competent authorities of the requested country, the competent authority of the requesting country should apply all the possible domestic procedures in the country.

In the new document this situation was clarified and documented in the following form: before seeking assistance in the recovery of claims with the competent authorities of the requested country, the competent authority of the requesting country should apply all possible domestic procedures in its the country, *except for the cases* when:

– it is obvious that there are no ways to recover claims in the requesting country, or procedures are not expected to lead to a recovery in full and the requesting authority has information confirming the existence of assets of the person located in the requested country;

– Application of such procedures in the requesting country will lead to disproportionate difficulties.

This clarification is appropriate to be included in the relevant international agreements of the Russian Federation, primarily with Kazakhstan and Belarus due to the closer cooperation of these countries not only within the CIS, but also in the integration of such entities as the Customs Union (CU) and the Common Economic Space (CES). In the future, perhaps the extension of the provision for interaction with other members states of CIS.

It was stated in the Directive of 2008, that the competent authorities of the requesting country, after consultation with the requesting party may, in case legal regulations or administrative provisions allow to provide deferral (time) to the debtors or to offer payment of a part with a possible interest charges. This provision was changed: in the new Directive, competent authorities of the requesting country can independently provide debtors time to pay the debt by installments or with a possible interest charges.

Provision stating that the competent authority of the requested country is not obliged to provide assistance in the recovery requirements, if the recovery of claims, given the situation that the debtor will create serious economic or social difficulties in the requested country, except in a situation where the laws, regulations or administrative provisions of the requested country allow such requirements at the national level, was left unchanged. In our opinion, this provision is particularly relevant and should be entered into the relevant international agreements, as the majority of the countries have not completely recovered from the global financial crisis.

Competent authority of the requested country is not obliged to provide assistance in tax claims recovery, in respect of which the date of the claim filing in the requesting country before signing the request for assistance in collecting the requirements occurred more than 5 years ago. However, if the claim or the document authorizing the enforced collection in the requesting country was disputed, the 5-year term starts from the moment when it is decided in the requesting country that the query or document cannot be further litigated. The provision of the 5-year term was completed in the new Directive: in cases where the claim or document authorizing the enforced collection in the requesting country is disputed, the competent authority of the requested country is not obliged to provide assistance in claims enforcement, for which the date of the claim filing in the requesting country exceeds than 10 years.

Directive 2010/24/EU of March 16, 2010 is effective for all taxes and duties imposed on behalf of and directly by the EU member states or their administrative and regional offices, including local ones, or introduced on behalf of the EU.

The new Directive contains several provisions not available in the Directive of 2008. Competent authorities of EU member states should establish a central contact office responsible for contacts with other countries - EU members in the field of mutual assistance in the implementation of the provisions of this Directive. Competent authorities of the countries - EU members can create multiple contact offices responsible for contacts with other EU member states in the framework of mutual assistance in one or more types or categories of taxes and duties. The competent authorities may also establish contact departments for mutual assistance within their territorial or operating competence. If a contact office or contact department receives the request beyond its competence, it shall forward the request to the competent office or department, if it is known, what office or department is such, or redirect the request to the central contact office, having informed the requesting competent authority. The competent authority of each of the countries - EU member states shall inform the Commission of the European Union there is a central contact office, contact offices, liaison departments. The Commission provides this information to EU member states.

There is the lower limit of the claim for recovery to be collected within the framework of mutual assistance: the competent authority of the requested country is not obliged to provide assistance in collecting the requirements if the amount of the claim less than Euro 1500.

We have not covered all changes adopted in 2010 in the framework of the relevant EU directives, but have highlighted only those provisions, which, in our view, would be reasonable to introduce in the effective or new international agreements with Russia. We'll call them again.

1. Definition of cases, when a competent authority of the requesting country has the right to request assistance in the claims enforcement to competent authorities of the requested country before application of all the possible procedures within the country.

2. Allowing the debtor additional time or payment by installments with a possible interest charges.

3. Refusal to provide assistance in the claims recovery, if such recovery, given the situation of the debtor, can create serious economic or social difficulties in the requested country.

4. Restrictions in age and the amount of claims for recovery subject to mandatory assistance.

5. Creating a central contact office responsible for contacts with other states for mutual assistance in the recovery of tax claims.

INTERNATIONAL TAX COMPETITION AS AN INNOVATION DEVELOPMENT FACTOR

A.Levashenko

In order to achieve innovation and modernization of its economy, Russia needs to modify its tax legislation in accordance with the experience of other states. Unlike the Russian Federation, practically all the other countries of the world consider small and medium-size businesses as a separate subject of taxation for the purpose of granting them a special tax regime.

It has become a widely accepted notion that the international competitiveness level of a country[1] indeed influences to a certain degree the quantity and level of development of its innovation-oriented enterprises.

In its turn, the level of international tax competitiveness of a country is directly or indirectly influenced by a broad range of factors. These factors include, for example, the inter-country differences in the degree of national economy development and in economic orientation (raw material production, innovation), as well as a variety of geopolitical and social circumstances. Also, countries can follow different principles of taxation, or practice different approaches to determining tax jurisdictions or to treating certain consolidated groups of taxpayers.

When it comes to debating the issue of international tax competition and its influence on the development of innovative enterprises in a given country, the first thing that is needed is a precise definition of the term ‘innovation’. Unfortunately, neither the economic nor legal doctrine has so far formulated any single concept of innovation. At present, more than four types of innovation are typically singled out: product innovation, process innovation, market innovation, and organizational innovation.

Product innovation is understood as the creation of products or services that are either technologically new or significantly improved. Significant improvements imply the introduction of improvements in the technical specification, components, materials and backup software of a product, and improvements of user backup or other functional characteristics.

Process innovation is understood as the production of new or significantly improved products, or the introduction of a new or significantly improved method of supply (or delivery), including the introduction of considerable changes in a relevant technology, equipment and (or) backup software.

Marketing innovation is understood as the introduction of new methods of marketing, which involve significant changes in the design, packaging, placement, promotion or evaluation (pricing) of a product.

Organizational innovation is understood as the introduction of new organizational into entrepreneurial practice and into the organization of jobs or external links[2].

Thus, one of the principal features of all innovations would be a certain element of novelty and improvement that they bring into the life of people as a result of their implementation.

Below, we will consider the purely legal factors that influence the competitiveness of a country and are directly made use of by the State in order to increase the attractiveness of the country from the point of view of innovation developers. In other words, we will focus on determining the characteristic features of a country that can influence its position in the system of international tax competition.

It is now an accepted fact that, in order to significantly increase the volume of innovations, it is necessary to introduce economic preferences in the form of special tax regimes, tax benefits

1 The tax competitiveness of a country is determined by the size of the rates and the sphere of application of its taxes, as well as by their stability, simplicity and predictability.

2 Oslo Manual: Guidelines for Collecting and Interpreting Innovation Data, 3 Ed. // URL: http://www.oecd.org (hereinafter to be referred to as the OECD Manual).

and targeted state subsidies. As state subsidies do not fall into the category of tax stimulation measures, the case in point will be the special tax regimes and tax incentives designed by the State to promote the development of innovation activities.

One of the major mechanisms of tax competition is the development of tax incentives in the sphere of law. At the early stage of development of the innovation process and the entire innovation space of a country, it is very important that the State should grant tax benefits to innovative enterprises. Such benefits should be granted in the form of tax holidays, providing the enterprises with complete exemption from some taxes for a limited period of time. It is precisely this mechanism of international tax competition that is applied in most countries.

Also, in one form or another, each state consolidates in its legislation certain tax incentives – such as reduction of the taxable base of an enterprise engaged in innovation activities, reduction of profits tax for such enterprises, tax benefits in the sphere of amortization of scientific equipment, etc. The extent of these tax incentives may vary from country to country.

The distinctive feature of a country can be the choice of an object of innovation-oriented tax stimulation. What is meant here is that any innovation goes through at least three major stages: training of scientific cadres, R&D and, finally, the commercialization of the innovation – namely, the creation, in a country, of a tax climate that would be favorable to making investments in innovation development.

An analysis of the international practice in the sphere of tax stimulation of innovations has indicated that each country independently determines which of the above stages would require the introduction of the most radical tax benefits for the purposes of strategic development of innovation-oriented enterprises. Thus, for example, US tax legislation envisages that equal benefits should be granted at each of the three stages of the State's innovation development. Germany's tax incentives are mainly focused on R&D. Nevertheless, nearly in all countries the profit-making innovation enterprises are endowed with the right to reduce their taxable bases by the amount of qualified expenditures (that is, corresponding to state-established criteria), or even by the value in excess of those expenditures.

Based on the data provided by the Directorate-General of the European Commission, the Maastricht Economic and Social Research and Training Center on Innovation and Technology has carried out a comparative analysis of the innovation performance of EU Member States and a number of non-EU countries (EIS)[1]. The analyzed countries are subdivided into the following four country groups:

Innovation leaders – Sweden, Switzerland, Finland, Denmark, Germany and the UK. Their innovation-performance indicators are the highest.

Innovation followers – Austria, Belgium, Cyprus, France, Iceland, Ireland, Luxemburg, the Netherlands, Estonia and Slovenia.

Moderate innovators – Czech Republic, Italy, Norway, Slovakia, Spain, Poland, Portugal, Malta, Lithuania, Greece and Hungary.

Catching-up countries – Bulgaria, Croatia, Latvia, Turkey, Serbia and Rumania.

Below we will consider the experience of some of these countries, so as to analyze in what ways tax legislation can influence the development of their innovation economies.

The United Kingdom, one of the current innovation leaders, has introduced a number of special tax benefits for small, medium-sized and large enterprises engaged in innovative activities.

Tax benefits are granted a) in the sphere of innovative activities - to companies engaged in R&D (companies engaged in innovation activities), which are exempted from corporate tax on the income derived from such activities; and b) in the sphere of depreciation tax deductions.

These tax benefits were introduced in 2000 for small and medium-sized enterprises, and were then extended, in 2002, to large companies. It should be noted that, in accordance with EU and UK legislation, a company should be defined as a large company if it does not fall into the categories of 'small' and 'small and medium-sized' companies. Small and medium-sized companies are defined as having less than 250 employees; their annual turnover, in money terms, does not exceed 50 mln Euro, and their balance sheet total is no more than 43 mln Euro.

1 http://www.proinno-europe.eu/page/european-innovation-scoreboard-2009

UK legislation regulating the granting of tax benefits for R&D consists of the following major normative legal acts: the *Income and Corporation Taxes Act 1988*, the *Finance Act 2000*, and the *Finance Act 2002*.

All companies spending more than 10,000 pound sterling on R&D (as defined for tax purposes) are entitled to a deduction when calculating their taxable profits of

– 150 % of qualifying expenditure for small and medium-sized companies, and

– 125% of qualifying expenditure for large companies.

This tax credit is not available to individuals and partnerships.

A company's expenditures qualifying for R&D tax credit purposes include its revenue expenditure on employing staff that are directly or indirectly engaged in R&D; expenditure on paying a staff provider for the staff provided to the company who are directly or indirectly engaged in R&D; expenditure on consumable or transformable materials used directly in carrying out R&D (broadly, physical materials which are consumed in the R&D); and expenditure on power, water, fuel and computer software used directly in carrying out R&D.

In order to obtain a tax credit, a company should submit its tax credit request to the local branch of HMRC in accordance with the established procedure.

As mentioned above, companies are also entitled to tax benefits in the sphere of depreciation deductions: 40 % of depreciation deductions[1], for small and medium-sized enterprises, with regard to investments in plant and machinery, except for those being leased out; 100% of depreciation deductions for small enterprises with regard to investments in information and communication technologies (for example, computers, computer software, etc.), and 100 % of depreciation deductions with regard to investments in water-saving equipment[2].

As regards the UK tax regime in general (the total amount of taxes, the total tax rate, the timing of tax payment, the ease of paying tax,), it should be said that the UK rates highly in 16th place in the World Bank's international ranking of tax regimes (covering 132 countries)[3].

Denmark, another innovation leader, uses other forms of tax stimulation, which are aimed nor so much at decreasing the total profits tax burden and the level of depreciation deductions as at the attraction of highly qualified staff. Thus, in order to attract investments to hi-tech enterprises, Denmark pays much attention to improving the training of staff for such enterprises. In this connection, enterprises are granted tax credits for hiring scientific personnel.

However, Denmark, like the UK, has a system of tax rebates for the entrepreneurial sector as a whole (introduced in 2002). This system makes it possible to reduce the taxable base of a company by an amount equal to up to 150 % of the company's expenditure on R&D.

Germany, yet another innovation leader, has abolished the so-called research-related tax benefits. Germany believes the mechanism of general reduction in corporate profits tax to be more efficient, because the maintenance of R&D tax benefits considerably complicates general tax legislation. At the same time, according to the World Bank, Germany's rating in the international rating of tax regime attractiveness is rather low – 80th place.

France, member of the group of innovation followers, is by far the most generous European country when it comes to tax benefits for innovation enterprises. According to a law adopted in 1983 and amended in 2008 in connection with the current reform of tax credit for research activities (*credit d'impot recherche*), aimed at stimulating investment in innovations, enterprises are granted tax benefits in correspondence with the amount of their investments in R&D.

The enterprises investing in R&D receive a 50-percent tax credit on R&D expenditures in the first year of research and development activities, a 40-percent tax credit – in the second year, and a 30-percent annual tax credit – in every subsequent year, provided that the total amount of expenditures does not exceed 100 mln Euro (expenditures in excess of this amount are compensated at the rate of 5 %).

France's national normative documents and programs concerning the stimulation of innovation activities also envisage various organizational measures. As a result, France has become a

1 Depreciation deduction is the amount of deductions for depreciation.

2 This material has been prepared on the basis of information posted on the official web sites of the UK Department for Business, Innovation and Skills (http://www.bis.gov.uk/) and the HM Revenue & Customs (www.hmrc.gov.uk).

3 World Bank 2009.

sufficiently attractive country for luring innovation enterprises into its territory[1], although it ranks only # 66 in the World Bank's international rating of tax regime attractiveness.

Although the EU and the Maastricht Economic and Social Research and Training Center on Innovation and Technology do not analyze the innovation indicators of such countries as the USA, Japan, India, China and the Republic of Korea, their achievements in international tax competition to attract business R&D are indisputably impressive. For example, according to analysis from the OECD, in 2007 USA spent a total of 369 bn USD on R&D, while Japan and China spent 148 and 102 bn USD, respectively (their expenditure has been converted into international dollars using PPP conversion factors). The same analysis established that in 2007 the size of research staff was 710 thousand in Japan, 1,426 thousand in the USA, 1,423 thousand in China, and 1,360 thousand in the EU.[2]

In 2010, the government of the *Republic of Korea* announced that the Korean State would grant significant tax benefits and financial assistance to companies promoting the development of eco-friendly technologies. According to the ROK Minister of Strategy and Finance, enterprises' tax payments are to be reduced by up to 30 % of the volume of their investments in green R&D.

Japan leads in such indicators as the skill level of research staff and engineers, companies' expenditure on R&D, and the introduction of innovations. For example, in accordance with the April 2009 package of anti-crisis measures designed to stimulate the economy, the Government of Japan has raised the status of its task of providing state aid for R&D and the development of innovation technologies and infrastructure to that of highest-priority strategic tasks.

In 2008, the Government of Japan adopted the decision that tax benefits for innovation enterprises should be expanded in order to promote private investment in research. At present, tax incentives for innovation in Japan include tax deductions. For large innovation enterprises, the cap on tax deductions is 30 % of total tax liability; for medium-sized and small innovation enterprises the cap is set at up to 100 % of total tax liability.

At the same time, it should be said that, notwithstanding the excellent results displayed by Japanese firms in R&D, Japan significantly lags behind its Western competitors with regard to the speed of patent examination and registration and to the speed of the actual implementation of inventions into practice. Also, it should be noted that Japanese taxpayers carry a heavier tax burden than their counterparts in other developed countries. In particular, the effective rate of income tax on legal persons (corporate tax) is 40 %.

Japanese legislation in the sphere of intellectual property protection completely lacks any incentives for private companies investing in the R&D of new methods of medical treatment.

Another shortcoming of Japanese legislation is that under Japan's Trademark Law only characters, devices and symbols are recognized and protected as trademarks, which makes it possible for competitors from other countries to promote their products through the illegal use of 'non-visual' images, including sounds, smells, colors, tastes, etc. created in Japan.

In *Russia,* according to the RF Ministry of Finance's data for 2009, state tax stimulation of innovative activities should be carried out in two directions:

– promotion of demand for innovations (the creation of incentives for enterprises to self-modernize and make use of innovations and research outputs);

– support for innovation initiatives (the creation of stimuli for the main enterprises configuring the structure and volume of innovative product supply).

1 In 2009, Germany superseded the USA as the largest foreign investor in France, where it now owns 18 % of all investment projects. Thus, ESG, a German company specializing in the development and integration of technologies for the automobile, aerospace and defense industries, has visibly strengthened its commitments in France. The company explains its decision, first of all, by France's readiness to cooperate, and also by the fact that her innovation technologies are now renowned across Europe, due to which France has become a leader in all the three fields that ESG has an interest in. The USA is now in second place (17 % of investments). General Electric is planning to invest 45 mln Euro in the creation of a research center in the La Dйfense business district of Paris. The majority of foreign investments is concentrated in three regions: Ile-de-France, Provence-Alpes-Cote d'Azur, and Rhone-Alpes. However, there are some exceptions. GlaxoSmithKline Biologicals, the world's number two pharmaceutical company, has chosen Nord-Pas-de-Calais for that region's openness and readiness to assist investors in implementing their projects, as well as for the excellent reputation of local specialists and the existence of a dense transport network.

2 Main Science and Technology Indicators. Paris: OECD, 1/2009, p. 24.

Table 1 presents comparative data on tax deductions in Japan, the USA, China, Canada, the UK, and France (2009 and 2010 data)

Table 1

Country	Tax deductions as percentage of R&D expenditure	Cap on tax deductions
Japan, at present	–	20 % of total tax liability
Japan (since 2008 financial year)	large companies - 8-10 %; small and medium-sized companies - 12 %	large enterprises – 30 % of total tax liability; small and medium-sized enterprises – up to 100 5 of total tax liability
USA	3–5 % of total R&D expenditure; 20 % of R&D expenditure in excess of established norm	25 % of total tax liability
Canada	20 % of total R&D expenditure	No data
UK	8.4 % of total R&D expenditure	No data
France	10 % of total R&D expenditure	16 mln Euro
China	15 % of total R&D expenditure	No data

According to Russian tax legislation, tax benefits designed to promote the development of innovation are granted, in the main, to 4 categories of persons: residents of SPZs (special economic zones); scientific research institutions (higher educational establishments); venture companies[1]; and R&D businesses[2]. Meanwhile, the international experience indicates that businesses or - to be more precise - small businesses will become the most numerous developers of the innovation space in the Russian Federation. At the same time, as our analysis of Russian tax legislation has demonstrated, R&D businesses do not enjoy any substantial, special and, most importantly, really available tax benefits enabling them to cut costs by reducing their tax payments with regard to a number of taxes. Moreover, and most unfortunately, R&D small businesses are not singled out as a special category of tax benefit recipients.

It is evident that RF tax legislation is more focused on the tax stimulation of R&D than on the tax stimulation of innovation as a whole.

In comparison with foreign legislation regarding corporate tax incentives for innovation development, the major problems and shortcomings of RF tax legislation are, firstly, the absence of a single legislative definition of *innovations / innovation activity* for the purposes of taxation. In this respect, the RF Tax Code exclusively refers to R&D. Secondly, RF tax legislation envisages the existence of different uncoordinated tax incentives for different entities engaged in innovation activities (residents of SEZs, scientific research institutions, venture companies, and businesses), which creates uncertainty and exposes taxpayers to the 'risk' of being denied even the existing meager tax benefits. Thirdly, it is the absence of a special tax regime for small / medium-sized enterprises engaged in innovation activities. In particular, one can point to the absence of tax holidays for such companies with regard to direct taxes (land tax, profits tax, corporate property tax). Also, the RF tax system has a serious general shortcoming which negatively influences the tax competitiveness of Russia, including from the point of view of innovation activity development. This is the extremely cumbersome procedure established for the preparation and submission of tax reports, and the low efficiency of the tax administering authorities.

Thus, it should be acknowledged that the tax competitiveness of a country is significantly influenced by the specific features of its legal system, including the legal instruments and mechanisms designed to ensure the efficiency of the chosen tax stimulation measures.

Countries across the globe have introduced a wide range of mechanisms of tax stimulation for enterprises engaged in the development of innovations. These benefits can differ by their targets

1 An investment company working exclusively with innovation enterprises and projects (startups).

2 The Skolkovo innovation center is granted a special legal, administrative, tax and customs regime in accordance with the Federal Law 'On the Skolkovo Innovation Center'. Its activities do not fall under the general norms concerning the tax benefits for the development of innovations established by RF tax legislation.

(granted only to large corporations or only to small businesses), by their aims (to reduce the cost value of science-intensive products, or to lure highly qualified researchers to the business environment, or to stimulate innovation activities in high-priority areas, etc.), and by their forms (a reduced rate of profits tax or incentives in the sphere of depreciation deductions). Correspondingly, each country can have its own combination of these mechanisms.

In some countries, the aim of the tax stimulation of innovation enterprises within the framework of international tax competition consists in the maintenance and improvement of conditions and possibilities for the conduct of research at state (or pioneering) laboratories, scientific research institutions and higher educational establishments. As far as the issue of tax incentives for enterprises engaged in innovation activities is concerned, the experience of a number of countries indicates the existence of some country specificities of tax competition in this sphere. For example, in Germany, tax benefits are granted only for R&D, while in France they are envisaged, in the main, for all stages of innovation development, etc. The specific sets of tax stimulation measures are characterized by significant country differences with regard to the typology of R&D, the minimum volume of R&D expenditure that endows a company with the right to claim tax benefits, the cap on tax benefits, the choice of a tax benefit addressee (a large or small a business, a high priority areas of R&D, a relevant branch of the economy, etc.), and the ratios between federal and regional tax benefits.

It should be acknowledged that, in contrast to the situation in the Russian Federation, small and medium sized innovation businesses fall under a special tax category and enjoy a special tax regime in nearly all foreign countries. Such special tax regimes have a number of similar features – for example, the exemption from profits tax during the first three years of functioning.

Thus, it appears that, apart from stimulating technical reconstruction and independent innovation activities at the enterprise level, accelerating the development of new and hi-tech industries, as well as the production of equipment, and introducing into industries the latest scientific and technological achievements in the sphere of hi-tech, Russia should also assist the development of medium-sized and small enterprises and their innovation activities through introducing a special tax regime for such entities.

INFORMATION RELEASED BY THE RF PENSION FUND (RF PF)

I.Tolmacheva

1. **Information released by the RF PF as of 11 January 2011, 'Alterations for Payers of Insurance Contributions in 2011'.**

The RF Pension Fund issued a reminder concerning the alterations introduced in the procedure for the payment of insurance contributions and for the submitting of и reporting documentation in 2011. Thus, in particular, in 2011 the aggregate tariff established for the insurance contributions to be paid to the off-budget funds is increased from 26 % to 34 %, of which: 26 % is due to the RF PF; 2.9 % – to the SIF[1]; 3.1 % – to the Federal Compulsory Medical Insurance Fund FCMIF[2]; and 2.0 % – to a TCMIF[3]. The base to be levied by the insurance contributions has been indexed. In 2011 the ceiling established for the amount of annual earnings to which insurance contributions are to be charged will be 463 thousand Rb (in 2010 this ceiling was set at 415 thousand Rb). The list of payers entitled to applying a lower tariff has been extended. The timelines for submitting reports and the composition of the reporting documentation forms have also been altered. It is stated that now the RF PF must receive not only the calculations of insurance contributions, but also the information concerning personified registers. Reports must be submitted no later that on the 15th day of the second calendar months following the end of a reporting period. In 2011, the dates established for submitting reports are as follows: 15 February, 16 May, 15 August, 15 November. Besides, from 2011 those employers whose staff amounts to more than 50 persons as of 1 January 2011 will be able to submit electronic reporting forms (previously this threshold amounted to 100 persons.)

2. Information released by the RF PF as of 14 January 2011

The RF Pension Fund established a transition period until 1 April 2011 for the submitting of applications by citizens concerning their refusal of the receipt of in kind welfare services, or the renewal of the period thereof. It should be reminded that certain alterations have been introduced in the Federal Law 'On State Social Assistance', which are to enter into force from 1 January 2011. Thus, in particular, from 1 January 2011 federal benefit recipients (including veterans of WW 2, veterans of combat actions, survivors of the WW2 siege of Leningrade, disabled persons) are endowed with the right to receive a package of welfare services to the value of 705 Rb per month, which is to include:

– provision with pharmaceuticals, medical products and dietary nutrition products for disabled children (543 Rb per month);

– health resort services package (84 Rb per month);

– free of charge travel to and from the place of medical treatment (78 Rb per month).

It should be reminded that since 1 April 2010 the value of the welfare services package adjusted by the indexation was nearly the same – 705 Rb 10 kopecks, but then the package consisted of only two services: supplementary medical care – 627 Rb per month; free of charge use of public transport – 78 Rb kopecks (see the RF PF's information release of 8 September 2010). Those citizens who have made up their minds as to the form in which they are willing to receive their welfare services are to submit their applications to the RF PF before 1 October 2010. To ensure better adaptation of citizens to the new package of services the RF Pension Fund has provided them with an opportunity to submit the relevant application until 1 April 2011. The applications will enter into force from the first day of the month following the month during which the application was submitted.

1 The Social Insurance Fund of the Russian Federation.
2 The Federal Compulsory Medical Insurance Fund of the Russian Federation.
3 A Territorial Compulsory Medical Insurance Fund.

AN OVERVIEW OF THE RF GOVERNMENT'S MEETINGS IN DECEMBER 2010

M.Goldin

In January, at the meetings of the Government Presidium of the Russian Federation, among other documents, the Draft Federal Law 'On the Introduction of Alterations in the Federal Laws "On Insolvency (Bankruptcy)" and "On Execution Proceeding" in the Part Relating to the Improvement of the Procedures Applied in Bankruptcy Cases of Strategic Organizations', and the Federal Law 'On the Introduction of Alterations in Article 27 of the Federal Law "On Higher and Postgraduate Education" and Article 5 of the Federal Law "On Science and State Science and Technology Policy"'.

On **20 January,** at the meeting of the RF Government Presidium, the Draft Federal Law 'On the Introduction of Alterations in the Federal Laws "On Insolvency (Bankruptcy)" and "On Execution Proceeding" in the Part Relating to the Improvement of the Procedures Applied in Bankruptcy Cases of Strategic Organizations' was discussed. The Draft Law had been introduced by the RF Ministry of Economic Development.

The declared purpose of the Draft Law is the preservation of strategically important production entities, more specific elaboration of certain provisions stipulated in the Federal Laws 'On Insolvency (Bankruptcy)' and 'On Execution Proceeding' and those addressing the specificity of the bankruptcy procedure applied to strategic organizations.

For the purposes of preventing abuse of a creditor's right to file an application to deem a debtor to be bankrupt, the newly introduced amendments establish that bankruptcy proceedings against a strategic organization can be initiated by an arbitration court, provided that the amount claimed from the debtor is not less than 5 mln Rb. Previously this limit was set at 500 thousand Rb.

It is also established that the decision to accept for consideration the application to deem a strategic organization to be bankrupt should contain an indication that the debtor is indeed a strategic organization. The arbitration court should then forward copies of its decision to accept for consideration the application to deem the strategic organization to be bankrupt to the applicant, the debtor, the control (supervisory) body, the declared self-regulatory organization of valuators, and also to the federal executive body responsible for the implementation of uniform state policies in the branch of the economy where the said strategic organization is operating.

The Draft Law envisages yet another limitation – a strategic organization cannot be deemed to be bankrupt, and no bankruptcy proceedings can be initiated against it in the event of the total amount of its creditors' claims not exceeding the value of property which is not included in the single production-and-technological complex owned by the debtor.

The Draft Law regulates the procedure for the sale of the single production-and-technological complex and the enterprise which comprises the single production and technological complex belonging to a strategic organization, as well as the procedure for its exclusion from the list of that strategic organization's property.

In the event of the activities relating to the sale of the said property being included in the external administration plan, and also in the event of such property being sold in the course of bankruptcy proceedings, the arbitration manager should ensure an independent valuation of such property.

The valuator's report is subject to mandatory expert examination at the self-regulatory organization of valuators whose members include the valuator who has drawn up the valuation report.

It should be mandatory that the valuator's report and the results of the mandatory examination at the self-regulatory organization of valuators whose members include the valuator who has drawn up the valuation report should be forwarded by the arbitration manager to the federal executive body responsible for the implementation of uniform state policies in the branch of the economy where the corresponding strategic organization is operating.

Within one month after the date of receipt of the valuator's report and the results of the expert examination at the self-regulatory organization of valuators, the federal executive body responsible for the implementation of uniform state policies in the branch of the economy where the corresponding strategic organization is operating or a relevant state corporation should have the right to announce the exercise of their right of preferential acquisition of the property at the price determined in the valuation report and confirmed by the expert examination carried out by the self-regulatory organization.

The corresponding statement should be forwarded by the federal executive body responsible for the implementation of uniform state policies in the branch of the economy where the corresponding strategic organization is operating or the relevant state corporation to the arbitration manager and the arbitration court which considers the bankruptcy case.

At its meeting on 20 January 2011, the RF Government also considered the Draft Federal Law 'On the Introduction of Alterations in Article 27 of the Federal Law "On Higher and Postgraduate Vocational Education" and in Article 5 of the Federal Law "On Science and State Science and Technology Policy"'. The Draft Law had been introduced by the Ministry of Education and Science of the Russian Federation. The aforesaid Laws, in their present wording, stipulate that, in the event of scientific and educational institutions becoming founders of economic societies, they should have the right to contribute to the charter capital of such societies their rights of use of intellectual activity results, while the exclusive rights to the said results should continue to be vested in the scientific and educational institutions. The rights of use of intellectual activity results that have been contributed to the charter capital of the economic societies founded by scientific and educational institutions cannot be transferred, under a contract or for any other reason, to third parties throughout the entire license period. According to the RF Ministry of Higher Education and Science, the fact that the economic society is legally prohibited from transferring, under a contract or for any other reason, the right of use of intellectual activity results to third parties is counterproductive because it hampers the actual introduction of intellectual activity results, especially in the spheres of software development and pharmaceutics.

In order to lift this ban, the Draft Law introduces alterations to this effect in the two aforesaid Laws. The adoption of the proposed legislation is intended to eliminate those provisions in the Laws that do not allow economic societies to transfer, under a contract or for any other reason, their rights of use of intellectual activity results to third parties.

At the same time, the Draft Law introduces no changes in the provisions stipulating that the exclusive right to intellectual activity results should be vested in a scientific or educational institution.

A REVIEW OF REGULATORY DOCUMENTS ON TAXATION FOR DECEMBER 2010 – JANUARY 2011

L.Anisimova

1. The Federal Law of December 28, 2010 N 395–FZ "On Amendments to Part II of the Tax Code of the Russian Federation and some legislative acts of the Russian Federation" in view of the lawmakers had to be primarily technical in nature, but in fact, it contains innovations that require particularly careful study. Let us review changes in accordance with the Law context order.

1) Changes relate to the date on which the project "Skolkovo" participant can claim for the right for benefits under VAT and income tax and the order of presentation of eligibility. In the previous version, the documents providing the right for exemption, the project participant should have sent to the tax authority no later than 20–th day of the first month of the tax period from which the participant had the right for benefit. In the new version, the right for a benefit can be used before the 1 st date of the month, following the month in which the status of the project participant was obtained.

2) The Law has provided VAT exemption for the operations of state and municipal property, not assigned to the state (municipal) treasury

3) Much of the amendments concerns the retention by tax agent of income tax of an individual (PIT) for the sale of securities and financial instruments, traded and not traded in an organized market. There provided a definition of a person who is recognized as a tax agent in respect of such transactions. Of particular interest is the attempt to legally regulate the procedure for transfer to a tax agent by a physical person (the owner of the securities and financial instruments) of documents written by third parties on the previously committed transactions for purposes of the tax agent personal income tax base assessment. The problem is that the duty of the fiscal agent to assess the tax base should be carried with the documents, issued by other persons and for which it therefore can not perform due diligence of confidence. The only mechanism to protect the fiscal agent in this case would be that such documents under the Act must be submitted with the application of the client and originals or properly certified copies. In order to avoid the situation where the tax authorities will challenge the authenticity of the documents and, therefore, apply some sanctions to the fiscal agent, we believe that tax agents should be encouraged to work only with certified copies (i.e., copies certified by independent legal structures), although this can significantly increase the overhead costs of investors.

4) Highly controversial is the newly introduced benefit for exemption from tax income earned from the sale (redemption) of shares in the authorized capital of Russian companies that are not traded on an organized market, provided that on the date of sale (redemption) of such shares (interest) they were permanently owned by the taxpayer or were in the ownership or other proprietary interest over five years. This rule essentially creates a way for tax evasion in regard to personal income tax and corporate profit tax. Let us explain it by example. Let's say, a Russian owner of the shares of Russian company sold to a foreign company, also owned by him (that is, to himself), the shares for a very high price, and immediately bought them back much cheaper. The outcome of the first stage: no losses, the money for cross–border transaction entered into Russia without tax, but without violating the law of the country, derived from capital, because in this country on the balance sheet there were reflected losses from the commission of the transaction. After completion in Russia all large–scale cash projects (these include the Olympic Games, FIFA World Cup) in which the Russian organization can participate as a contractor or supplier of goods, works and services (and the transactions of the Tax Code provides tax incentives) , will be precisely those 5 years, after which there is a right imposed on the use of Federal Law № 395–FZ of the tax exemptions for income from sale of shares of Russian companies that are not traded in an organized market. Let us consider the second stage of the analyzed financial schemes Tax Evasion. Shares of the Russian side once again sold to foreign companies, but this time in a reverse way – cheaply sold and then repurchased for high price.

As a result, at the time of the transaction money goes to the country from which originally came the capital, and in Russia on the balance sheet losses are reflected on a business transaction. The subtlety of the situation is that, in accordance with international agreements on avoiding double taxation of income from the sale of movable property (as securities relate to movable property) are taxed at the place of tax residence of the seller – in Russia! That is, where the deal in the balance sheet shows losses. The result of the operation: Russia's budget does not receive any revenue, and the budget of a foreign country, from where «hot capital» came, can also get nothing (if it is possible to reflect the balance of costs within the revenue). But the organizer of the deal in shares is not enough that will not pay a penny as a result of taxes on profits earned in any of the budgets, in doing so he also will retain the image of a respectable and efficient foreign producers because it compensates for those losses that 5 years ago were «hanging» on the balance of its foreign firm.

In our opinion, the tax policy of the Russian authorities should be carried out with great caution, because Russia may not only lose a significant share of the revenue base of its budget, but also cause complaints from foreign governments that its actions resulting in damage to the interests of other states, because contribute to the formation of channels of tax evasion. This is an extremely negative impact on the investment attractiveness of Russia as foreign governments will be compelled under its domestic law by administrative means to block channels of tax evasion, introduce a compensatory tax burden on income received from Russia, which will make investments in the Russian economy inefficient. Eliminating the tax evasion is one of the cornerstones of a market tax policies of any State.

5) The Act attempted to resolve the situation for the elimination of the tax base for income tax on foreign currency exchange. Directly in the text of the Tax Code in Art. 271 and 272 states that in determining the amount of income (expenses), advance payments are recorded at the exchange rate on the date of receipt (payment). But as the advances themselves are not income (expense) in economic terms, the legislative recording of payments has become necessary above all to have legitimate grounds to regard earnings (gross expenses) in rubles on the transaction as a direct sum of two quantities: – advance and balance payments, converted at exchange rates at the relevant dates.

6) A tax benefit is introduced on profit for the medical and educational institutions in the form of the 0% rate on all income provided that the share of income from core activities (for educational institutions – from education and science) is not less than 90%. The introduction of such benefit, apparently is aimed at mitigating the potential social concern due to the entry into force in July 2012 rules on the change in the status of public institutions, the consequence of which will transfer educational and medical institutions with direct budget financing for budgetary subsidies.

Waiver of tax revenue, according to the authors of the amendments will allow to slow down the growing cost of education and medical care at least at first stages. The question of whether this decision leads to a decrease in revenues of regional budgets, and whether the federal budget in parallel provides the amount of compensation decreased income of the regional budgets is an ambiguous issue, because in accordance with applicable law educational and medical institutions are non–profit.

2. Federal law of Dec. 28, 2010 N 409–FZ legislatively defined the period of 3 years, after which declared but unclaimed dividends by shareholders should be recovered in the retained earnings of the society without paying (to the society) again the corporate income tax. Thus, in the Tax Code, there secured a single mechanism of corporate income tax, convertible into capital.

3.. Federal law of Dec. 28, 2010 N 425–FZ of the text of the Tax Code separately describes the procedure for classifying expenses the cost of health and safety in coal mining as part of production costs. There is no anything fundamentally new in the economic decision, it rather provides a reformat of the old mechanism of classifying expenditures, including those associated with the creation or acquisition of equipment to ensure the safety of miners on costs. These amendments reflect the society's response to the tragedy at the mine Raspadskaya. Doubts are provoked by the differentiation of tax rates for mining by type of coal.

Tax system, in our view, should provide fiscal liaison between the revenue base budget with the producers' income without distorting the motives of their activities, i.e., without the direct influence of taxes on the structure of market prices. In this regard, we believe that it should be avoided whenever possible economically unjustified differentiation of the tax burden and establishment of individual tax rates and tax regulation schemes. Special tax treatments are accompanied with imbalance of the competitive market, which leads to distortions in prices compared to actual prices and conditions prevailing in the open market.

4. Another example of personalization of the schemes of mandatory payments in the Russian Federation is the Federal Law of December 28, 2010 N 432–FZ. Against the general background of growing insurance rate by 2.4 times from January 1, 2011, there is formed a list of activities of organizations, applying the simplified taxation system (UPDF), under which in the coming years there will be used entirely different, much lower insurance premium rates . The definition of certain types of activities given in the text of the Act, requires clarification, such as "the activities of sports facilities" (any activity?), "Activities of libraries, archives, clubs and similar institutions (except for the activities of clubs), etc.

5. In late 2010 – early 2011, there have been quite understandable upsurge of requests for the structure of the income taken in the analysis of eligibility, permitting organizations to apply special tax regimes (e.g., compliance with the criterion of agricultural producers, or the criteria for the organization, applying the simplified taxation system and etc.). In fact, Art. 58 of the Federal Law of 24.07.2009, № 212–FZ on the insurance premiums to the state social extrabudgetary funds provided for preferential rates of insurance premiums for several organizations, including using special tax regimes. It is noteworthy that a number of revenue and income from financial operations are derived for the calculation scheme of such criteria. Thus, in accordance with the letter RF Ministry of Finance to December 22, 2010 N 03–11–06/1/27, when determining the share of income from the sale of agricultural products in the total income from sales of goods (works, services) has not included proceeds from the sale property rights. That is, income from assignment of claims and the sale of its share in the capital of another company are not considered when determining the share of income from sales of agricultural products in the total income from sales of goods, works and services. A similar explanation is given in the letter of the RF Ministry of Finance of December 27, 2010 N 03–11–06/1/28 in respect of income of farmers in connection with the transfer of property under a sublease. Income from the subleasing agreement also does not affect the status of the taxpayer. If in the tax revenues that do not participate in the qualifying tax status of the taxpayer, nut nevertheless, are not exempt from taxation and are subject to general rules, the rate of the premium paid is determined depending on the tax status of the payer. In this connection, apparently, one should expect significant growth in agricultural organizations, applying the simplified taxation system, and other organizations, using special tax regimes, which due to their tax status are subject to preferential rates of insurance premiums, but are performing intensive and extensive operations in the financial markets.

6. It is known that stimulating regimes are introduced in the tax laws sometimes as a way to implement the promises stated in the highest state level in response to complaints or criticism from a particular social group. Opportunistic nature of such measures may appear rather curious. In a letter to the Ministry of Finance of the Russian Federation of December 29, 2010 N 03–04–06/6–322 on the issue of taxation of personal income (PIT), the amounts of interest on trust loans (credits) clarifies the application of benefits in respect of interest on loans attracted by the employee organization for the purchase of housing, if such interest is paid by the organization. The RF Ministry of Finance explained that in accordance with paragraph 40 of Article. 217 of the Tax amounts paid by organizations to their employees for reimbursement for payment of interest on loans (credits) to purchase and (or) construction of residential premises to be included in expenses taken into account when determining the tax base income Code are not subject to taxation on personal income. But in the case of payment by the organization for the employee interest on a loan (credit) directly to the bank rate of paragraph 40 of Article 217 of the Code, is not applicable because the employee compensation includes amounts previously paid as a tax base for corporate income. But in the case of payment by the organization for the employee the interest rte on a

loan (credit) directly to the bank, provisions of paragraph 40 of Article. 217 of the Code are not applicable, because compensation previously paid to the employee is not made. In fact, the main financial body of the country is compelled, by relying exclusively on the formal side of the deal, in different ways to qualify the situation with the application of the benefit to personal income tax, depending on whether the interest was reimbursed by a natural person, or the organization paid for these percentages.

It is evident that in economic terms the situation in both cases are absolutely identical – and in fact, and in another case, beneficiary interest under a contract associated with the acquisition of housing advocates employee organization. This kind of internal contradictions of the Tax Code violates the principle of tax equity. We believe that the prompt settlement of such situations in the tax legislation should be introduced to formal comments from the higher courts at the request of the Ministry of Finance of the Russian Federation, since the RF Ministry of Finance is authorized only to clarify the application of tax laws and may not interpret the legal situation in general, i.e., determine whether there is a violation of economic interests of taxpayers, or a violation of fairness in taxation or not, and how they can be corrected.

7. The letter of the Federal Tax Service of December 30, 2010 NPA–37–6/19020 has explained the procedure for granting by the tax authorities of the information contained in the Uniform State Register of Legal Entities and the Unified State Register of Individual Entrepreneurs.

CHANGES IN THE NORMATIVE BASE OF THE BUDGETARY PROCESS

M.Goldin

In January 2011, the Resolution of the Government of the Russian Federation was adopted, whereby the specific features of the execution of the federal budget in 2012 – 2013 were established.

By the RF Government's Resolution of 28 December 2010, No 1171, 'On Measures Aimed at the Implementation of Federal Law of 13 December 2010, No 357-FZ, "On the Federal Budget for 2011 and the 2012 and 2013 Planning Period"', the specific features of the execution of the federal budget in 2012 – 2013 were established.

In particular, the procedure for granting subsidies to legal entities and individual entrepreneurs in 2011 was elaborated more specifically.

It was established that the sums of subsidies granted to federal budget-funded and autonomous institutions and intended to finance the provision of public services assigned thereto by the government should be distributed on a quarterly basis (as a percentage of the annual amount of a subsidy).

It was envisaged that the recipients of funding from the federal budget, when concluding the agreements (or government contracts) on the supply of goods, performance of work or provision of services within the relevant limits of budget obligations set in the established procedure for 2011 and the 2012 and 2013 planning period, as well as the contracts to be implemented at the expense of proceeds from commercial services and other profitable activities, should have the right to demand advance payments. In particular, such payments may be made in the following amounts:

a) 100 % of the sum of a government contract concluded under agreements (or government contracts) on the provision of transport services involving the shipment of humanitarian aid cargoes via railways during humanitarian campaigns launched by the RF Ministry for Civil Defense, Emergency Situations and Disaster Relief or by the recipients of funding from the federal budget supervised by that Ministry, with Russian contractor organizations under agreements (or government contracts) concluded as part of the implementation of agreements concerning the provision of financial aid earmarked for the restoration (or construction, reconstruction, or capital repairs) of certain objects and the acquisition of fixed assets in the Republic of South Osetia and the Republic of Abkhazia;

b) up to 30 % of the sum of a contract, but not in excess of the limits established for budget obligations earmarked for the relevant financial year, – under contracts on the performance of work involving construction, reconstruction and capital repairs of capital construction objects representing public property of the Russian Federation in amounts exceeding 600 mln Rb, as well as subsequent advance payments against the work in progress in the aforesaid amounts, after the performance of the amount of work envisaged in the contract and corresponding to the amount of the advance payment has been confirmed;

c) up to 50 % of the sum of a contract, but not in excess of the limits established for budget obligations earmarked for the relevant financial year, – under contracts concluded with producers of motor transport vehicles and road construction equipment manufactured in the territory of the Russian Federation;

d) up to 30 % of the sum of a contract, but not in excess of the limits established for budget obligations earmarked for the relevant financial year, – under agreements (or government contracts) on the supply of goods, performance of work and rendering of services as part of gratis technical and humanitarian aid provided by foreign states on a bilateral basis;

e) up to 30 % of the sum of a contract, but not in excess of the limits established for budget obligations earmarked for the relevant financial year, – under other agreements (or government contracts), if not otherwise provided by the legislation of the Russian Federation.

Besides, the RF Ministry of Finance was charged with the task, when redistributing budget allocations on the basis of proposals submitted by the principal managers of federal budget funding in respect of the funds saved as a result of the actual use, in 2011, of federal budget allocations in an amount not exceeding 50 % of the sum of the aforesaid savings, to allocate the remaining part of the undrawn funds, in accordance with the established procedure, for the provision of additional financial support to measures aimed at modernizing the national economy.