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## RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES

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## RUSSIAN ECONOMY IN MARCH: TENTATIVE DATA AND BASIC TRENDS

### **Social and Political Background: Political Vitamin Deficiency**

*Socio-political background in March remained fairly stable, but a number of signs indicate the likelihood of the situation aggravation in view of the forthcoming parliamentary and presidential elections.*

*Last elections before the parliamentary ones were held to regional legislatures in 12 regions, and in the majority of them “United Russia” has won the first place with an average 42% of votes. Practically everywhere the result was significantly worse as compared with the parliamentary elections of 2007 (a decline is 15-20%), but it is comparable with the results of previous regional voting (a lower mobilization is typical to regional elections as compared with the federal level). However, in the context of the upcoming federal campaigns, their legitimacy in public opinion is far more important than the actual results of controlled elections. Here, attention is drawn to a significant increase of negative assessments: for example, according to the Fund “Public opinion”, the number of those who assessed the elections held in March 2011 as unfair, was 38%, while such assessments for the elections of March 2010 and October 2010 were given, respectively, by 26% and 21% of respondents.*

*In general, sociological data show a marked deterioration in public assessments of the situation in the country and reducing credibility in regard to the first persons of the state. Sociologists note both, quantitative reduction in the level of confidence to Vladimir Putin and Dmitry Medvedev, as well as qualitative deterioration in the image of the first persons (in particular, Vladimir Putin). It takes place at the background of general decline of optimism in regard to the economic and social situation. Thus, the index (balance) of estimates of the situation in the country, monitored by “Levada Center”, was rapidly declining during autumn-winter, and in March entered the negative zone, which was not observed even at the bottom of the crisis in early 2009.*

*Attention of experts and analysts in March was attracted to distant debate between Vladimir Putin and Dmitry Medvedev on the allied actions in Libya, but, in our opinion, the issue is not essential to relations within the “tandem”, and the controversy fits well into the classical role distribution among the “good and bad cops”. The escalating public conflict between the General Prosecutor’s Office and the Investigative Committee concerning the case of “protection racket” for gambling business in the Moscow Region can be considered to a greater degree systemic and is reflecting the tension in the “high spheres”. New round of confrontation directly involves Yuri Chaika, the Attorney-General, whose son’s name is mentioned in the files of the case. However, recurrent conflicts between law enforcement agencies are quite traditional for Russian policy, and serve rather as mechanism of control over them and balance support, than as a reflection of a real crisis management.*

*In connection with the entry into force of the law “On Police”, re-certification and cleaning of the regional police leadership is in progress. We would like to recall, that strengthening of the vertical accountability of Internal Affairs structures is one of the essential provisions of the new law.*

### **Macroeconomics: the capital is not attracted by the smell of oil**

*After a sharp rise of oil prices in the last decade of February (due to the worsening situation in Libya), in March they were held at current levels near USD 115 per barrel (Brent). Further dynamics will depend, according to analysts, on the situation in Arab countries - the risk of further spread of revolutionary trends is still preserved. However, the accident in Japan and the civil war in Libya are apparently already reflected in the market. In any case, the contango in the market of oil futures is replaced by backward trend, which indicates the probable decline in prices. However,*

the U.S. Department of Energy has raised the estimates of average annual price for Brent in 2011 to USD 102 per barrel, what exceeds the historic peak of 2008 prices (USD 99.75).

Costly oil induced the main trends in macroeconomic developments and the strategy of monetary authorities. During February the Bank of Russia has been actively pursuing interventionist policy, struggling with the ruble strengthening, but at the same time had to take into account the increasing risks of high inflation. As a result, in early March, the Central Bank has extended the corridor, thereby reducing the risk of inflation and allowing ruble to strengthen. On March 31, the exchange rate of USD to RUR was 28.43 (as compared with RUR 28.9 / USD 1 on March 1, +1.6%), the value of the two-currency basket has dropped to RUR 33.64 (versus RUR 33.81 as of March 1, +0,5%).

Redemption of currency from the market in January and February led to an expressed increase in international reserves of the Central Bank of Russia: from February 25 to March 25, they increased from USD 492.2 billion to USD 504.0 billion (+2.4%) and reached the values of the mid-October 2010 (the period when they started to decline). Positive trade balance in January was USD 17.3 billion (the highest indicator since August 2008), and in February, according to the Ministry of Economic Development, remained at the same level. Further growth in oil prices will ensure the stability of this indicator, even despite the record import growth, which, according to the FCS (imports from foreign countries), increased in February by 41% against February 2010. In 2010, these and higher annual growth rates were observed in May (140% versus the same month of previous year) and in August (153%); in the other months from March to December, they were in the range of 24-34% and in total for the year amounted to 30%.

The absence of the actual budget deficit is also based on the high oil prices. According to the monitoring of oil prices over the period from February 15 to March 14, 2011, the average price for Urals oil amounted to USD 108.2 per barrel. Thus, the marginal rate of export duty on crude oil from April 1, 2011 will be increased by 16% - up to USD 423.7 per ton from the March rate of USD 365 per ton.

Against this favorable background, attention is drawn to sluggish dynamics of stock indices. Moderate growth was accompanied by high volatility; as a result, the MICEX index rose from 1,758 p. as of March 1 to 1,813 p. on March 31, and RTS - from 1,962 p. to 2,044 p. (cumulative growth of + 3.6%) . Even more troublesome factor is the continued in February outflow of capital, which reached USD 6 billion (against USD 11 billion outflow in January). The latest trend observed over the past 6 months has no unambiguous interpretation yet.

In March the trend of slowing inflation, emerging in February, has continued. Except for the second week of March, when prices rose by 0.2%, from the last week of February through March 28, the weekly inflation fell to 0.1%. According to the results of March, CPI made 0.5%. For the second consecutive month the price growth rate remain well below the last year values (0.6% in March 2010). Nevertheless, the cumulative inflation since the beginning of the year is still higher than the relevant indicator of 2010 (3.7% versus 3.1%). Reducing inflation was the result of the end of the season and the increase in tariffs of regulated monopolies, as well as various government measures aimed at reducing fuel and food prices (grain interventions, control over rising costs of fuel, reduction of import duties). In addition, the Bank of Russia was taking measures against inflationary pressures through tighter monetary policy (higher interest rates, mandatory reserve requirements and changes in the mechanism of exchange rate policy). At the same time, upward pressure on inflation will inevitably be provided by planned indexation of pensions by 10%, and the rapid increase in prices of industrial producers, who will shift the increased costs on consumers.

In February, the excessive reserves of commercial banks declined: as of the month results, they were equal to RUR 1.7559 trillion (-7.6%). Reduction of excessive liquidity was the result of gradual reduction of resources, traditionally received by banks at the end of the previous year as a result of the peak of budget expenditures, as well as tightening by the Bank of Russia the refinancing terms for banks and increase the rates of mandatory reserves.

In general, trends in macroeconomic sphere can be assessed as follows: high oil prices reduces the risks to macroeconomics (such as budget deficit, deteriorating trade balance due to the rapid growth

of imports), but this does not add optimism to investors, what is reflected both, in the capital outflow and a sluggish dynamics of the stock market.

### **Real sector: looking forward for spring**

Decline in investment activity can be regarded as the most important trend in the first months of the new year. In January-February 2011 investment in fixed assets amounted to 97.7%, and the scope of construction works made 99.7% of the levels in January and February of the last year, while during the previous 10 months the dynamics of investment was in the positive zone, and revival of construction works was ongoing over the past two quarters.

Another important trend is the reduction in real disposable incomes of population, which in January and February amounted to 96.6% against January-February 2010 (in January-February 2010, revenues grew by 9.2% as compared with the same period of 2009). The growth of retail trade turnover, which in January and February amounted to 101.9% against the last year, has slowed down. However, for the first time since the crisis of 2008 in January and February the turnover of the retail market for consumer goods grew with faster pace (102.6% against January-February of 2009) and with respect to the food products (101.1%). However, indicators of real income, retail trade and investment in fixed assets show an improvement in February in relation to the January failure.

In January and February 2011 an increase in industrial production amounted, respectively, to 106.7% and 105.8% of the corresponding period of the last year. In fact, this means an increase of 0.7% compared to the previous period in January (seasonal factors are excluded) and stagnation against January, in February. The largest contribution to industrial growth occurred in processing industries (growth by 11.8% in January-February as compared with the same period in 2010).

According to the Federal State Statistics Service, in March there continued the trend of seasonal growth in the index of business confidence. Herewith, the growth in optimism in the manufacturing and extractive industries is somewhat higher than in March 2010 (i.e., the index is in the positive zone, even after clearance of seasonal factors). Expectations of growing demand and higher output are higher in the mining sector than in manufacturing. Industrial surveys of Gaidar Institute show that although the intentions and expectations regarding the growth of product prices has slowed down as compared with the January upsurge, they still remain extremely high. However, a positive trend is typical for companies in regard to recruitment. Plans to hire employees in March and April reached the maximum level during the crisis: from III quarter of 2008, there was never such significant predominance of the intention to increase the number of employees over the intention to reduce it in the industry. ●

## POLITICAL AND ECONOMIC RESULTS IN MARCH 2011

S.Zhavoronkov

*Twelve subjects of the Russian Federations simultaneously held elections for their parliaments. In the majority of these subjects United Russia achieved worse results than in the 2007 general election, and only in a few of them it managed to improve its previous performance. As a result, the party ended up with an average of 42 % of the votes cast. The three other parliamentary parties – the CPRF, the LDPR and Fair Russia – almost everywhere easily overcome the legal threshold, and collected more than 10 % of the votes cast. Thus, chances are high that after the next general election the State Duma will continue to be composed of four parties. The three non-parliamentary parties once again failed to show an impressive performance, and it is likely that they will not be able to at least approach the seven-percent legal threshold required for entry into the State Duma. March saw the entry into force of a number of amendments to the RF Criminal Code. Initiated by President Dmitry Medvedev, these amendments remove or mitigate the lower limit of penalties for a number of economic offenses, crimes against property and crimes against persons, including thefts, robberies, kidnappings, and the infliction of bodily injuries causing death. After a number of inter-departmental discussions, it was decided that no cardinal reform of the system of state purchases should be urgently undertaken, and that amendments to existing legislation on public tenders would suffice for the time being. A loud corruption scandal broke out between the RF Investigative Committee and the RF Procurator General's Office, whose leadership was accused of being involved in a wide range of criminal activities in the Moscow area.*

In March 2011, 12 subjects of the Russian Federation held elections to their legislative assemblies. These elections were seen as the last big test of public opinion before Russia's general election due in December 2011 (regional elections in the rest of RF subjects will apparently be held in conjunction with the afore-said elections to the State Duma). Once again, in the majority of these regions *United Russia* managed to come first in party-list voting, although its performance had considerably deteriorated (by 15 to 20 %) in comparison with the 2007 election to the State Duma. A drastic drop in the number of votes cast for *United Russia* was registered in all the regions, with the exception of the small and relatively rich Chukotka Autonomous Okrug (71 % vs. 78 % in December 2007), and Tambov Oblast (59 % vs. 65 %) with its very specific regime actually controlling all the local branches of the existing political parties<sup>1</sup>. Also, *United Russia* got more than 50 % of the votes cast in Dagestan, Adygeya and the Komi Republic, and more than 40 % in Kaliningrad, Kursk, Nizhnii-Novgorod and Orenburg Oblasts, as well as in Khanty-Mansi Autonomous Okrug. Its worst results were registered in Tver Oblast (39 %) and Kirov Oblast (36 %). Tver Oblast is traditionally a tough nut to crack for the party of power (for example, the CPRF has always defeated *United Russia* at elections to the City Duma there). To complicate matters further, the long-serving Tver Oblast Governor, Dmitry Zelenin has so far failed to consolidate the local elite, while Kirov Oblast Governor, Nikita Belykh, the former head of the *Union of Right Forces* party, declined to be included in the electoral list of *United Russia* and delegated that task to his deputy. Also, Belykh's image of a progressive governor could hardly have been compatible with the unhesitant use of the so-called administrative resource. As regards the severity of the drop, the steepest decline in *United Russia's* popularity was registered in the extremely rich Khanty-Mansi Autonomous Okrug (44 % instead of 65 %), which is difficult to assess otherwise than the population's protest against the sacking of the super popular governor, Aleksandr Filipenko, and his replacement by Natalia Komarova, a total stranger to the Okrug<sup>2</sup>. It

1 Except for the *Jabloko* party, whose electoral list was denied registration for the 2011 elections to the legislative assembly of Tambov Oblast.

2 These elections have brought to the Okrug Duma the ex-governor's namesake, Aleksandr V. Filipenko, a *Fair Russia* candidate. Filipenko No 2 collected 30 % of the votes despite all the efforts of the official mass media to explain to the electorate that this politician had nothing to do with his famous namesake and was an absolutely ordinary person.

was critically important for *United Russia* to score well in Kaliningrad Oblast, the scene of last year's mass protests and governor replacement. From *United Russia's* point of view, the electoral results it achieved there were mediocre: after gaining 40 % of the votes cast and winning in some of the single-member electoral districts, the party ended up with a majority of seats in the regional parliament. However, this result was not impressive enough. Moreover, to add insult to injury, the leader of last year's protests, Konstantin Doroshok, came first in one of the single-member electoral districts.

On the whole, judging by the results of the spring 2011 elections, *United Russia* has failed to achieve its goal – to breach the 50-percent threshold and to form a stable constitutional two-thirds majority in parliament. Vladimir Putin characterizes the results of the recent regional elections as follows: «*This means that despite their weariness people feel positive about United Russia's activity ... The number of votes dropped a bit due to a lack of coordination in United Russia itself*». So, we should expect that at the forthcoming general election the authorities will increase the use of the 'administrative resource'.

The 'systemic parties' – the CPRF, the LDPR and *Fair Russia* - scored relatively well by having overcome the electoral threshold almost without a glitch (the LDPR, whose leader has recently embarked on rhetorical diatribes against Caucasians, failed to get any seats in the Dagestan elections; the CPRF, always at serious loggerheads with the Chukotka regional authorities, stumbled in Chukotka Autonomous Okrug; while *Fair Russia* failed in Tambov Oblast, where it collected more than 5 % of the vote and received one 'consolation' seat in the regional parliament). Practically everywhere, these three parties got more than 10 % of the votes cast, which clearly increases their 'safety margin' even despite the fact that Russia is known to have a number of territories where the whole election process is totally manipulative, such as some of her national republics and Kemerovo Oblast. The CPRF showed its best results in Nizhnii-Novgorod Oblast (28 %), the LDPR – in Khanty-Mansi Autonomous Okrug, and *Fair Russia* – in Tver and Kirov Oblasts (21 %). In most of the regions, electoral results directly depended on whether or not some or other political party had established strong branch organizations led by well-known and regionally influential political figures. The only exception to this rule was Khanty-Mansi Autonomous Okrug, where the local LDPR leaders were of absolutely no renown, but the party brand turned out to be capable of attracting protest votes, including the votes previously cast for *United Russia* (a more than 10-percent growth on 2007).

Among the non-parliamentary parties, the best results, as usual, were achieved by Gennadii Semigin's party, *Patriots of Russia*, which managed to breach the electoral threshold in two regions – Kaliningrad Oblast and the Republic of Dagestan. At the same time, it is hard to predict whether or not *Patriots of Russia* will indeed be capable of a strong performance at the forthcoming general election: while it was possible for some of this party's local leaders to overcome the 7-percent electoral threshold at the regional level by investing their own resources in the campaign and by having a brand without a rating or anti-rating, the same feat will be very hard to achieve at the federal level, bearing in mind the fact that Gennadii Semigin is almost unknown to the electorate and that he does not spend lavishly on his electoral campaign.

As always, both *Yabloko* and *Right Cause* had a hardly visible electoral presence in practically all the regions under consideration. *Yabloko* was defeated in Kursk Oblast, although its electoral list there was led by the eccentric former deputy of the State Duma Aleksandr Fedulov. Formally, the three-year old *Right Cause* scored its first electoral success by gaining a seat in the Dagestan legislature. A rather inglorious success, it should be added. After the votes were counted, it turned out that *Right Cause* had picked up 4 % of the votes cast in the republic. What happened then had few precedents outside Dagestan<sup>1</sup> - a general recount of the votes that miraculously added to the party's electoral results a bit here, a bit there, and a bit everywhere. As the saying goes, every little helps, and as a consequence of all these efforts, the party ended up with 5 % of the votes and got one 'consolation' seat. It should not be forgotten, though, that situations when the leader of a local branch of *Right Cause* is hand in glove with the head of the regional executive branch are extremely rare. Moreover, nobody should hope for such 'recounts' to take place on country-wide scale.

1 A similar vote recount took place in the aftermath of the 2007 elections to Dagestan' State Council. As a result, the CPRF managed to get a foothold in the said Council.

In March 2011, President Medvedev signed a draft law, already adopted by the State Duma and the RF Federation Council, which was designed to mitigate the criminal responsibility for a number of crimes by removing the lower limit of the penalty of the deprivation of liberty for 68 offences, while the lower limit of the penalty of correctional labor and arrest was removed thereby for 118 offences. The new version of the Criminal Code will make it possible for the legal authorities to use fines as the principal penalty for 11 offences and to impose the penalty of correctional labor for another 12 offences. The newly introduced amendments will make the procedure for replacing a conditional sentence by an unconditional one more complicated in the event of the commission of a new offence of small to medium gravity.

This draft law that was originally introduced into parliament and is now adopted was almost unanimously approved at the phase of its conceptual declaration in the Presidential Message. However, after having been discussed and adopted, the Draft Law began to be viewed negatively rather than positively because, while leaving the upper limit of penalties unchanged, it increases its margins, thus creating corruption stimuli for a court of justice, and also because it envisages a mitigation of penalties for many kinds of violent crimes, which was not declared in the Message. The case in point is that this penalty mitigation is not limited to illegal entrepreneurship, libel and violations of the privacy of correspondence and telephone conversations, but is extended to smuggling, thefts, plunders and robberies. RF Justice Minister Aleksandr Konovalov characterizes these alterations in the Criminal Code as *'revolutionary in many respects ... Due to these amendments to the CC, the number of inmates in Russian penal colonies could drop by one third'*. In the eyes of Russia's educated society and rights activists this 'liberalization' strongly resembles the famous 1953 Amnesty, whose beneficiaries included persons convicted for violent crimes. In particular, this law – which has now come into force – envisages that the minimum penalty for kidnapping; the infliction of harm to one's health resulting in death; and plunders and robberies should be the deprivation of liberty for a term of up to two months. The case in point is that the courts of justice are now actually vested with the right to treat 'protected' bandits with the utmost leniency. Such a 'liberalism' is totally unknown in developed countries, where penalties for crimes against persons, unlike in Russia, display a trend toward toughening.

March 2011 saw the culmination of the long-going controversy over the proposed reform of the system of state purchases, which involved the Federal Anti-Monopoly Service, the RF Ministry of Economic Development, the Higher School of Economics, and the RF Ministry of Finance. In early March, the concept of the draft law on the creation of a 'federal contractual system' developed by the RF Ministry of Economic Development and the Higher School of Economics was finally published by its authors. The Draft Law envisages that the existing Law 'On the Placement of Orders for the Supply of Goods, the Performance of Work and the Provision of Services for State and Municipal Needs' should be repealed, as it is over-formalized and fails to take into consideration the numerous nuances that could emerge in the course of carrying out state purchases. This proposal was opposed by the RF Ministry of Finance (because, according to the new concept, control over the planning of budget expenditures should be passed from the RF Ministry of Finance to the RF Ministry of Economic Development) and the RF Federal Anti-Monopoly Service (whose existing wide powers in the sphere of state orders should be passed to some unnamed 'state agency'). Part of the experts community and a number of well-known suppliers of products for state needs were also critical of this initiative. They drew attention to a number of very vague phrases like the distribution of a state order 'by the method of competitive negotiations'. This debate has spread into the public sphere, just as it happened one and a half years ago with the controversy over the Draft Federal Law 'On Trade'.

March 2011 saw the beginning of yet another scandalous war amongst Russia's power structures – this time between the RF General Procurator's Office and the RF Investigative Committee. Actually, this conflict had been smoldering since the moment when the once all-embracing General Procurator's Office was split into two agencies – the Investigative Committee entrusted with investigation of serious crime, and the General Procurator's Office entrusted with supervising the Investigative Committee's activities. The scandal was sparked by the detention of one Ivan Nazarov, who was charged with fraudulent activities and with organizing an illegal gambling business in Moscow Oblast. The Investigative Committee published a number of photos and videos showing that Nazarov was a close acquaintance of Moscow Oblast Procurator Aleksandr Mokhov and his first deputy, Aleksandr Ignatenko. They were then suspended from office by RF Procurator

General Yuri Chaika, but very soon, in mid-March, Mokhov was reinstated. He immediately began to repeal the rulings of the Moscow Oblast Investigative Committee dealing with the affairs that Nazarov was mixed up in. In their turn, some of those rulings were repealed by the Serpukhov City Court. Nazarov was also charged with extorting a considerable amount of money from the head of Serpukhov raion of Moscow Oblast, Aleksandr Shestun; according to the Investigative Committee of Russia, this money was intended for the leadership of the Moscow Oblast Procurator Office. At his trial, witnesses for the prosecution stated that the criminal activity of Ivan Nazarov was coordinated by Artem Chaika, son of the RF Procurator General.

Like the previous wars between these two agencies and the well-known conflicts between the leaderships of various power structures dealing with the so-called Three-Whales affair and the Bulbov affair, the current scandal is based on competition for illegal incomes. All these conflicts resemble feudal internecine strife. In its turn, the leaderships of Russia's power structures have gained significant prestige and merits in the eyes of her two leaders, which makes it difficult for them to take sides in any such conflict. Therefore the country's leaders always try to find compromise solutions to such scandals (for example, the Three-Whales and Bulbov affairs ended up in a compromise, when both the then Prosecutor General Vladimir Ustinov and the then head of the Federal Narcotics Control Service Viktor Cherkesov were removed from office and heavily demoted). The official mass media always treats the scandalous nature of such affairs as a reason for thoroughly investigating the rights and wrongs of each of the parties.

Foreign commentators were highly intrigued by the difference in the opinions on the events in Libya expressed by RF Prime Minister Vladimir Putin and RF President Dmitry Medvedev. For reference: After the UN Security Council adopted a resolution authorizing a military operation to protect the Libyan population from being attacked by Muammar Gaddafi's army with aviation and heavy weapons, and Russia abstained from the vote, the Libyan regime's aviation, anti-aircraft defenses and part of its heavy weapons were destroyed. Libya has been witnessing the emergence of a dynamic and at the same time stable equilibrium between the rebels who are controlling the eastern part of the country (their provisional government has already been recognized by France and Qatar) and the armed forces of the Libyan dictator Muammar Gaddafi who controls its western part. EU members countries and NATO are discussing the possibility of a ground operation designed to remove Gaddafi from power. However, the USA still refuses to give its backing to such an operation, and it is not clear as yet whether or not it will ever take place. Vladimir Putin sharply criticized the military operation undertaken by the coalition and the UN Security Council's resolution (which had been, in fact, supported by Russia): '*... It is defective and flawed, it resembles a medieval call for a crusade, ... it allows for a foreign intervention in a sovereign state*'. At the same time, Putin emphasized that he was expressing his personal opinion. Several hours later his remarks were commented by RF President Dmitry Medvedev: '*One should be cautious when assessing the current situation... Under no circumstances is it acceptable to use expressions which essentially lead to a clash of civilizations, such as 'crusade' and so on*'. State TV channels transmitted both speeches, but then the Putin/Medvedev polemic abruptly stopped, and officials declined to offer any comment in this regard.

These developments have engendered a lot of comments reputed that Dmitry Medvedev and Vladimir Putin had different views on foreign policy – just like it was reputed in December 2010 that they had different views on the Yukos affair. We believe that these comments are not sufficiently substantiated. Firstly, the personnel composition of the government, the power structures, the management of state-owned companies and the leadership of the *United Russia* party has not significantly changed over the past three years. Considerable changes have been observed only in the ranks on the governors, but any 'Medvedev's faction' worth mentioning has so far failed to emerge within their cohort. Secondly, the country's political system has undergone no substantial changes (while the alterations introduced therein, like the ban on election deposits or the ban on the submission of electoral lists by public organizations in municipal elections, can by no means be characterized as positive). Thirdly, the framework of the public discussion between these two persons of the most exalted station closely resembles that of the 2006 – 2007 polemic between Dmitry Medvedev and Sergei Ivanov – in both cases the aim of the discussion was to keep the intrigue going, and nothing else. ●



## INFLATION AND CREDIT AND MONETARY POLICY

N.Luksha

*In February-March 2011, inflation has slightly declined. In February, consumer prices growth slowed down three times as compared with January, having reached 0.8 per cent at the end of the month. In March, after three weeks, inflation dropped to 0.4 per cent (0.5 per cent over the relevant period of the last year). As a result, cumulative inflation since the beginning of the year to March 21 has reached 3.6 per cent (3.1 per cent over the same period in 2010). On March 1, 2011 the Bank of Russia increased flexibility in exchange rate policy, expanding the range of admissible values of the two-currency basket, and reducing the amount of accumulated interventions, which lead to a shift in the boundaries of the interval. In mid-March it was informed that since July 1, 2011 the conclusion of direct REPO transactions with banks was suspended. In addition, it was decided to increase mandatory reserve thresholds from April 1, 2011.*

In February, inflation slowed down three times as compared with January: as of the month results, CPI amounted to 0,8 per cent (see Fig. 1). For the first time since June 2010 the February consumer price index was lower than in the last year (0.9 per cent). Price growth rate reduction was observed in all groups of goods and services. The largest slowdown was observed in commercial services: they rose by only 0.8 per cent as compared with 4.1 per cent a month earlier. Prices growth for housing utilities continued, but was markedly lower than in January (1 per cent versus 9.1 per cent). Increased fees for kindergartens served as a basis for further growth in prices for preschool services (1.8 per cent). As a month earlier, in February foreign tourism services became cheaper (-0.3 per cent).

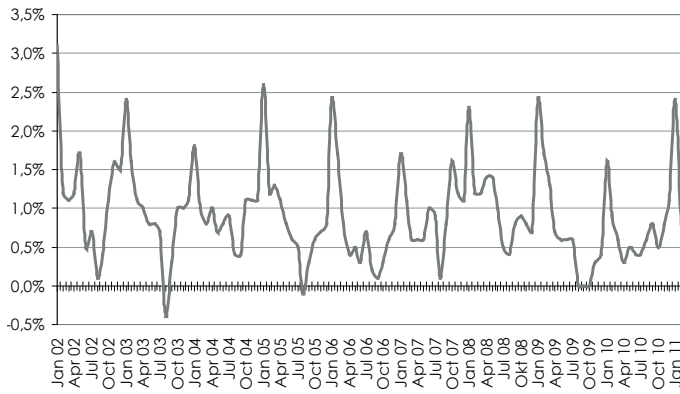
Foodstuffs continued to grow in price in February. The contribution of foodstuffs in consumer prices in February was again the largest. Nevertheless, the growth rate of food inflation was much lower than in January (1.2 per cent versus 2.6 per cent). Slower growth in prices contributed to a number of factors, namely: a significant reduction in the rate of increase in prices for fruit and vegetables (2.7 per cent against 11.2 per cent in January), sugar (1.5 per cent versus 7.4 per cent in January) and sunflower oil (1.8 per cent against 4.1 per cent in January). In February, prices for cereals and beans rose nearly by 1.5 times slower than in the previous month (4.8 per cent). In addition, eggs became dramatically cheaper (-4.1 per cent).

The basic consumer price index<sup>1</sup> in February 2011 amounted to 0.7 per cent (against 09.9 per cent for the same period in 2010).

In March, the trend for slowing down of inflation has remained. Except for the second week of March, when prices rose by 0.2 per cent, since the last week of February through March 21, the weekly inflation fell down to 0.1 per cent. As of results of three weeks of March, the CPI made 0.4 per cent, as compared with 0.5 per cent for three weeks in March 2010. For the second consecutive month the rate of price growth remains below the last year values. Nevertheless, the cumulative inflation since the beginning of the year is still higher than in 2010 (3.6 per cent versus 3.1 per cent).

To combat inflation, the Government has taken a wide range of administrative measures (grain interventions, control over the rising cost of fuel, reduction of import duties). These measures have provided some effect: in March fuel and food inflation has reduced: over three weeks of the month fuel price fell down by 0.4 per cent, there was some decline in prices for some food products (chicken, sugar and potatoes fell from 0.3 to 1.6 per cent), market prices for grain became equal to the interventional ones. The latter ones could be also influenced by the expiring effect of the summer shocking proposals. With the end of the period of growing regulated tariffs for housing

<sup>1</sup> 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



Source: RF Statistical Service.

Fig. 1. The Growth Rate of the CPI in 2002 - 2011  
(% per month)

producers, who will shift the increased expenses on consumers. At the same time, restriction factors for inflation will be ruble strengthening, as well as slowing the growth rate of monetary supply (growth rate of monetary supply M2 in January fell down by 3.5 per cent). In addition, the Government intends to continue to restrain prices growth in the future: Vice-premiers were authorized in mid-February to keep control over the rising prices for food, fuel, and growing tariffs for housing utilities, electricity. Great influence on the inflation rate as of 2011 results will be certainly provided by fiscal policy. In case of growth of expenditures in anticipation of elections, it will be extremely difficult to keep inflation under control.

According to IEP model assessments, inflation as per 2011 results will not meet the forecast of the Ministry of Economic Development level of 7 per cent. Nevertheless, in our estimates, it will not exceed 10 per cent, which anticipated by many experts in early 2011 against the background of accelerating growth in consumer prices. Depending on the scenario of socio-economic development of Russia in 2011-2020, the CPI in the current year will make 8.1 per cent - 8.9 per cent (at an average annual oil price, respectively, at USD 81 dollars per barrel and USD 100 per barrel in the second option, given the fiscal expansion during the election period).

In February, the monetary base in broad definition continued to decrease: as of the month results, it has declined by 0.9 per cent to RUR 7,431.1 bn. The decline of the monetary base was provoked by nearly 1.5-fold decrease of credit organizations' deposits with the Bank of Russia, which made RUR 522.6 as of March 1. Other components of the monetary base were growing: cash in circulation with regard to the fund balances in credit organizations has grown by 1.4 per cent (having grown to RUR 1.6 trillion, correspondent accounts of credit organizations with the Bank of Russia grew by 16.5 per cent (RUR 633.6 billion, mandatory reserves – by 1.6 per cent to RUR 195.2 billion, bonds of the Bank of Russia with credit institutions – by 0.7 per cent to RUR 599.7 billion).

In February, the excessive reserves of commercial banks<sup>1</sup> have significantly decreased: as of the month results, they made RUR 1755.9 bn (-7.6 per cent). Reduction of excessive liquidity was the result of a gradual reduction in resources, which were traditionally received by banks at the end of the previous year as a result of the peak of budget expenditures, as well as tightening the refinancing terms for banks and raising the threshold of mandatory reserves by the Bank of Russia. In March, the RF Central Bank continued its program of reduction anti-crisis support to credit institutions: from July 1, the conclusion of direct REPO transactions with the banks to replenish liquidity will be suspended. These transactions have been started in February 2009 to overcome the systemic liquidity insufficiency in the banking sector in the post-crisis time. Currently, however, they ceased to be in demand among by the lending institutions.

In February the growth in the volume of cash in circulation by 1.4 and increase of mandatory reserves by 1.6 per cent urged the extension of monetary base in narrow definition (cash plus

utilities, heating and hot water supply became cheaper (-0.1 per cent). The RF CB, in turn, is struggling with inflationary pressures through tighter monetary policy (raising interest rates, mandatory reserves requirements and changes in the mechanism of exchange rate policy). The impact of ruble appreciation on inflation would be likely felt in the near future, as the time lag between the strengthening of the exchange rate, which started in December 2010, and the reduction of inflation is about three months.

At the same time, upward pressure on inflation will inevitably be made by planned indexation of pensions by 10 per cent, as well as the rapid increase in prices of industrial

<sup>1</sup> 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.

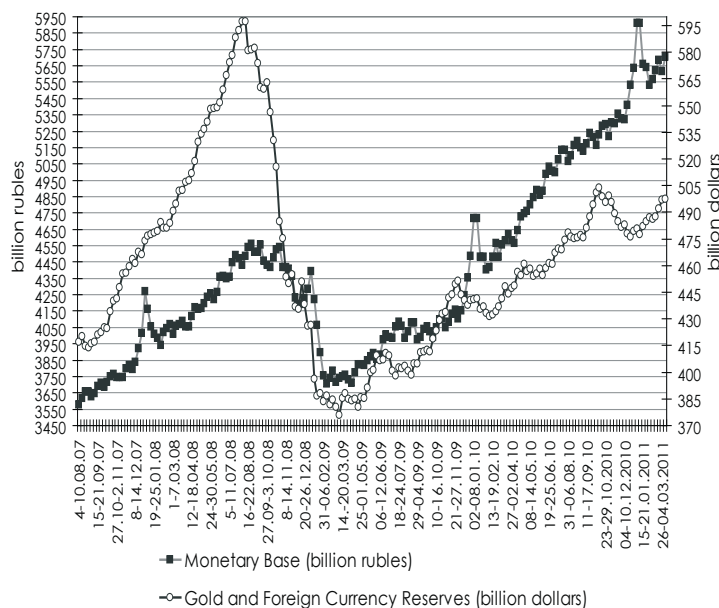
mandatory reserves)<sup>1</sup> by 1.4 per cent to RUR 5675.1 bn (see Fig. 2).

Since the second decade of February the international reserves have been continuously growing, their volume increased by 2.6 per cent over the month, having reached by March 18 USD 500 billion. At the background of rising oil prices, international reserves returned to the indicators of October 2010, when for the first time since the crisis of 2008 they overcome the level of USD 500 billion. As in the last month, an increase of reserves was primarily based on currency revaluation. An additional source of growth in reserves was the purchase of foreign currency by regulator.

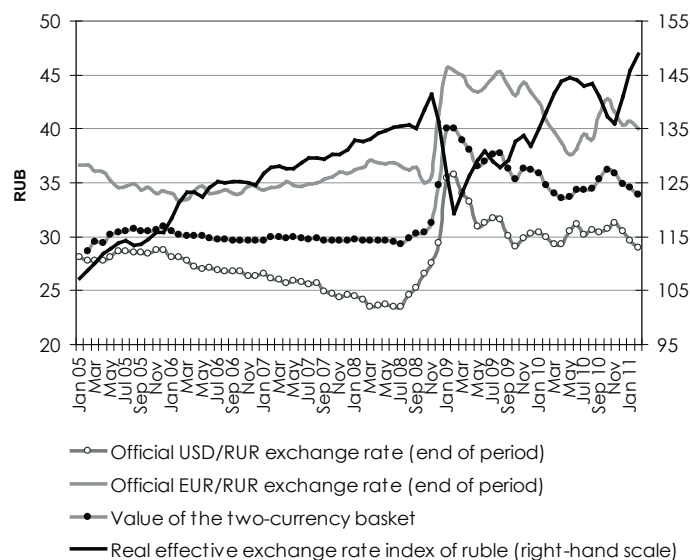
Despite the record peak of oil prices in February, according to preliminary estimates of Alexander Ulyukayev, First Deputy Chairman, capital outflow from the country continued and amounted to about USD 6 billion. In January the outflow was even higher - USD 11 billion. Partially the inflow of foreign currency is absorbed by the Central Bank Russia for international reserves replenishment. However, what is not bought by the controller, is “floating away” from the country to be placed in less risky assets abroad. Situation in our country is characterized by political and economic uncertainty, which does not contribute to non-speculative capital inflow. The political negative factors include the resignation of the Mayor Yuri Luzhkov and the second trial against M. Hodorowsky at the end of the last year, as well as the risks associated with the upcoming elections. One cannot regard investment climate as favorable in view of accelerating inflation in early 2011, as well as increasing the tax burden on business.

Against the background of high oil prices, for the third consecutive month, the real effective exchange rate has continued to strengthen: in February it has grown by 2.1 per cent. Real effective exchange rate index reached 145.71<sup>2</sup> (see Fig. 3<sup>3</sup>).

March was one more reflection of the dependence of the ruble on the dynamics of the world oil prices. Strengthening of the ruble at the beginning of the month against both, dollar, and Euro, which was a continuation of the dynamics of the past months, when, due to high oil prices, the Russian currency was growing in price. Earthquake in Japan and the associated with it expectation of falling demand for energy sources brought about a



Source: RF Central Bank  
Fig 2. Changes in the Monetary Base and in the Gold and Foreign Currency Reserves in 2007 - 2011



Source: RF Central Bank, author's estimates.  
Fig. 3. Indicators of Ruble's Exchange Rate Dynamics

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

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

decline in the world oil prices. As a result, the ruble has decreased against both foreign currencies. The subsequent growth and stabilization of oil prices at the level of USD 115 per barrel because of the war in Libya and possible growth of oil demand in case of reducing the use of nuclear energy contributed to the growth rate of the Russian currency.

Spring brought no changes in the dynamics of the value of the two-currency basket: ruble continued to strengthen, and the two-currency basket grew cheaper. On March 26, it decreased to 33.53 rubles. (-1.1 per cent).

In line with our forecast, the ruble nominal average exchange rate in 2011 will amount to 29.4 rubles to the dollar and the ruble exchange rate against Euro - 38.22 RUR / EUR. Strengthening of the ruble will be primarily due to higher oil prices.

In the framework of a gradual transition to the regime of inflation targeting, from March 1, 2011, the Bank of Russia has changed the parameters of the mechanism of exchange rate policy:

- symmetrically extended operating range of admissible of the two-currency basket values from 4 to 5 rubles;

- reduced the amount of accumulated interventions, resulting in the shift in the operational range by 5 kopecks., from USD 650 million to USD 600 million.

This measure was undertaken in accordance with the basic trends of monetary and credit policy for 2011-2013 and is aimed at reducing the direct interference of the RF CB in foreign exchange rate formation in the domestic market. Balancing between the excessive appreciation of the ruble curbing and inflation acceleration, the RF CB has decided to allow some appreciation of the ruble for the slowdown in prices. High world energy prices urge the inflow of foreign currency earnings to the country. In February, in the framework of foreign exchange intervention, the Bank of Russia came to the market with net purchases of currency in the amount of USD 3.5 billion (which is five times higher than in January of this year) and Euro 796 million (6.5 times higher than January purchases). Extending of the operating range since March, most likely, will increase the range within which the Bank of Russia will not intervene in exchange rate regulation through foreign currency intervention, and thereby will limit additional ruble emission. Thanks to that measure, monetary inflation will slow down its growth. We would like to remind, that earlier the central bank expanded the foreign currency range from 3 to 4 rubles in October 2010.

On March 25, 2010 the Central Bank decided to leave unchanged the refinancing rate and interest rates on the Bank of Russia operations. At the same time, the Central Bank increased the mandatory reserves requirements from April 1, 2011:

- under the liabilities of credit institutions to non-resident legal entities, denominated in rubles and foreign currency - from 4.5 to 5.5 per cent;

- under the liabilities to individuals and other liabilities of credit institutions, denominated in rubles and foreign currency - from 3.5 to 4.0 per cent.

This is already the third standards' upgrading in the current year. Regulator's decision to leave interest rates unchanged due to the fact that for the second consecutive month inflation has slowed down (from 9.6 per cent in January to 9.4 per cent March in annual terms). At the same time, inflationary risks remain high, ruble liquidity excess is preserved, and the danger of speculative capital inflows against the background of ruble increases. In this regard, the Bank of Russia has again upgraded compulsory reserves threshold. However, in our opinion, in order to reduce inflation, there is a need for more decisive steps to tighten monetary policy. ●

FINANCIAL MARKETS<sup>1</sup>

N.Burkova, E.Khudko

The main focus of the financial markets in March 2011 was drawn to the events in Japan, the natural disasters of which, besides the huge financial and human costs, have led to increased levels of contamination, fears about a possible nuclear accident, and uncertainty about the pace of further global economic recovery. Political instability in the Middle East and North Africa, in particular the developments in Libya, led to the dynamics of growth of petroleum quotations. This trend has resulted in a general upward dynamics of the Russian financial market in March.

## Government securities market

In March, growth in the global oil prices, high ruble liquidity, strengthening of the ruble against the dollar contributed to a substantial increase in demand for government securities market and their yield reduction. However, the Bank of Russia refinancing rate upgrading up to 8 per cent, high level of February inflation rate, the tension in view of the events in Japan, that put pressure on market quotations. In addition, it may be noted that on February 24, the RF Ministry of Finance have placed seven-year ruble-denominated Eurobonds for the amount of 40 billion rubles with the yield of 7.85 per cent per annum and maturity date on March 10, 2018.

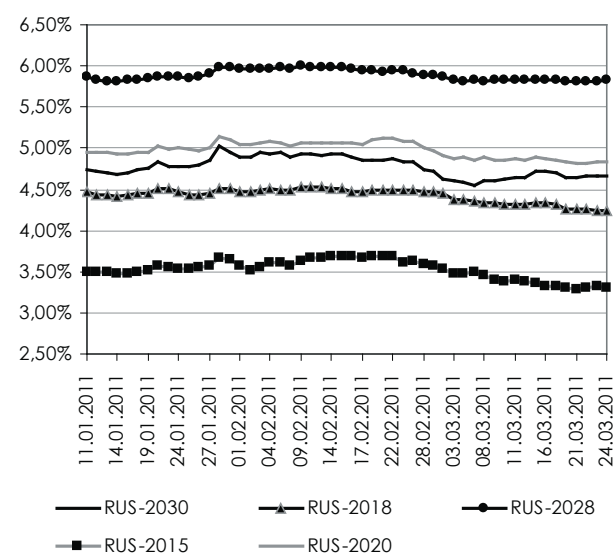
As of March 24 of the current year, the Russian Eurobonds RUS-28 yield to maturity has insignificantly decreased as compared with the level of February 23. The yields of external currency debt bonds demonstrated a similar trend. (See Figs 1- 2).

Within the period from February 24 to January 24, 2011, the total turnover of the secondary market of government bonds amounted approximately RUR 530.63 billion at the level of RUR 26.53 bn (about RUR 244.19 bn with an average daily turnover of RUR 11.63 billion in February), which means a significant growth of an average monthly turnover by 2.3 times.

Within February 24 through March 24, there were four auctions for government bonds issue at the primary market (there were five auctions a month before) (See Table 1). Herewith, the total actual amount of placement amounted to 78 per cent from the planned volume. There were no additional government bonds placement in the secondary market.



Source: "Finmarket" Information Agency data.  
Fig. 1. Minfin bonds' yields to maturity in January – March 2011



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 January–March 2011

<sup>1</sup> 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.

Table 1

PLACEMENTS IN THE GOVERNMENT BONDS PRIMARY MARKET

Auction date	Issue	Issue volume, RUR mln	Issue volume at face value, RUR mln	Average weighted yield
02.03.2011	OFZ-26203-PD	20,000.00	18,380.52	7,62
09.03.2011	OFZ-25076-PD	30,000.00	28,665.81	6,83
16.03.2011	OFZ-25077-PD	30,000.00	10,219.14	7,60
23.03.2011	OFZ-26204-PD	25,000.00	24,757.82	7,89
Total:		105,000,00	82,023.29	

Source: RF Ministry of Finance data.

Stock market

Stock market situation

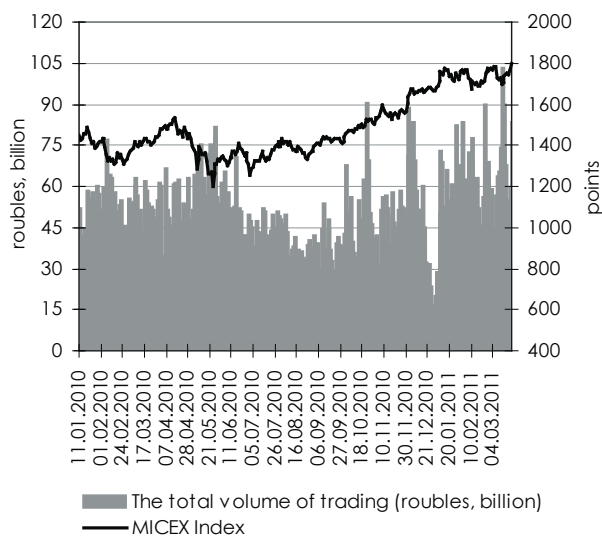


Fig. 3. Dynamics of MICEX Index and trading volume

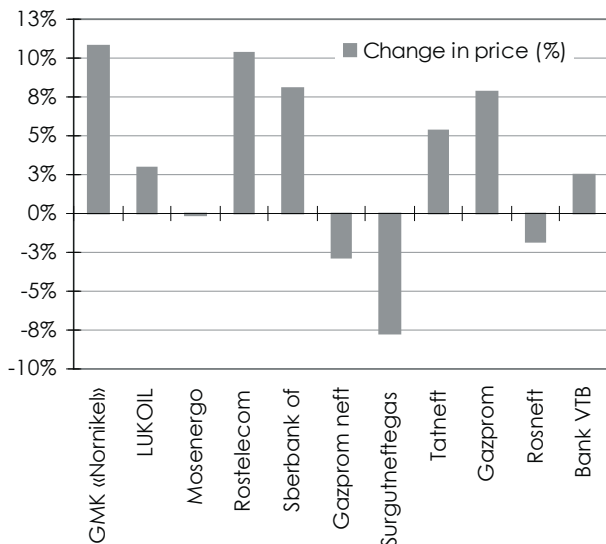


Fig. 4. Dynamics of the Russian Blue Chips from February 24 to March 24, 2011

Positive factors that influenced the stock market in March, were the increase in oil prices, rising trade surplus of the Russian Federation in January 2011 to 17.7 per cent, international reserves, sales of new passenger cars (by 77 per cent in annual terms) and Industrial production in Russia in January-February 2011, as compared with January-February 2010, by 6.3 per cent, the reduction of unemployment in Russia by 7.4 per cent from the economically active population in February, as well as positive financial statements of a number of major Russian companies. On the other hand, the limited growth of Russian securities in March, contributed to high inflation in Russia, a negative external background provoked by the situation in the Middle East, North Africa and Japan. The maximum value within the month the MICEX index has reached on March 24, having reached – 1,795.4 points (1,767.77 points in the preceding month). The minimum value for the period the MICEX index has reached on March 15 – 1,700.54 points (against 1,676.77 points in the preceding month) (See Fig. 3).

In general, within the period from February 24 to March 24, 2011, the MICEX index has increased by 5.55 per cent, what makes about 94.42 points in absolute terms (from March 25, 2010 through March 24, 2011, the MICEX index has been upgraded by 27.64 per cent). Therefore, the average monthly turnover of trades in securities included in the stock market in March has increased as compared with the preceding period by 7 per cent.

As of the period under review, the leaders among the “blue chips” securities were the securities of GMK “Nornickel” and Rostelecom, which have grown by 10.81 and 10,35 per cent accordingly (See Fig. 4).

According to MICEX information, as of March 24, the top five leaders of the domestic stock market

in terms of capitalization were: “Gazprom” – RUR 5,294.58 bn, “Rosneft” – RUR 2,835.22 bn, “Sberbank of Russia” – RUR 2,229.5 bn, “LUKOIL” - RUR 1,731.58 and GMK Nornickel – RUR 1,284.15.

### ***Futures and Options Market***

In March the average daily turnover in the MICEX futures market has increased by 10 per cent as compared with the preceding month. The largest volume of trading in March, like a month before, was observed in contracts for futures and equity instruments, amounting to RUR 106.19 billion (373.88 thousand of transactions). Herewith, in terms of the trading volume in this section of the futures market, the MICEX derivatives are followed by the futures supply contracts for the shares of Nornickel, Gazprom, Sberbank and LUKOIL. We would like to note, that the value of the MICEX index (the price of transactions) for June 2011 was at the level of 1,680–1,770 points, i.e., there expected 1.5–6.5 per cent points index reduction and for March 2011 – at 6.5 reduction versus the indicator of March 24, 2011.

The second place in terms of trading volume (RUR 50.21 bn) within the month of March was taken by foreign currency futures contracts. Herewith, the first place in this section was taken by the futures contracts for USD, followed by the futures contracts for Euro/USD and Euro/RUR rate. Prices of futures contracts, concluded in March for RUR/USD futures in the MICEX market were within RUR/USD 28.4–29 for June 2011, i.e., 0.5-2.5 per cent decline is expected as compared with the indicator of March 24, 2011. We would like to note, that since March 28, the MICEX launches trading with 3 futures supply contracts for the bonds of federal short, medium and long-term basket.

Similar trends were observed in the RTS FORTS futures market, where the investors' average daily activity in March has increased by 10 per cent as compared with the previous month. 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 USD-RUR rate, for Euro/USD rate and for the shares of Sberbank of Russia and Gazprom shares. Prices of the latest transactions, concluded in the RTS FORTS on futures contracts RUR/USD rate for the date of execution on June 15, 2011, were basically within RUR 28.4–29 /USD, i.e., there expected 0.5–2.5 per cent RUR reduction versus the indicator of March 24, 2011. The value of futures contract for the RTS index (based on the prices of recent contracts) with the execution date on June 15, 2011 made 1,850–1,990. Options enjoyed far less demand, the turnover made about RUR 298.06 bn (369.54 thousand transactions and 3.62 of contracts). The maximum daily turnover in the short-term RTS futures market in the period under review made RUR 161.68 billion (as of February 21), and the minimum was RUR 161.68 (as of February 11). It should be noted, that from February 17, 2011 in the futures market of RTS FORTS there were started trading in futures for the basket of federal loan bonds. We would like to note, that from March 15, 2011 OAO «Saint Petersburg Stock Exchange» in the framework of a joint project with RTS Group there were started trades in wheat futures contract with deadlines in March, May, July, September and December.

### ***External factors behind the Russian stock market dynamics***

One of the main factors supporting the Russian stock market in March was the global oil market, which experienced significant growth of quotations, inspired by political instability in the countries of Middle East and North Africa, major oil exporters (see *Table 2* and *Fig. 5*).

The largest downfall for the month was demonstrated by Japan stock index Nikkei-225 (10.81 per cent). At the same time, emerging markets have shown an increasing trend by 1.8 per cent per month (see *Table 2* and *Fig. 5*).

*Table 2*

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

Index	Ticker	Value	Dynamics within the month(%)*	Dynamics from the year beginning (%)
MICEX (Russia)	MICEXINDEXCF	1 795,40	5,55	6,36
RTS (Russia)	RTSI	2 027,89	8,17	14,55
Dow Jones Industrial (USA) Average (USA)	DJI	12 170,56	0,54	5,12
NASDAQ Composite (USA)	NASD	2 736,42	0,49	3,15
S&P 500 (USA)	SPX	1 309,66	0,17	4,14
FTSE 100 (UK)	FTSE	5 880,87	-0,72	-0,32
DAX-30 (Germany)	DAX	6 933,58	-3,63	0,28
CAC-40 (France)	CAC	3 968,84	-1,10	4,31

Table 2, cont'd

Index	Ticker	Value	Dynamics within the month(%)*	Dynamics from the year beginning (%)
Swiss Market (Switzerland)	SSMI	6 319,23	-4,58	-1,81
Nikkei-225 (Japan)	NIKKEI	9 435,01	-10,81	-7,76
Overpay (Brazil)	BUSP	67 532,97	0,93	-2,56
IPC (Mexico)	IPC	36 872,38	1,12	-4,35
IPSA (Chile)	IPSA	4 596,71	7,28	-6,71
Straits Times (Singapore)	STI	3 043,03	1,37	-4,61
Seoul Composite (South Korea)	KS11	2 036,78	3,83	-0,69
ISE National-100 (Turkey)	XU100	64 355,86	1,94	-2,50
BSE 30 (India)	BSE	18 350,74	0,95	-10,52
Shanghai Composite (China)	SSEC	2 946,71	2,94	4,94
Morgan Stanley Emerging Frontier Markets Index	EFM	897,15	3,39	-1,60

\* – Versus index indicator valid on February 23, 2011. Таблица 2

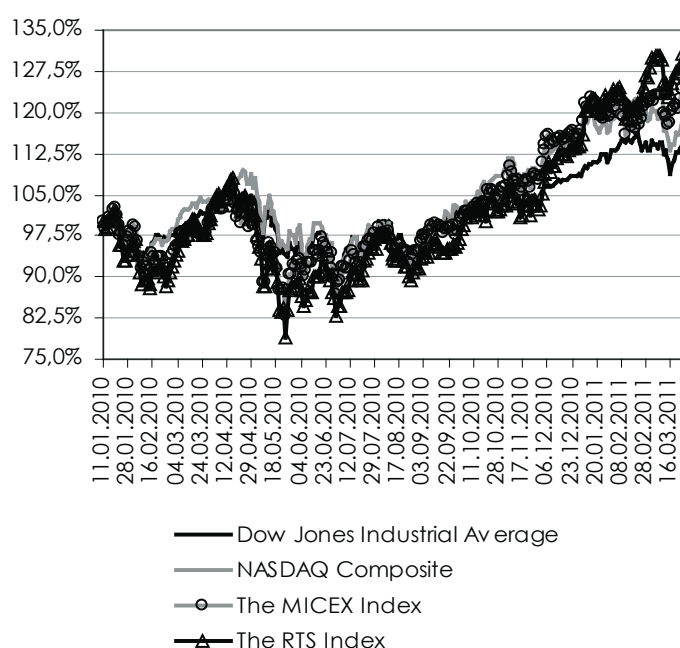


Fig. 5. Dynamics of the main USA and Russian stock indices (in % to the date 11.01.2010)

Summarizing the results, we can say that there is no clear trend in the Russian stock exchange markets. Despite the increase of the main Russian indices in March against the background of high oil prices has resulted in positive dynamics of the Russian market and provided opportunities for continued growth, one cannot speak of a substantial recovery of the Russian stock market yet. This conclusion is also supported by expectations of the futures market investors for reduction of the indices as of June 2011. The Impact on the Russian market in the next few months will be provided by the US macroeconomic statistics, the situation in the Middle East and North Africa, directly effecting the dynamics of the world oil prices, as well as the economic situation in European countries, largely affected by the financial crisis (in particular, Portugal and Spain).

### 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 March of the current year after two months of stability and continued its growth and at the end of January reached the level of RUR 2,992,2 bn, having demonstrated a significant growth against the relevant indicator of the late February (+5.1 per cent)<sup>1</sup>. It should be noted that the maximum capacity of the corporate bond segment for the entire period of the Russian securities market. At the same time, the number of emitters in the debt sector of corporate bonds market has somewhat decreased (355 emitters against 362 in the preceding month), whereas the number of bond emissions in circulation, denominated in national currency on the contrary, increased (from 722 issues against 718 in late February). Such volatile dynamics of the two indicators suggests that the number of participants in the market becomes less, but each of them actively borrow through bonds, placing a few issues of securities at a time. There is still one emission of bonds in circulation, denominated in US dollars and one in Japanese yens.

The turnover of secondary trading in the stock market has reached its peak within the last three years. Thus, in the period from February 24 to March 24, the total volume of transactions in

1 As per Rusbonds information



the MICEX Stock Exchange amounted to 149.3 billion rubles (for comparison, from January 25 to February 22, the volume of transactions was equal to 143.2 billion rubles.). The number of transactions has somewhat decreased: from 28.4 thousand as of February level to 27.4 thousand in March, which is also a very high value<sup>1</sup>.

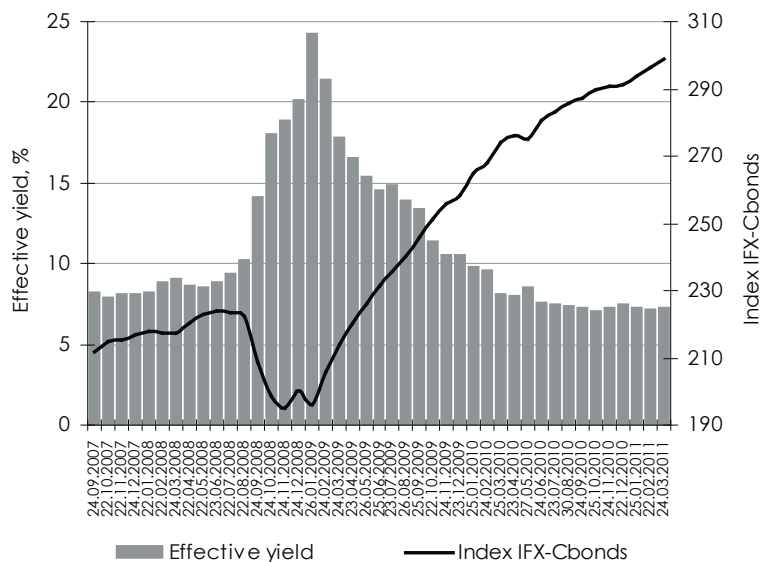
Index of the Russian corporate bonds market IFX-Cbonds demonstrated a stable growth from the beginning of the year (by 2.3-2.7 points or 0.8-0.9 per cent per month). The relative weighted average effective yield of corporate bonds in the period under review has somewhat increased (from 7.17 per cent at the end of February to 7.32 percent at the end of March), but in general remained within the range of June of the last year, 7.1–7.6 per cent (Fig. 6). Such a correction in the level of profitability was the result of raising the refinancing rate from February 28 to 0.25 percentage points. The index of portfolio duration of corporate bonds discontinued the downward trend and by the end of March was 597 days, which is 57 days more than the value at the end of February. This is an indication that, despite the increase in profitability, the share of the long-term commitments in the market increased.

The growth of the bonds yield bonds on average in the market was ensured by the emitters of the second tier, and the most liquid bond issues in the period under review have in general demonstrated a downward trend.

In March of this year very high levels of state registration of corporate bonds have been recorded. Thus, in the period from February 24 to March 24, there was registered 25 bond emissions totaling to RUR 106.0 billion. However, such a number of issues was made only by 7 rather large emitters, which have been represented in the stock market for a long time. They are actively using the tool of stock bonds, so 18 out of 25 of reported emissions were made in the stock bonds.

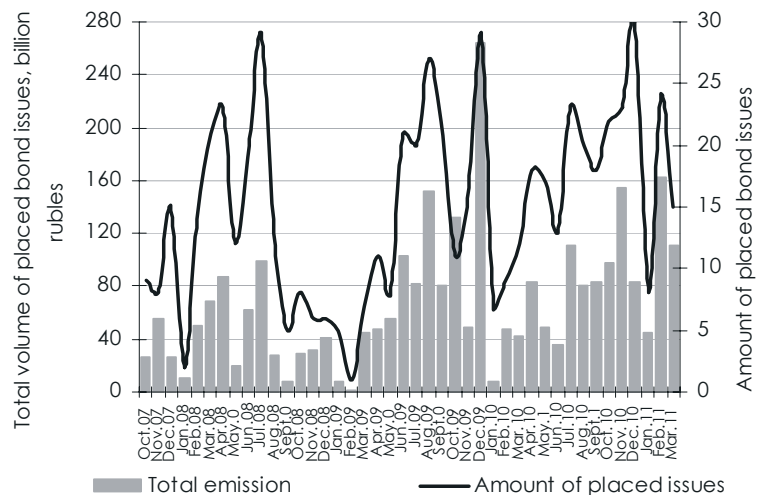
Indicators of primary bond market declined against the record set in February, but still remained at a very high level: the total amount of emissions, placed in the period from February 24 through March 24 amounted to RUR 110.9 billion (versus RUR 162.8 billion from January 26 to February 22), and the amount of emissions was 15 (for the preceding relevant period there were placed 24 emissions) (Fig. 7).

In the period from February 24 to March 24, the Russian Federal Financial Markets Service has canceled two debut issues of bonds issued by modest emitters due to non-placement of any security and the state registration was revoked.



Source: Cbonds data

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



Source: Rusbonds data

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

1 As per "Finmarket" Information agency.

In the period from February 24 to March 24, twenty two bond emitters were to be redeemed for the total nominal value of RUR 33.4 billion. However, two emitters have failed to perform their liabilities and announced a technical default on redemption of their bonds with the total nominal value of 6 billion rubles (as compared with one emitter who failed to perform its liabilities for the total nominal value of 6 billion rubles in due timeframes). In April 2011, 13 corporate bond issues totaling to RUR 20.4 billion are expected to be redeemed<sup>1</sup>.

The situation with the performance of current debt liabilities by emitters is still not easy. On the one hand, from February 24 to March 24, the real default on bonds coupon yield redemption was announced by six emitters (against only one emitter from January 26 through February 22), but herewith, during the period under review none of the emitters did not declare an actual default on repayment of bonds or early redemption thereof (in the previous period two emitters failed to repay the invested funds, and one emitter failed to redeem the securities on offer ahead of time)<sup>2</sup>.

### Market News

On March 24 there were reports that the Republic of Tatarstan plans to sign a mandate to issue Islamic bonds - Sukuk (in accordance with Muslim law, which prohibits to charge interest on credits) for the amount from USD 100 to 200 million with the maturity at the end of June 2011. The organizers of the loan are Kuwait Finance House, Malaysia and the Malaysian trust company Amanah Raya Berhad, a co-organizer is Linova company, Tatarstan. The emitter of the securities will be a specially organized SPV, the originator will be a state-owned company, whose name has not been disclosed, and a guarantee will be the land and real estate. Currently several options of sukuk are under consideration: most likely they will be the sites of Malaysia and Luxembourg, there is also an option of their placement in the Russian Federation. Among the investors are the countries of Persian Gulf, Southeast Asia and Europe. The proceeds from the sukuk placement will be addressed to the long-term infrastructure projects. ●

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1 Rusbonds data.

2 Cbonds data

## REAL ECONOMY SECTOR: TRENDS AND FACTORS

O.Izryadnova

*In January-February 2011 the industrial production in the Russian economy continued to grow, the situation at consumer and investment markets, however, was unstable. As compared with January-February 2010 the increase in industrial production made 6.3%, in retail trade turnover – 1.9%, while investments in fixed assets went down by 2.3%. Despite the acceleration of manufacturing production growth rates, the structure and dynamics of the recovery growth as broken by types of economic activities is more and more influenced by the increasing volumes of import.*

In January-February of the current year the positive dynamics of industrial production was observed to recover. In February and January-February 2011 the increase in industrial production made 105.8% and 106.3%, correspondingly, versus the analogous periods of the previous year, which has supported the growth of the demand for transportation services by 5.3%, including the increase in demand for railway transportation by 10.9% versus January—February 2010.

The situation remained quite difficult at consumer and investment markets. The increase in retail trade turnover in February and January-February 2011 made, correspondingly, 103.3% and 101.9% versus analogous periods of the previous year, non-food goods retail market turnover growing at anticipating rates (102.6% versus January-February 2009) as compared with foodstuffs market (101.1%). Such a ratio after the crisis of 2008 was observed in the 4<sup>th</sup> quarter 2010 for the first time. The consumer behavior is defined by both the change in prices structure and the pressure of deferred demand formed during the acute phase of 2008-2009 crisis. The population's expenses structure was influenced by the increased inflation expectations together with the decrease in the real incomes of the population. In January-February 2011 real disposable monetary incomes of the population made 96.5% of the level of the corresponding period of the previous year.

The situation at the labor market is improving gradually. After a continuous period of reduction, the demand for the labor force is increasing. The demand of employers for employees as declared to the state employment agencies made 1.11 million of vacant positions in February as compared with 0.89 of positions a year ago. The tension coefficient as calculated per 100 of declared positions lowered to 1.5 versus 2.9 in the corresponding month of 2010. In February 2011, according to the preliminary data, the total number of the unemployed (calculated in concordance with the ILO methodology) made 5.6 million, the number of officially registered unemployed made 1.7 million, which is 13.4% and 27.4% below the level of last February.

The situation in the investment sector of the economy is characterized by low level of investments in fixed assets financing by both the public and private investors, which is typical for the beginning of the calendar construction cycle. The same applies to the dynamics of the workload in construction (99.7% versus January-February 2010) and the volumes of residential area implementation.

Recovery of the industrial growth takes place in the environment of anticipating growth rates of manufacturing versus extractive industries. In January-February 2011 the growth of manufacturing industries made 11.8%, minerals extraction – 3.4%, electricity, gas and water production and distribution decreasing by 1.8%.

It is the ration of internal and external demand growth rates has a determining influence in the nature of post-crisis recovery in 2010 and 2011. The initial conditions for crisis overcoming were characterized by the drop of the volume of physical output for the basic types of economic activities by 9.8% in 2009 versus the previous year, of export – by 3.0% and of physical volume of import – by 36.7%. In 2010 the volume of output for the basic types of economic activities went up by 4.7% versus the previous year, physical volume of export – by 10.0%, of import – by 35.4%. Thus, the analysis of the economic dynamics as broken by external and internal demand components illustrates its high dependence upon the foreign economy factors. The absence of structural changes, inertial development of both export-oriented industries and final consumption industries based on

extensive use of primary factors, high proportion of import in the internal market resources acted as factors causing profound system crisis in 2008-2009 and defining low competitive ability of the Russian economy in the recovery growth environment in 2009-2011.

A sharp contraction of the import volumes during the crisis had a substantial impact on the dynamics and structure of the internal market. Unfavorable shifts took place in the general structure of supplies: investment goods import decrease took place against the realignment for consumer and intermediate demand goods import.

Table 1

PROPORTION OF CONSUMER, INTERMEDIATE AND INVESTMENT COMMODITIES IN THE TOTAL VOLUME OF IMPORT IN THE RUSSIAN FEDERATION (ON THE BASIS OF BALANCE-OF-PAYMENTS METHODOLOGY), AS PERCENTAGE TO THE TOTAL

	Commodities		
	consumer	investment	intermediate
2009			
1 quarter	46.8	18.6	34.9
2 quarter	44.0	18.1	38.4
3 quarter	42.9	20.6	36.5
4 quarter	43.9	19.5	36.6
Year	44.3	19.7	36.0
2010			
1 quarter	43.5	16.8	39.7
2 quarter	39.5	18.7	41.8
3 quarter	42.1	19.8	38.1
4 quarter	40.0	21.5	38.5
Year	40.7	19.5	39.8

Source: Federal State Statistics Service

Formation of this trend was accompanied with the expansion of the import share in the retail trade goods resources throughout 2010, this share making 44% as a result of the year as compared with 41% a year ago. It should be noted that import goods form 34% of foodstuffs market turnover and 54% of non-food goods market turnover.

Table 2

STRUCTURE OF RETAIL TRADE GOODS RESOURCES IN 2009–2010, AS PERCENTAGE

	Retail trade goods resources	Including	
		domestically produced	imported
2009			
1 quarter	100	55	45
2 quarter	100	60	40
3 quarter	100	59	41
4 quarter	100	61	39
Year	100	59	41
2010			
1 quarter	100	56	44
2 quarter	100	58	42
3 quarter	100	55	45
4 quarter	100	55	45
Year	100	56	44

Source: Federal State Statistics Service

In this connection the problems of production modernization and diversification with the aim to expand the proportion of internally produced good at the market are crucial for the increase in recovery growth efficiency. Favorable situation at the world market of energy carriers allowed the enterprises of minerals extraction sector to get a balanced financial result of RUR 6132.9 billion in January-December 2010, which exceeds the corresponding figure of 2009 by 19.5%. Financial situation at manufacturing industry enterprises has somewhat improved: in 2010 their balanced financial result made RUR 1598.0 billion, which is 66.6% higher than the corresponding level of 2009.

However in 2010 balanced financial result of construction sector enterprises made RUR 98.0 billion or only 95.0% of the corresponding figure of 2009.

Abnormal nature and climate conditions of the elapsed year had a negative influence on agriculture production and as a consequence on the financial results of agriculture sector enterprises. In 2010 balanced financial result of agriculture sector made RUR 72.2 billion exceeding by 19.5% the figure of 2009 when a drop of 12.5% versus 2008 was observed – this is explained by the dynamics growth of the agriculture producers' prices.

Table 3

## PROFITABILITY OF SOLD GOODS, PRODUCTION, WORKS, SERVICES AND ASSETS AS BROKEN BY TYPES OF ECONOMIC ACTIVITIES IN 2008-2010, AS PERCENTAGE

	Profitability of sold goods, production, works, services			Assets profitability			For reference		
							January-December 2010 versus January-December 2009		December 2010 versus December 2009
	2008	2009	2010	2008	2009	2010	Financial result growth rates	Physical volume index	
Total	13.0	11.5	11.1	5.4	5.7	5.1	119.5	104.7	
including:									
agriculture, hunting, forestry	10	8.4	10.3	4.8	3.1	3.4	119.5	88.1	123.6
fishing, fish breeding	7.4	21.4	20.8	1.0	14.5	13.9	115.6	98.5	
minerals extraction	25.4	29.2	35.5	10.5	11.3	14.5	151.7	103.6	117.1
manufacturing industries	17.1	12.5	14.4	8.6	5.6	7.8	166.6	111.8	116.9
electricity, gas and water production and distribution	4.9	7.6	7.2	2.3	3.6	4.9	240.0	104.1	113.8
construction	5.6	6.6	5.7	3.1	2.9	1.2	95.0	99.4	109.1
wholesale and retail trade; motor vehicles and motorcycles servicing; household appliances and items of private use repair	10.8	8.3	7.6	5.3	7.9	7.4	153.3	104.4	108.8
transportation and communication	14.2	14.1	13.7	5.4	4.5	5.0	131.5		

Source: Federal State Statistics Service

In January 2011 according to live data balanced financial result of organizations (not taking into account small business, banks, insurance companies and budget organizations) in real prices made RUR +685.7 billion, exceeding by 56% the corresponding period of the previous year. It should be noted that the financial result of manufacturing industries increased by 2.5 times versus January 2010, which, other conditions being equal, allows us quite optimistically regard the prospects for this time of activity development by the end of the year. According to the estimation of the Gaidar Institute for Economic Policy the expected growth of manufacturing industry production as a result of 2011 will make 110.2%.

## RUSSIAN INDUSTRY IN FEBRUARY

S.Tsukhlo

According to the polls carried out by the Gaidar Institute<sup>1</sup>, in February the situation in industry was characterized by the recovery of the pre-new year growth rates of the demand and output accompanied by growing optimism as regards forecasts thereof. Renewal of hiring of the personnel and plans to hire more workers may be considered as a positive signal. However, enterprises' unwillingness to increase the stocks of finished products, high actual growth in prices and intentions to preserve that trend are the negative factors which prevailed in the beginning of 2011.

### Demand in industrial products

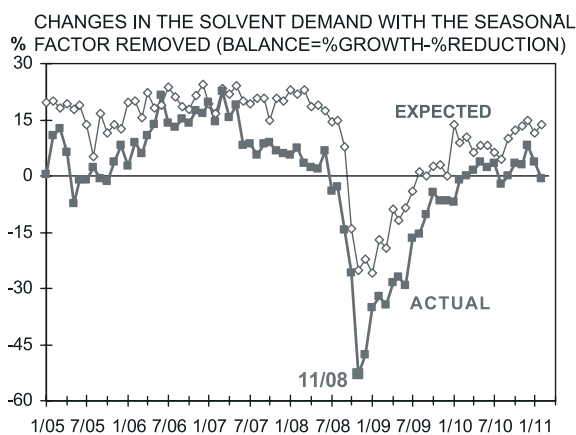


Fig. 1.

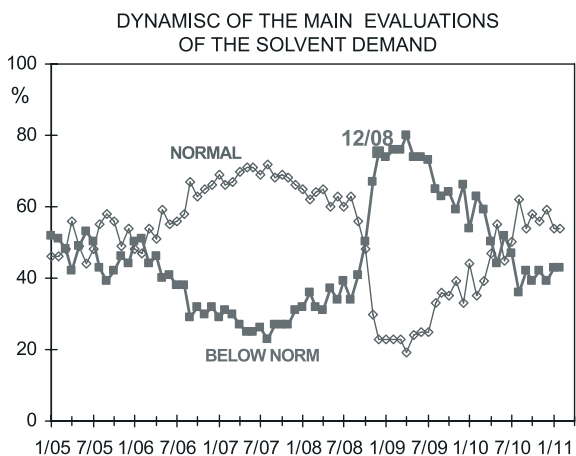


Fig. 2.

### Stocks of finished products

The balance of evaluations of stocks of finished products has remained a zero one since November 2010 (Fig. 3) when the industry decided to back expectations of growth in the demand by giving up

The exit of the economy from the new-year holidays shows only that a drop in sales was stopped (such a situation is typical of January), but the demand failed to grow in February. Such are the initial data on the dynamics of the demand. Removal of the seasonal factor showed the absence of growth in February, too, however the cleared results of January were positive, though to a smaller extent, than those in December. Nevertheless, there was growth in January (with the effect of holidays excluded) (Fig. 1).

In February, forecasts of the demand (the initial ones) improved by another 10 points and achieved the pre-crisis maximum level. In other words, such a substantial prevalence of growth expectations over downturn expectations was not registered from July 2008. (Fig.2). Removal of the seasonal factor adjusted the optimism of initial expectations to the average level of the past five months: the most stable and optimistic expectations of growth in the demand have been registered in industry for the first time since October 2010.

Lack of growth in the demand in February had an impact on satisfaction with sales. The share of normal evaluations of the demand remained at the minimum level of the past seven months. It is only the highly optimistic sales forecasts that prevent the above index from falling.

1 Polls of managers of industrial enterprises have been carried out by the Gaidar Institute in accordance with the European harmonized methods on a monthly basis since September 1992 and cover the entire territory of the Russian Federation. The panel size includes around 1100 enterprises which account for over 15% of the workforce employed in industry. The panel is biased towards large enterprises by each type of the surveyed sub-industry. The return of queries amounts to 65% to 70%.

the policy of minimization of stocks which was typical of the period of uncertainty; in other words though the industry has managed to get rid of uncertainty it still lacks confidence.

**Production output**

The initial growth rates of the output (in case of the polls there is a balance of answers), as well as growth rates of the demand renewed in February after a drop in January to the average values of the 4<sup>th</sup> quarter of 2010. With the seasonal factor removed, the result remained the same. According to evaluations of enterprises, the growth rates of production remained the same since May 2010. (Fig. 4).

In February, the initial production plans increased by 15 points and attained the crisis maximum level. Growth in production output is expected in all the industries, while the most intensive one is predicted in iron and steel industry and building materials industry. Removal of the seasonal factor has adjusted the rise in forecast expectations in January and February to a level which was typical of the past two months.

**Prices of enterprises**

In February, growth in prices of enterprises slowed down by 12 points after a leap in January. However, prices failed to return to the pre-new year level: the current actual balance of growth in prices amounts to 35 points, while in the 4<sup>th</sup> quarter of 2010 it amounted to 17 points. Thus, enterprises have to (probably, due to the most intensive growth in costs during the crisis) increase their prices twice as fast than late last year (Fig. 5). The most intensive growth in prices was registered with iron and steel industry, chemical industry and petrochemical industry. In February, food industry was the only one where growth in selling prices was stopped.

Enterprises' plans point to a possibility of preservation of the February growth rates of prices in March and April, as well. The balance of the expected changes in the index was equal to 37 points and remained at the level of the January plans. Iron and steel industry, timber industry, chemical industry and petrochemical industry are likely to be the leaders in it.

In February, there was the most intensive growth in costs of industrial enterprises from the beginning of the economic crisis (Fig. 6). It is to be noted that the above growth was predicted as early as November 2010. The highest growth in costs took place in iron and steel industry (balance +73 points), timber industry, light industry and engineering (+64 points in each industry), chemical industry and petrochemical industry (+61 points).

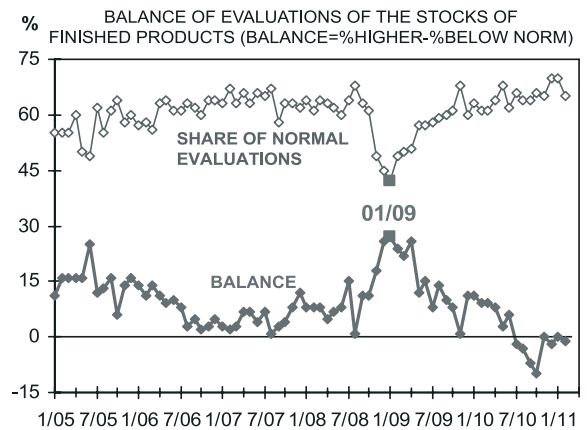


Fig. 3.

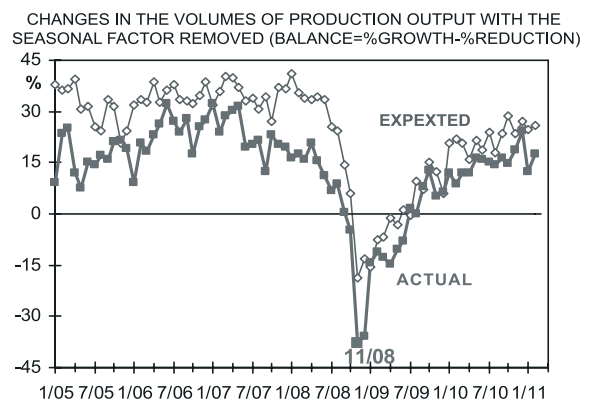


Fig. 4.

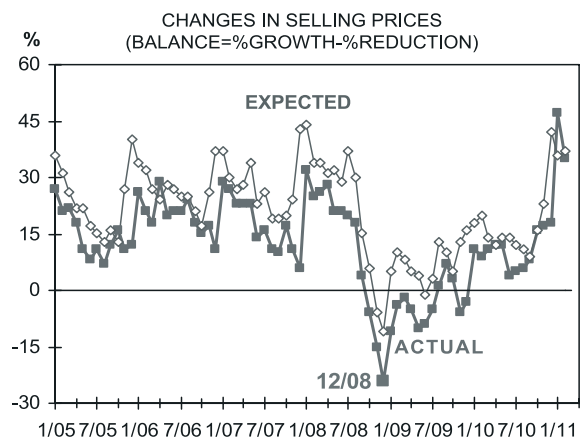


Fig. 5.

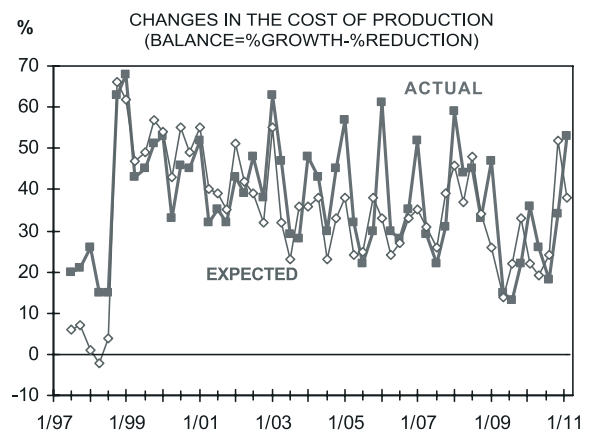


Fig. 6.

### Actual dynamics and lay-off plans

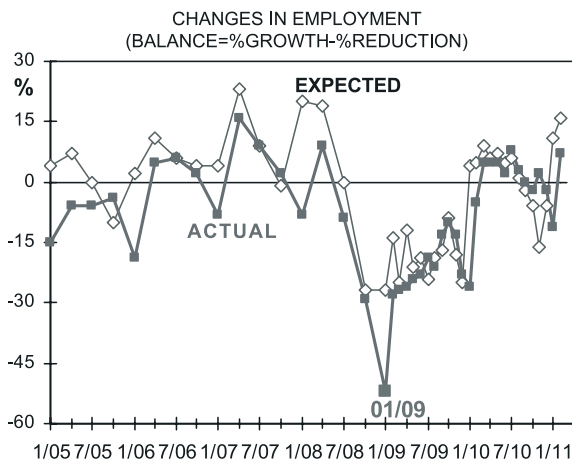


Fig. 7.

excessive workforce (due to expectations of changes in the demand) are pushing upwards both the actual rate and the predicted rate of hiring.

### Lending to industry

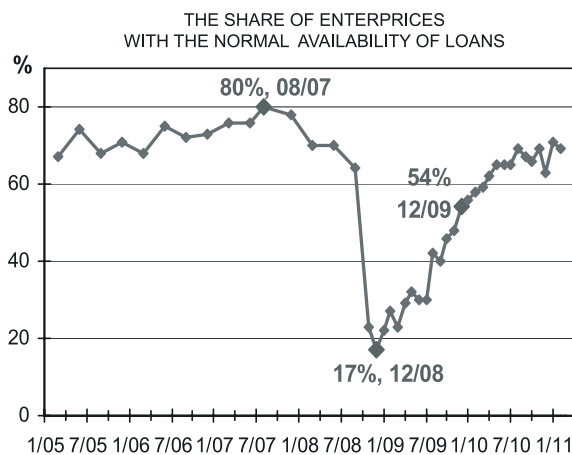


Fig. 8.

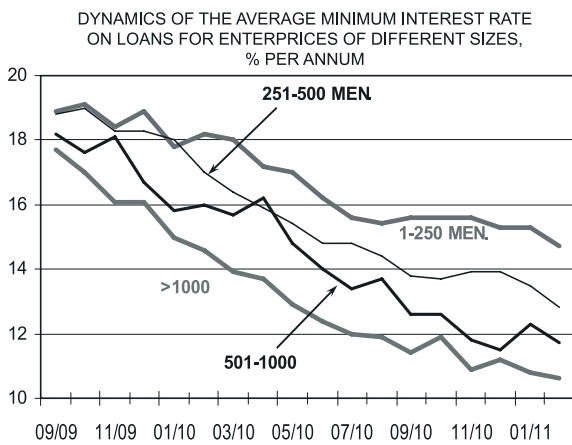


Fig. 9.

In February, after a traditional drop in activities on the labor market hiring of new personnel was started in industry. After being in the zero zone for four months late in 2010, the balance became definitely positive (Fig. 7). In February, lay-offs of workers continued only in light industry and wood-working industry, while the most active hiring of new workers took place in electric-power industry, iron and steel industry and building materials industry.

In March and April, hiring plans achieved the pre-crisis maximum level, that is, there has been no such substantial prevalence of intentions to increase the number of workers in industry over intentions to reduce it since the 3<sup>rd</sup> quarter of 2008. The largest hiring of workers is predicted in building materials industry, light industry and iron and steel industry. Thus, the high optimism as regards the forecast of the demand and the output, as well as depletion of the

In February, availability of loans for industry failed to maintain the weak growth trend which was formed in November and January. At present, only 69% of industrial enterprises are satisfied with their access to bank loans (Fig. 8).

Banks' priorities remain the same. The most comfortable lending terms are offered to enterprises of iron and steel industry (in January-February 85% of enterprises had a normal access to credit facilities with the average minimum interest rate on loans amounting to 9.4% per annum in February), food industry (76% of enterprises and the interest rate of 11.8% per annum), chemical industry and petrochemical industry (72% of enterprises and the interest rate of 11.2% per annum) and engineering industry (74% of enterprises and the interest of 12% per annum). The situation was quite the opposite in light industry (38% of enterprises and the interest rate of 13.9% per annum) and building materials industry (53% of enterprises and the interest rate of 14.5% per annum). Both small and mid-sized enterprises (with the workforce of 1–250 employees) are offered loans with the interest rate of 14.7% per annum, while large enterprises (with workforce of over 1000 employees), loans with the interest rate of 10.6% (Fig. 9).

The industry's demand in loans in the 1<sup>st</sup> quarter of 2011 remains positive, that is, more enterprises plan to increase the demand in loans (24%) than to reduce it (7%). As compared to the 4<sup>th</sup> quarter of 2010, the growth rate of that index did not change. However, lack of loans is not much of concern to Russian industrial



enterprises. On the one hand, in 2010 banks offered more favorable lending terms as regards the size of the interest rate and other parameters, while, on the other hand, sluggish economic growth determined the weak demand in loans on the part of enterprises. Thus, at present lack of credit facilities is the factor which has the least effect on growth in Russian industrial output as compared to other resources.

In industry, the ability to service the existing loans amounts to 82%. The highest rate of creditworthiness is with enterprises of iron and steel industry (100% of those enterprises consider that they are business solvent), engineering industry (83%) and food industry (82%). ●

**FOREIGN TRADE**

N.Volovik and K.Kharina

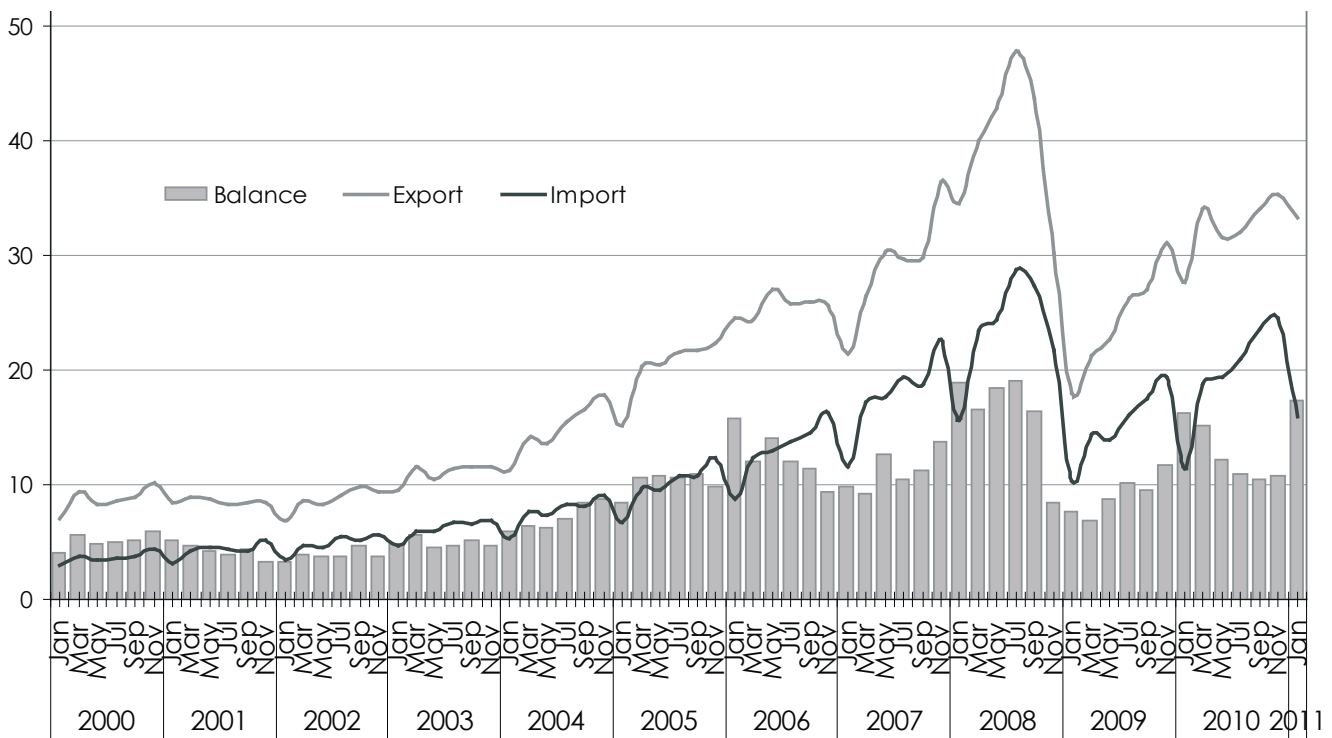
*In January 2011, significant growth in Russian main foreign trade indices was registered with the monetary volume of imports exceeding the January 2008 level. The trade balance reached the maximum level since August 2008.*

In January 2011, the dynamics of the Russian foreign trade was formed in a situation of political unrest which started in Tunisia and Egypt and triggered growth in global prices on oil.

In January 2011, Russia's foreign trade turnover calculated in accordance with the methods of evaluation of the balance of payments rose by 26.3% to USD 49.3 billion as compared to January 2010.

In January 2011, the volume of Russian imports amounted to USD 16 billion which figure is 41% higher as compared to January 2010. That was the highest growth within a month from August 2010 where imports rose by 53.7%. As the first month of the year is normally characterized by a seasonal drop in business activities, the above value is unusually high for January. Another unusual phenomenon consisted in the fact that in January acceleration of import growth rates was accompanied by the weak investment and consumer demand. In January, growth in the trade turnover amounted to the mere 0.5% as compared to that in January 2010. It is to be noted that a 0.5% decrease in that index was registered as compared to December. Consequently, appreciation of the RUR exchange rate is still the main factor behind growth in imports.

In January 2011, growth rates of the monetary volume of exports appeared to be more modest (20.3%) and, as a result, exports amounted to USD 33.3 billion. An increase in the value of exports is related to growth in prices on export goods, particularly, energy carriers and nonferrous metals.



Source: The central Bank of Russia.

Figure 1. Main indices of the Russian foreign trade (Billion USD)

In January 2011, oil prices went up due to developments in Egypt. On January 31, Brent oil prices rose to USD 100 a barrel. In January 2011, the average price on Brent oil amounted to USD 96.62 a barrel (an increase of 7.78% in a month's time).

In 2011, the US Department of Energy (EIA) raised the forecast of the average price on Brent by USD 9 a barrel to USD 102 a barrel. The above index is higher than the annual average price in the year 2008 (USD 99.75 a barrel) where the prices reached their record-high maximum.

In January 2011, the average price on Urals oil amounted to USD 93.8 a barrel (an increase of 23.6% as compared to January 2010). As compared to December 2010, prices on oil rose by 4.8%. According to the monitoring of oil prices in the period of from February 15, 2011 to March 14, 2011, the average price on Urals oil amounted to USD 108.2 a barrel. So, from April 2011 the marginal rate of export duties on the crude oil increased by 16% from USD 365 a ton (which duty was in effect in March) to USD 423.7 a ton. From April 1, 2011, the preferential rate of export duties on oil from 22 oil deposits in Western Siberia and two deposits of OAO LUKOIL in Northern Caspian Sea increased from USD 150.4 a ton to USD 191 a ton (+21.3%). It is to be noted that from April 1 export duties on light oil products will amount to USD 283.9 a ton, against USD 244.6 a ton (+13.84%), while those on dark oil products, to USD 197.9 a ton, against USD 170.4 a ton (+13.89%).

In January, prices on non-ferrous metals were determined by the USD exchange rate, foreign economic news and the macroeconomic situation in China. Both the positive auto sales statistics and political tensions in Africa had an effect on non-ferrous metals prices.

After a dramatic drop in 2009, sharp growth in copper prices was registered. By now, copper prices have surpassed their record-high maximum registered in 2008 where the average monthly price in April amounted to USD 8,684.9 a ton and still remain high due to growth in demand in copper. The demand in copper grows on the part of Asian states which consume over 60% of the global production of copper since they carry out large-scale programs of the industrial development and, consequently, need more durable goods with a large content of copper. In particular, China which accounts for nearly 40% of the global production of copper has increased consumption of the above metal.

Prices on aluminum are getting higher and higher in a situation of a cutback in production in China where inefficient energy-intensive enterprises are being closed. As most enterprises are situated in the Middle East, the industry depends on the political stability in the region and prices on energy carriers. Now, Bahrain, Iran, Oman, Qatar and the UAE account for 7% of the global production of aluminum with a number of new powerful projects being under implementation.

In the 1<sup>st</sup> quarter of 2011, the global production of nickel is expected to fall. Supplies of nickel ore from Australia and the Philippines – the countries which were badly hit by the floods – have decreased. China has reduced production of nickel cast iron because of the severe winter, irregularities in coal supplies and power supply limitations. Due to the above factors, the shortage of nickel supply in the market may become more acute and give rise to further growth in prices.

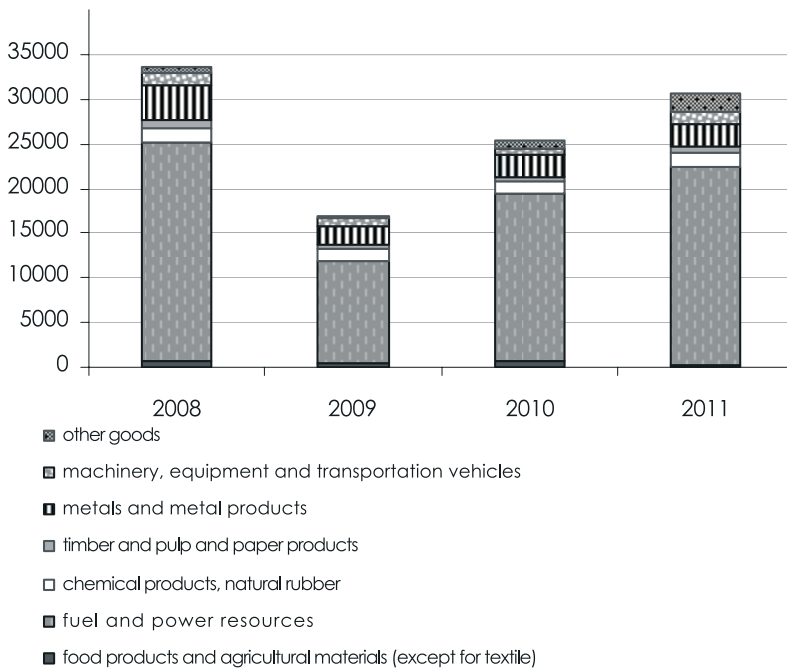
Also, a soft monetary and lending policy of leading countries – the policy which brings about growth in the volume of cheap liquidity in the world – is a factor behind growing prices on primary products.

Table 1

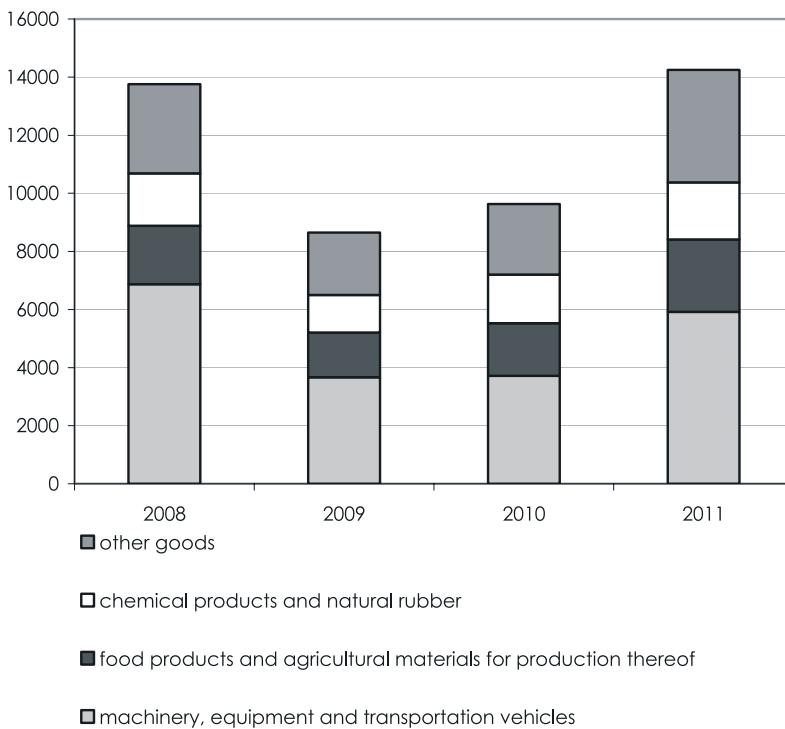
## AVERAGE MONTHLY PRICES IN JANUARY OF THE RESPECTIVE YEAR

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Oil (Brent), USD/a barrel	26.0	19.4	28.1	31.3	42.9	62.5	54.8	92.4	45.7	76.2	96.29
Natural gas, USD/1 million BTU	5,214	2,146	5,048	6,156	6,907	8.47	8.56	10.7	13.89	8.8	9.61
Petroleum, USD/a gallon	0.865	0.573	0.852	0.992	1.291	1.849	1.59	2.38	1,115	2.04	2.45
Copper, USD/a ton	1849.6	1557.8	1571.3	2441.9	3170	4734	5668.7	7061.6	3220.7	7385	9556
Aluminum, USD/ a ton	1641.5	1377.9	1291.1	1608.2	1832	2378	2808.3	2445.5	1413.1	2234.5	2440
Nickel, USD/a ton	7091.3	6094.6	7643.9	14855	14505	14555	36795	27689	11307	18430	25646

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



The source: Rosstat.  
Figure 2. Russian export in January of the respective year (million USD)



The source: Rosstat.  
Figure 3. Russian import in January of the respective year (million USD)

The structure of Russian exports remained virtually unchanged. In January 2011, the backbone of Russian exports consisted of energy carriers followed by metals, chemical products, machinery and equipment.

As compared to January 2010, growth in exports was registered with all the aggregated commodities groups, except for food products and agricultural materials (as regards the above two groups export supplies decreased by 51.7%). However, the January 2008 export level was surpassed only by the group of precious stones and precious metals (136.2%) and the group of machinery, equipment and transportation vehicles (106.5%). As regards other groups of commodities, the pre-crisis export level was failed to be achieved so far.

A larger portion of goods imported to the country are machinery and equipment followed by food products, chemical products and metals.

In January 2011, the import to Russia of food products and materials for production thereof increased by 39% as compared to January 2010. Growth in imports of some products was quite significant: sunflower oil (1,150%), vegetables (110%) and cereal crops (200%). The import of meat and dairy products grew by 47% and 31.4%, respectively.

Due to the abnormal heat in 2010, the volume of milled crops was 37% less than that in 2009. In 2010, a drop in crop harvesting was not a disastrous one, but created some problems with provision of cereal grain and forage grain. As of March 1, 2011, the stock of grain in Russia amounted to 28.37 million tons which figure is 22.1% (or 8 million tons) lower than that as of the same date last year. In 2011, Russia will need grain supplies

from abroad as the estimated stock of grain may be insufficient in case of another drought in 2011. Due to the that, the Commission of the Customs Union of Russia, Belarus, and Kazakhstan made a decision to set to nil import duties on wheat, rye and oats both of the food sort and the forage sort. The duties which currently amount to 5% are to be reduced to nil by June 30, 2011.

The government of Russia regards abolition of duties as an important measure aimed at stabilization of prices on the grain market. It is to be noted that the situation is more acute as

regards the forage grain, rather than food wheat; prices on the former have exceeded those on the latter and rose to RUR 8,700 a ton.

In order to reduce the cost of the forage base of the livestock husbandry, the Sub-Commission on Customs and Tariff and Non-Tariff Regulation has advised to reduce to nil import duties on soy oil meal. At present, the import duty on soy oil meal amounts to 5%. However, the above duty will be lifted only for a period of three months. Such a measure is expected to restraint growth in prices on meat products. The decision is to be approved at the meeting of the Commission of the Customs Union.

In March 2011, a regular meeting of the Sub-Commission on Customs and Tariff and Non-Tariff Regulation and Protective Measures in Foreign Trade of the Government Commission of Economic Development and Integration was held. On the basis of the results of the discussion, the Sub-Commission found it expedient to reduce import customs duties on multilayer paper and cardboard with bleached coats from 15% to 5%. Also, a decision was passed to establish a duty-free regime as regards the import of semi-submersible drilling units which are not produced in Russia today.

Participants in the meeting supported the idea to include floating drilling units meant for prospecting in the list of goods temporarily imported with full conditional exemption from customs duties and VAT payment.

The members of the Sub-Commission agreed to the proposal to cancel a 15% customs duty on some types of digital motion picture projectors meant for public digital film showing. In such a case, cinema networks may save Euro 10,000 to Euro 15,000 on each new cinema hall which factor is quite important taking into account the government's requirement that the number of cinema halls should be doubled in Russia.

In order to support domestic manufacturers of telecommunication equipment, the Sub-Commission approved introduction of a 10% import duty on base stations for wireless telecommunications with an option to work in the carrier-frequency range of 2.2 Ghz and the equipment for fiber optic networks systems working exclusively in the carrier-frequency range of 1270 NM – 1610 NM.

Decisions of the Sub-Commission are recommended for consideration by the meeting of the Commission of the Customs Union. ●

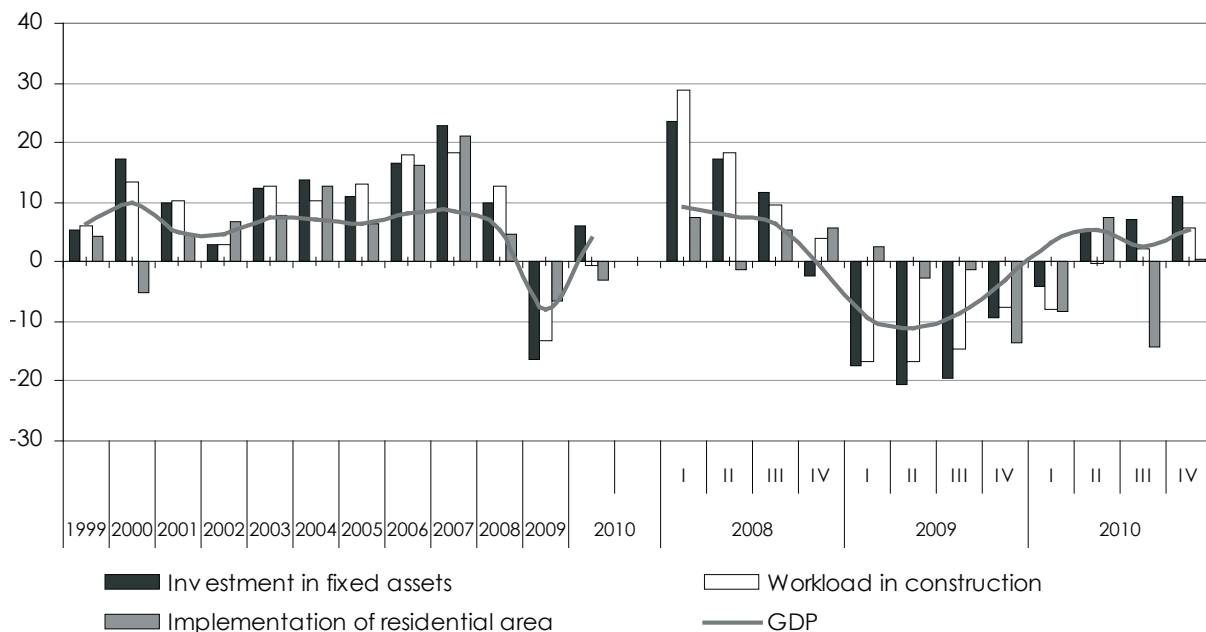
## INVESTMENTS IN REAL SECTOR OF ECONOMY

O.Izryadnova

*In January-February 2011 the business activity was observed to decrease. This is accounted for by the specific characteristics of the construction works seasonal cycle as well as by the delay in public investments financing, considerable withdrawal of the capital and low activity in the banking sector. In January-February 2011 investments in fixed assets made 97.7%, workload in construction – 99.7% and implementation of residential housing area – 88.5% versus the corresponding figures of the previous year.*

In 2010 the situation in the investment sector was observed to change gradually. The peak of the investment crisis was overcome in the 1<sup>st</sup> half of 2009 and starting with the 3<sup>rd</sup> quarter the trend to the slow-down of investment recession has been registered, which was supported by the improvement of enterprises' financial situation. On the whole, over 2010 the increase in investments in fixed assets made 6%, GDP growing by 4% versus the previous year. The dynamics of investments in fixed assets was considerably differentiated by large and small enterprises. At large enterprises the increase in investments in fixed assets made 5.1% in 2010; however, taking into account the drop of 17.5% in 2009, in 2010 the volumes of investments in fixed assets made only 86.7% of 2008 figure. Financial support of small and medium-scale enterprises in 2010 was among the government priorities. In 2010 the total volume of budget allotments allocated for the government support of small- and medium-scale enterprises, made RUR 17.97 billion. In 2010 investment in fixed assets in the segment of small-scale enterprises went up by 8% (decrease of 13.5% in 2009), their proportion in the total volume of investments into economy growing to 32.1% versus 27.2% in 2009.

The period of 2009-2010 was characterized by the reduction of the residential area implementation. In 2010 the implementation of residential area contracted by 3%. The proportion of investments in housing construction in the structure of investments in fixed assets on the whole throughout the

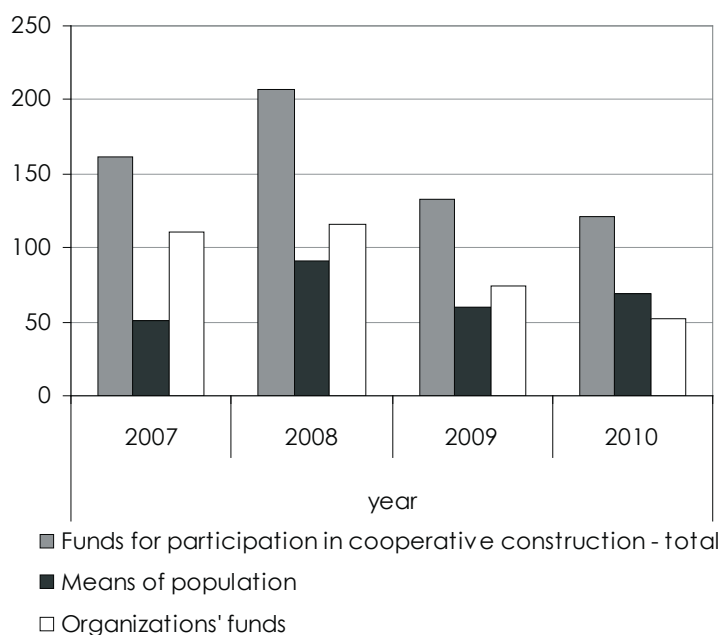


Source: Federal State Statistics Service.

Fig. 1. GDP Growth Rates, Investments in Fixed Assets, Workload in Construction and Implementation of Residential Area as Broken by Quarters in 1999-2010, as Percentage to Corresponding Period of the Previous Year

economy in 2010 lowered to 1.9% versus 2.6% and 3.3% in 2009 and 2008. In 2010 in contrast to the previous year the volume and the proportion of means of population in cooperative housing projects were observed to grow, while the organization's funds went down. In 2010 means of population in cooperative housing construction financing made RUR 69.6 billion, exceeding by RUR 10.4 billion the figure of the previous year, while organizations' funds contracted by RUR 21.9 billion. At the same time it should be noted that in 2010 implementation of residential area at the expense of population's own and borrowed funds made 25.3 million cu m, which is 3.2 million cu m below the level of 2009, while the implementation at the expense of organizations' funds went up by 1.5 million cu m.

The trend towards the decrease in budget financing of investments in fixed assets which was observed in 2008-2009 ceased in 2010. In 2010 RUR 1242.7 billion was financed at the expense of budget funds, which is RUR 1.9 billion more than in the previous year. At the same time the volumes of investment financing at the expense of the federal budget went up by 19.2 billion as compared with 2009 and made RUR 642.1 billion, compensating the contraction of Federation's subjects expenses for investment purposes.



Source: Federal State Statistics Service

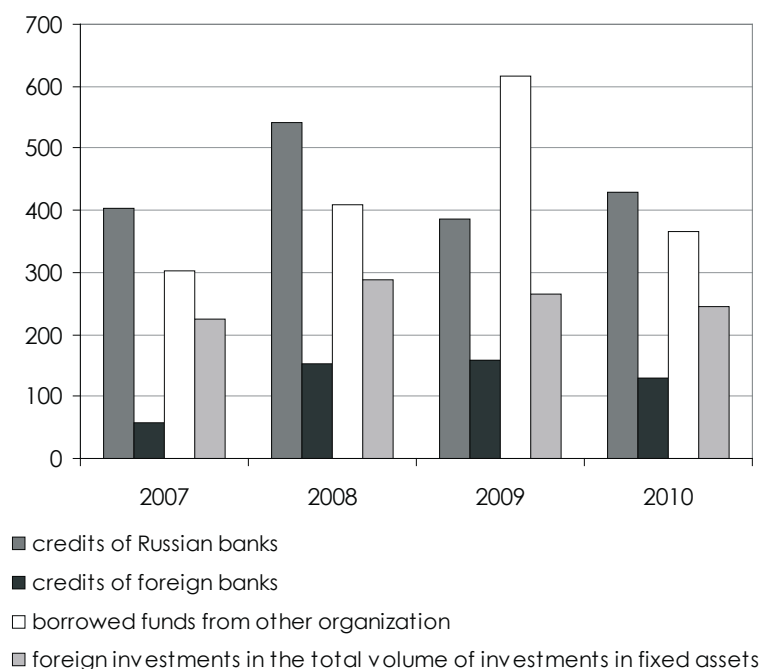
Fig. 2. Funds Received for Participation in Cooperative Housing Construction in 2007-2010, as RUR billion

Table 1

STRUCTURE OF INVESTMENTS IN FIXED ASSETS AS BROKEN BY SOURCES OF FINANCING, AS PERCENTAGE TO THE TOTAL (NOT TAKING INTO ACCOUNT SMALL ENTERPRISES AND PARAMETERS OF INFORMAL ACTIVITIES)

	2008	2009	including			
			2010	1 <sup>st</sup> quarter	1 <sup>st</sup> half of the year	January-September
Investments in fixed assets – total	100	100	100	100	100	100
including as broken by sources of financing:						
own funds	39.5	37.1	41.2	45.1	44.9	43.0
of which:						
Profit	18.5	14.8	14.7	15.0	16.3	16.0
borrowed funds	60.5	62.9	58.8	54.9	55.1	57.0
of which:						
banks' credits	11.8	10.3	8.7	9.5	9.2	9.1
including those from foreign banks	3.0	3.2	2.0	3.2	2.8	2.7
borrowed funds from other organizations	6.2	7.4	5.6	6.4	6.6	6.6
budget funds:	20.9	21.9	19.4	12.9	15.5	17.4
of federal budget	8.0	11.5	10.0	5.5	7.6	8.5
of budgets of subjects of the Russian Federation	11.3	9.2	8.2	6.6	7.1	7.8
other	21.2	23.0	24.8	25.9	23.4	23.6
of which funds for participation in cooperative construction projects	3.5	2.6	1.9	2.0	2.2	2.0
including means of population	1.9	1.3	1.1	1.0	1.1	1.1
foreign investments in the total volume of investments in fixed assets	4.3	4.3	3.8	5.8	5.3	4.8

Source: Federal State Statistics Service



Source: Federal State Statistics Service  
 Fig. 3. Structure of Funds Borrowed for Investments in Fixed Assets Financing in 2007- 2010, as RUR billion

Slow recovery rates of internal market and crediting accounted for the maintenance of the trend for the enterprises to use primarily own funds to finance investment programs. In 2010 enterprises' own funds used for investment purposes made RUR 2644.7 billion against RUR 2092.0 billion in the corresponding period of the previous year their proportion in sources of financing increasing from 237.1% to 41.2%. The trend towards contraction of banks' and borrowed funds participation has intensified. In 2010 banks' credits accounted for RUR 559.2 billion of RUR 2769.0 billion or 14.8% as compared with 18.4% in 2008. In 2010 banking sector recovering after the crisis and business activity surging up the growth of domestic banks credits fully exceeded the contraction of foreign banks credits volumes. As a result the proportion of foreign investments in the total volume of investments in 2011 reduced to 3.8% versus 4.3% in the previous year.

The situation was aggravated by intensification of the net capital withdrawal. According to the preliminary estimation of the Central Bank of the Russian Federation, in 2010 net export of private capital reached USD 38.3 billion.

Table 2

NET IMPORT/EXPORT OF PRIVATE SECTOR CAPITAL, ACCORDING TO BALANCE OF PAYMENTS, AS USD BILLION

	Net import/export of private sector capital, total	including:	
		Net import/export of capitals by banks	Net import/export of capital by non-financial organizations and households
2007	82.4	45.8	36.6
2008	-132.8	-56.9	-75.8
2009	-56.9	-30.4	-26.6
2010 (estimation)	-38.3	11.4	-49.7

Source: Central Bank of the Russian Federation

Table 3

STRUCTURE OF INVESTMENTS IN FIXED ASSETS AS BROKEN BY THE FORM OF OWNERSHIP IN 2008-2010, AS PERCENTAGE TO THE TOTAL (NOT TAKING INTO ACCOUNT SUBJECTS OF SMALL ENTREPRENEURSHIP AND VOLUMES OF INVESTMENTS NOT OBSERVED BY DIRECT STATISTICAL METHODS)

	2008	2009	2010
Investments in fixed assets	100	100	100
of which by forms of ownership: Russian	79.4	80.8	83.9
government	23.3	24.9	23.5
federal	13.3	15.4	15.2
subjects of the Russian Federation	9.9	9.4	8.1
private	37.5	42.2	45.2
joint Russian	12.8	8.8	9.9
ownership of state corporations		-	1.3
foreign	9.6	8.9	6.2
joint Russian and foreign	11.0	10.3	9.9

Source: Federal State Statistics Service



In 2009-2010 the role of institutional investors started to change. Private Russian business was oriented at maintaining the positions at the internal market both the volumes and proportion of investments in foreign and joint foreign and Russian ownership decreasing.

In 2010 structural shifts in the investments in fixed assets as broken by types of economic activities were defined by the increase of the proportion of the industry in the total volume of investments in fixed assets (not taking into account subjects of small business) up to 45.1% versus 43.2% in 2009 and 40.9% in 2008. At the same time investments in fixed assets of extractive industries in 2010 went up by 8.9%, of processing industries – by 3.3%, in electricity, gas and water production and distribution - by 24.1%. At the same time the investments in the majority of economic activities remained at the level considerably below that before the crisis.

Table 4

INVESTMENTS IN FIXED ASSETS VOLUME AND DYNAMICS AS BROKEN BY TYPES OF ECONOMIC ACTIVITIES IN 2008-2010 (NOT TAKING INTO ACCOUNT SUBJECTS OF SMALL-SCALE ENTREPRENEURSHIP AND PARAMETERS OF INFORMAL ACTIVITIES)

	2008	2009	2010	2008	2009	2010
	RUR billion			as % to the previous year		
Total	6272.1	5769.8	6413.7	105.6	82.5	105.1
of which: agriculture, hunting and forestry	243.0	192.6	190.9	95.7	75.2	88.9
minerals extraction	1040.9	967.8	1109.8	103.9	88.3	108.9
including: fossil fuels extraction	950	893.5	1021.5	104.8	89.1	108.7
processing industries	1034.0	881.9	993.7	107.8	78.2	103.3
electricity, gas and water production and distribution	558.2	585.6	786.3	111.3	99.8	124.1
construction	91.7	162.7	194.1	91.7	66.1	117.3
wholesale and retail trade, repair works	168.7	138.4	158.4	95.6	75.7	108.9
transportation and communication	1628.0	1624.6	1696.1	112.4	99.1	109.0
including communication	257.4	180.6	207.3	95.1	66.6	108.6
financial activity	74.7	74.6	77.2	95.6	99.4	107.1
operations with real estate, rent and services rendering	733.8	558.2	658.3	100.9	70.8	92.8
of which for research and development	31.9	48.9	62.8	101.9	131.9	114.4
state management and military safety security; compulsory social insurance	128.2	133.0	120.5	109.7	89.5	87.0
education	162.9	117.4	142.9	96.9	78.7	113.7
health care and social services rendering	188.0	145.7	161.3	116.0	82.1	105.6
other utilities, social and personal services rendering	128.8	168.6	185.8	127.9	85.1	102.8

Source: Federal State Statistics Service

Problems of investment crisis overcoming in 2010 were mainly accounted for by extremely complicated conditions of the previous year. Thus, the general volume of investment in fixed assets growing by 106% in 2010, they still remained 11% below the pre-crisis level of 2008.

In January-February 2011 investments in fixed assets made 97.7%, workload in construction – 99.7%, implementation of residential area – 88.5% of the corresponding figures in the analogous period of the previous year.

According to the Gaidar Institute for Economic Policy forecast, the average value of annual increase in investment in fixed assets is expected to be at the level of 7.6%. ●

## FOREIGN INVESTMENTS

E.Ilukina

The better part of 2010 was characterized by the decrease in foreign investors' activity. The growth of foreign investments in the 4<sup>th</sup> quarter 2010 provided for the increase of aggregated foreign investments as a result of the year. Foreign investments were mainly concentrated in the industrial and financial activity sectors. It was the investments in manufacturing industries that grew at fastest rates in the sector of industry. The largest volume of investments into the Russian Federation was directed from the UK, Netherlands and Germany.

As a result of 2010 the total increase in foreign investments into Russian economy was observed of 40.1% versus 2009, which is due to a considerable growth of foreign investments inflow in the 4<sup>th</sup> quarter (by 2.5 times versus the level of the 4<sup>th</sup> quarter 2009). In 2010 USD 114.7 billion of foreign investments was directed into the Russian economy. The volume of foreign investments went up from 6.7% of the GDP in 2009 to 7.8% of the GDP in 2010.

Table 1

STRUCTURE OF FOREIGN INVESTMENTS IN THE RUSSIAN ECONOMY IN 2006–2010

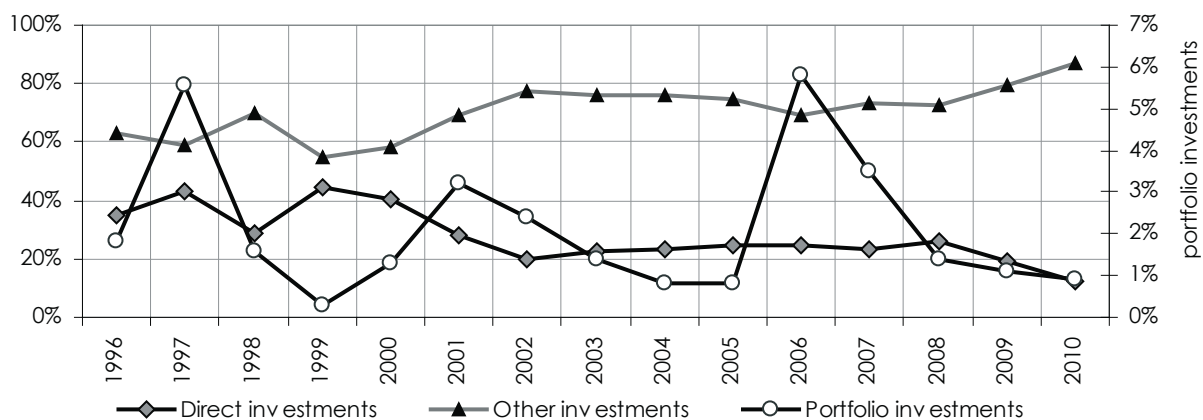
	As USD million				As percentage on the previous year			
	Total	Direct	Portfolio	Other	Total	Direct	Portfolio	Other
2006	55 109	13 678	3 182	38 249	102.7	104.6	700.0	95.3
2007	120 941	27 797	4 194	88 950	219.5	203.2	131.8	232.6
2008	103 769	27 027	1 415	75 327	85.8	97.2	33.7	84.7
2009	81 927	15 906	882	65 139	79.0	58.9	62.3	86.5
2010	114 746	13 810	1 076	99 860	140.1	86.8	121.9	153.3

Source: Federal State Statistics Service

It was mainly the growth of other investments, which made USD 99.9 billion as a result of the year that accounted for the increase in the total volume of foreign investments received by the Russian economy in 2010.

As compared with the previous year in 2010 the structure of foreign investments into the Russian economy was not subject to significant changes.

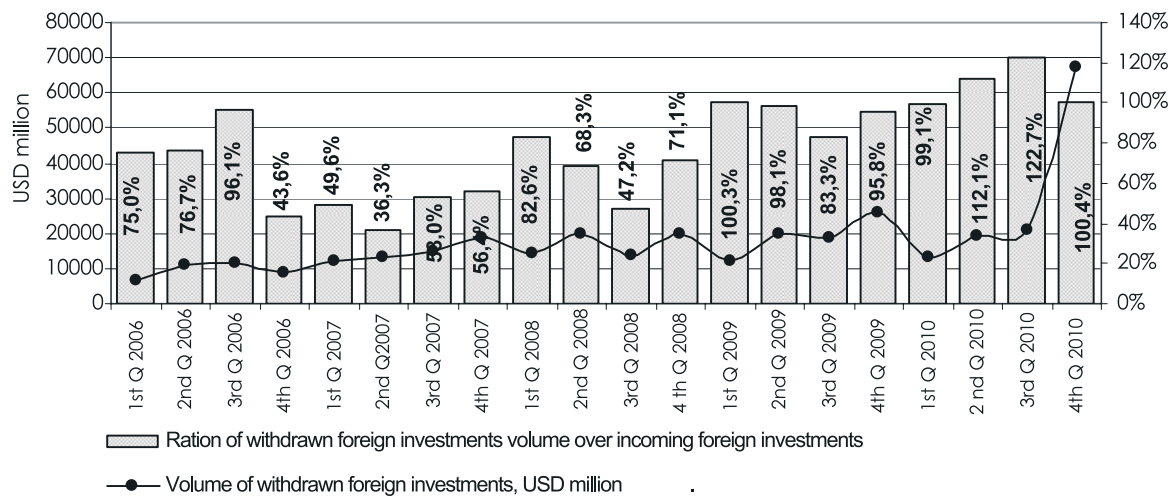
In 2010 priorities of foreign investors shifted significantly: foreign investments were observed to concentrate in industry and financial activity. As compared with 2009 foreign investments in industry went up by 44.2%, in financial activity – by 14.3 times.



Source: Federal State Statistics Service

Fig. 1. Structure of Foreign Investments in the Russian Economy

## FOREIGN INVESTMENTS



Source: Federal State Statistics Service

Fig. 2. Withdrawal of Foreign Capital from the Russian Economy in 2006–2010

As compared with 2009 investors became less interested in trade, as well as in transport and communication. Reduction of investments in trade, real estate sphere, transportation and communication against the background of the growth of investments in industry and financial activity resulted in the decrease of their proportions in the structure of foreign investments by types of economic activities. Distribution of foreign investments as broken by sectors of the Russian economy is presented in *Table 2*.

Table 2

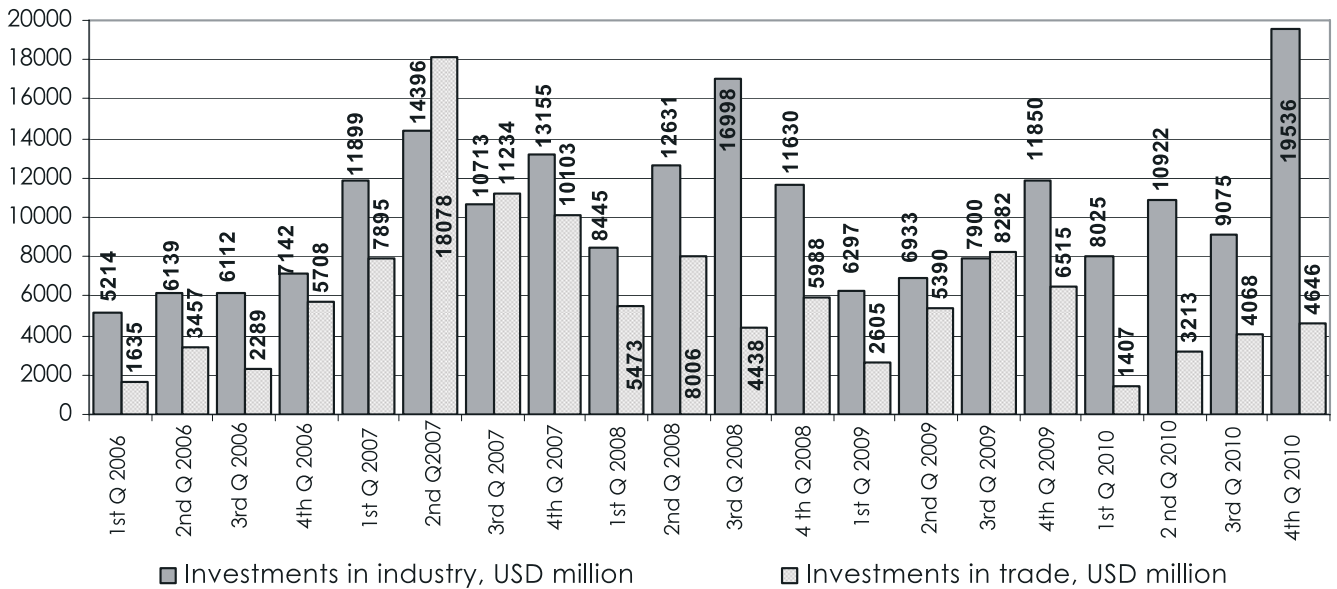
### STRUCTURE OF FOREIGN INVESTMENTS IN RUSSIAN ECONOMY AS BROKEN BY TYPES OF ECONOMIC ACTIVITIES IN 2008-2010

	As USD million			Change as % on the previous year			As % to the total		
	2008	2009	2010	2008	2009	2010	2008	2009	2010
Industry	49 704	32 980	47 558	99.1	66.4	144.2	47.9	40.3	41.4
Transportation and communication	4 861	13 749	6 576	72.5	282.8	47.8	4.7	16.8	5.7
Wholesale and retail trade; motor vehicles and motorcycles servicing; household appliances and items of private use repair	23 905	22 792	13 334	50.5	95.3	58.5	23.0	27.8	11.6
Operations with real estate, rent and services rendering	15 378	7 937	7 341	182.8	51.6	92.5	14.8	9.7	6.4
Financial activity	4 977	2 658	37 913	111.8	53.4	1426.3	4.8	3.2	33.0
Other sectors	4 944	1 811	2 024	126.7	36.6	111.8	4.8	2.2	1.8

Source: Federal State Statistics Service

The analysis of quarter-by-quarter dynamics of foreign investments in industry in 2010 as compared with 2009 demonstrates that foreign investments grew throughout the whole year. It should be noted that in the 4<sup>th</sup> quarter 2010 the volumes that exceeded by 4.9% the maximum figure of the 3<sup>rd</sup> quarter 2008 were registered (as compared with the 4<sup>th</sup> quarter 2009 the growth made 64.9%). Quarter-by-quarter volumes of foreign investments in trade sector increased continuously during 2010 though remained below the corresponding figures of 2009.

As a result of 2010 it was the investments in manufacturing industries that grew at fastest rates: as compared with 2009 this type of investments went up by 49.2% (in 2009 the contraction was equal to 34.5%). Foreign investments in fossil fuels extraction went up by 43.2% (in 2009 the reduction was equal to 16.0%).



Source: Federal State Statistics Service

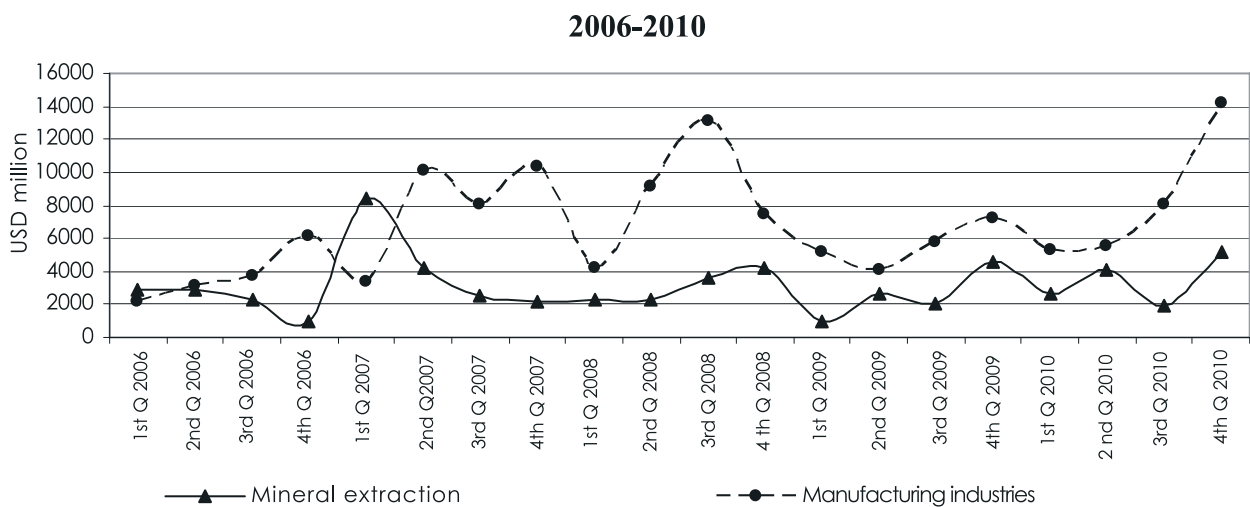
Fig. 3. Foreign Investments in Industry and Trade in 2006–2010

Quarter-by-quarter statistics of foreign investments in minerals extraction and manufacturing industries demonstrates the growing trend towards the end of 2010.

It should be noted that whereas in the 1<sup>st</sup> half of 2010 quarter-by-quarter dynamics of foreign investments in different sectors of industry as compared with the corresponding periods of 2009 was going upwards and differentiated by sectors only by growth rates, in the 2<sup>nd</sup> half of 2010 it was diversified. For instance, investments in fuel and energy complex reduced in the 3<sup>rd</sup> and 4<sup>th</sup> quarter 2010 s compared with the corresponding periods of 2009 by 7.2% and 7.6%, respectively, whereas investments in coke and oil products production went up by 55.9% and 3.6 times, correspondingly.

The structure of foreign investments by types of economic activities in industry was also subject to changes. Proportion of direct investments in mineral extraction sector continued to decrease – by 35.9% down to USD 2.0 billion, which resulted in contraction of their proportion in the aggregated investments in this sector in 2010 down to 14.7% (30.7% in 2009). The proportion of other investments in extractive industries, which growth in 2010 was estimated to be 1.7 times (up to USD 11.8 billion), went up to 85.0% (65.8% in 2009).

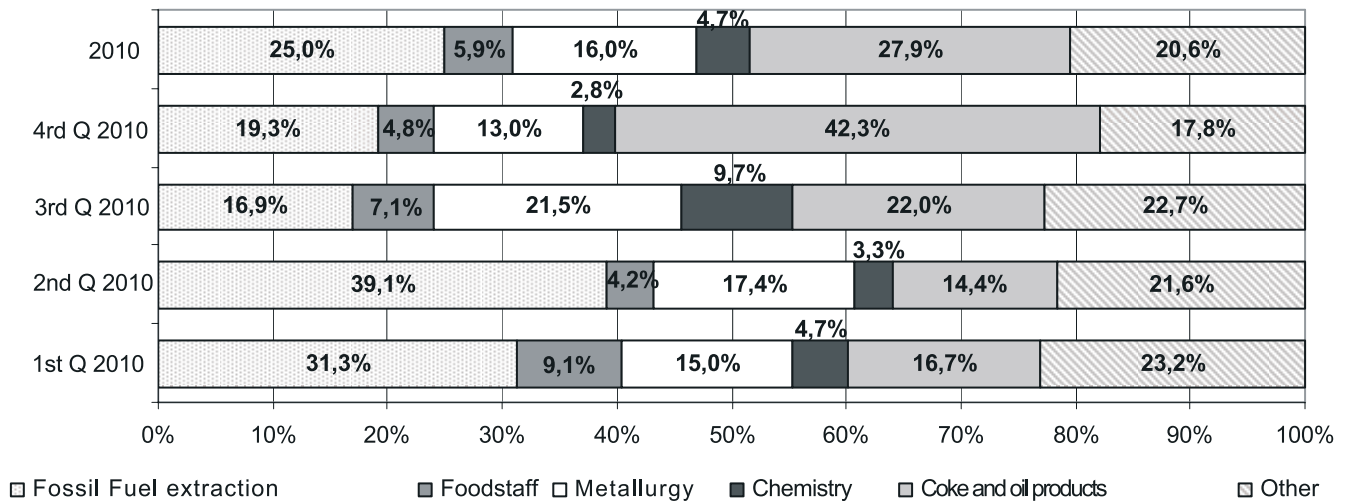
In manufacturing industry in 2010 it was also other investments that accounted for the biggest part of investments, they went up by 1.6 times making 85.4% (80.6% in 2009) in the resulting



Source: Federal State Statistics Service

Fig. 4. Inflow of Foreign Investments in Extractive and Manufacturing Industries in 2006-2010

## FOREIGN INVESTMENTS



Source: Federal State Statistics Service

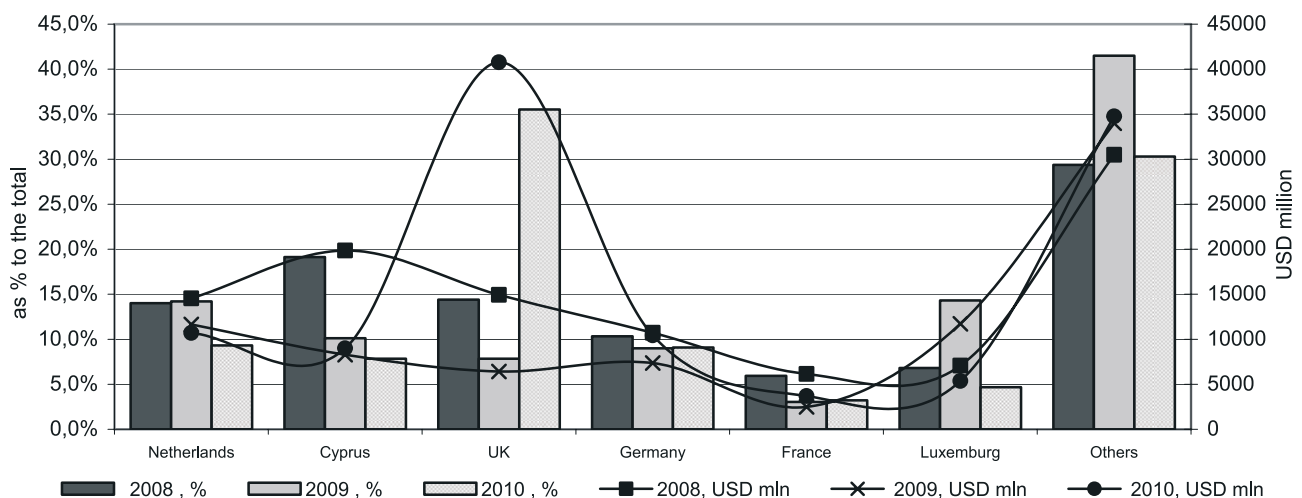
Fig. 5. Structure of Foreign Investments by Sectors of Industry in 2010

figures of investments in manufacturing industries. Direct investments in manufacturing industries increased by 13.3%. At the same time proportion of direct investments in manufacturing industries decreased to 14.0% in 2010 (18.5% in 2009).

As for the geographical aspect of foreign investments, as a result of 2010 the biggest volume – USD 40.8 billion (35.5% of the total volume of foreign investments received by the Russian economy) – was directed from the UK, and USD 10.7 billion was received from the Netherlands. Three leading countries importing capital in the Russian Federation also include Germany, which investments in the Russian economy made USD 10.4 billion.

In 2010 it was investments from the UK that grew at fastest rates – by 6.3 times as compared with 2009, investments from Ireland went up by 3.4 times, from Germany and France - by 41.7% and 48.6%, correspondingly. At the same time investments from Luxemburg decreased by 54.2%, from China – by 21.8%, from Japan – by 63.3%, from the Netherlands – by 8.1%. The differences in investments dynamics resulted in the change in the geographical structure of foreign investments in the Russian economy.

Geographic structure of foreign investments as broken by sectors which accounted for 97.8% of aggregated foreign investments in the Russian economy in 2010 is presented in table 3.



Source: Federal State Statistics Service

Fig. 6. Geographical Structure of Foreign Investments in the Russian Economy

Table 3

GEOGRAPHIC STRUCTURE OF FOREIGN INVESTMENTS AS BROKEN BY TYPES OF ECONOMIC ACTIVITIES OF THE RUSSIAN ECONOMY IN 2010

Type of activity	Geographic structure of foreign investments
Minerals extraction	<p>0% 10% 20% 30% 40% 50% 60% 70% 80% 90% 100%</p> <p>■ Netherlands    ■ Germany    ■ Luxemburg    ■ Other countries</p>
Manufacturing industries	<p>0% 10% 20% 30% 40% 50% 60% 70% 80% 90% 100%</p> <p>■ China    ■ Germany    ■ UK    ■ Switzerland    ■ Other countries</p>
Trade	<p>0% 10% 20% 30% 40% 50% 60% 70% 80% 90% 100%</p> <p>■ Luxemburg    ■ Cyprus    ■ Netherlands    ■ Germany    ■ Other countries</p>
Transportation and communication	<p>0% 10% 20% 30% 40% 50% 60% 70% 80% 90% 100%</p> <p>■ China    ■ Ireland    ■ UK    ■ Netherlands    ■ Other countries</p>
Operations with real estate	<p>0% 10% 20% 30% 40% 50% 60% 70% 80% 90% 100%</p> <p>■ Cyprus    ■ Germany    ■ Ireland    ■ Other countries</p>
Financial activity	<p>0% 10% 20% 30% 40% 50% 60% 70% 80% 90% 100%</p> <p>■ Cyprus    ■ UK    ■ Other countries</p>

Source: Federal State Statistics Service

As at the end of 2010 aggregated foreign capital not taking into account bodies of monetary and credit regulation, commercial and saving banks, including ruble investments recalculated in US dollars made USD 300.1 billion, which is by 11.9% more than the corresponding figure at the beginning of the year. Direct accumulated investments went up by 6.6% since the beginning of the year.

As a result of 2010 the Cyprus, the Netherlands, Luxemburg, China and Germany are the leaders as to the volume of the accumulated foreign investments, their share being 64.4% (66.3% in 2009). At the same time the share of the first five countries-investors in the segment of other investment went up to 64.8% (62.9% in 2009), and in the structure of direct and portfolio investments it is estimated to be 67.1% and 21.9% (69.0% and 85.1% in 2009).

In the structure of foreign investments accumulated by the end of December 2010 it is other investments that prevail, accounting for 58.3%. Analogous figure for direct foreign investment made 38.7%.

According to UNCTAD World Investment Report 2010, published in July 2010, the Russian Federation is in the 6<sup>th</sup> place in the world by the volume of attracted direct foreign investments in 2009 (5<sup>th</sup> place in 2008, 9<sup>th</sup> place in 2007, 10<sup>th</sup> place in 2006). The same as in the previous year Russia holds the 2<sup>nd</sup> place after China among developing countries. According to the report, Russia's share accounted for 3.5% of world direct foreign investments (4.1% in 2008) and 8.2% of direct foreign investments in the developing countries (11.9% in 2008).

In 2010 international rating agencies did not change Russia's sovereign rating leaving it at the level below the pre-crisis one. At the same time as long ago as December 2009 S&P international rating agency noting the improvement in the Russian economy raised the forecast for the Russian Federation rating from "negative" to "stable", maintaining the rating at the investment level "BBB". In September 2010 Fitch agency, confirming the current level of rating, changed its forecast for "positive". In the opinion of the agency "Russian economy is recovering after a serious blow from the global financial crisis". ●

## STATE BUDGET

E.Fomina

According to updated information of the Ministry of Finance, the federal budget for January-February was executed with a surplus (0.7 per cent of GDP), whereas during the relevant period of 2010 budget deficit reached 2.7 per cent of GDP. Such a difference in the results of budget execution is largely temporary in nature and is based on the slow rates of expenditures in the current year (by 4 per cent of GDP lower than in 2010). There is a high probability we can expect that in the coming months, the surplus will be replaced by a habitual budget deficit. Only in case the average annual oil price exceeds 115-120 dollars per barrel and provided that the Government does not undertake additional budgetary commitments during the current fiscal year (which is hardly feasible in the pre-election year), the annual deficit (3.7 per cent of GDP) can be reduced to zero.

### Analysis of the main parameters of the expanded government budget execution in January 2011

According to the report disclosed by the RF Treasury on the execution of the consolidated budget for January of 2010, the volume of the revenues of the *budget of the expanded government* has decreased against the level of the relevant period of 2010 by 1.3 percentage points of GDP<sup>1</sup>. Herewith, the expenditure part of the budget in relative terms has been reduced by 1.2 p.p. of GDP, whereas in absolute terms expenditures have grown by approximately RUR 70.3 bn. As a result, the budget of the expanded government has been executed with a significant surplus of 13.4 of GDP, which is by 0.1 p.p. of GDP lower than the relevant period of 2010 (See *Table 1*).

Table 1

#### EXECUTION OF THE BUDGET OF ALL LEVELS IN TERMS OF REVENUE AND EXPENDITURES IN JANUARY 2010-2011

	January 2011		January 2010		Change, against GDP, p.p.
	RUR, bn	% of GDP	RUR, bn	% of GDP	
Federal budget					
Revenues	804.9	23.0	737.6	25.2	-2.2
Expenditures	657.4	18.8	650.5	22.2	-3.4
Deficit (-) /Surplus (+)	147.6	+4.2	+87.1	+2.9	+1.3
Consolidated budgets of the RF Subjects					
Revenues	311.8	8.9	355.5	12.1	-3.2
Expenditures	214.1	6.1	192.7	6.6	-0.5
Deficit (-) /Surplus (+)	+98.7	+2.8	+162.8	+5.6	-2.8
The budget of expanded government					
Revenues	1115.9	31.9	972.7	33.2	-1.3
Expenditures	647.0	18.5	576.7	19.7	-1.2
Deficit (-) /Surplus (+)	+468.9	+13.4*	+395.9	+13.5	-0.1
For reference: GDP, bn rubles	3 498.0		2 930.0		

\* A significant surplus of the budget of the expanded government as against the 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

<sup>1</sup> 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.



*Consolidated budget of the Subjects of the Russian Federation* over January 2011 was also executed with a surplus of 2.8 per cent of GDP against 5.6 per cent of GDP over the same period of 2010. Reduction of the budget surpluses of the RF subjects is due to a sharp decline in revenue, redistributed through regional budgets. Thus, revenues volume for January 2011 decreased by 3.2 percentage points of GDP, among them 3 p.p. of GDP - because of the reduced grants (financial assistance) from the budgets of other levels.

Exploring the structure of the formation of expanded government revenues (*Table 2*) it may be noted that the dynamics of revenues still largely depends on revenues from foreign trade.

Revenue from mineral extraction tax (MET) and income from foreign economic activity over January 2011 increased by 0.5 percentage points of GDP for each of those taxes. The basic grounds for high tax collection level in both, absolute and relative terms were provided by the growth of global oil prices against the relevant period of 2010 (USD 98 per barrel against USD 74 per barrel).

*Table 2*

THE DYNAMICS OF THE BASIC TAX REVENUES TO THE BUDGET OF THE EXPANDED GOVERNMENT OF THE RUSSIAN FEDERATION IN JANUARY 2010–2011, % OF GDP

	January 2011	January 2010	Change, p.p. of GDP
Level of tax burden (1+2+3)	29.0	28.4	+0.6
1. Revenues from taxes (1), including:	18.6	19.8	-1.2
Corporate profits tax	1.9	1.4	+0.5
Single social tax	2.8	2.9	-0.1
VAT	7.1	7.7	-0.6
Excise duties	1.4	1.6	-0.2
Severance tax	4.3	3.8	+0.5
2. Insurance contributions for compulsory social insurance	3.1	1.8	+1.3
3. Revenues from foreign economic activity	7.3	6.8	+0.5

*Source:* The Ministry of Finance of the Russian Federation and Rosstat; Gaidar Institute assessments.

Following a tangible increase of oil and gas revenues, other than oil industries also demonstrate a trend of revenue growth in nominal terms, but in relative terms one can observe a volatile nature in their dynamics (*Table 2*).

The growth of revenue from *corporate profit tax* in the expanded government budget within January of 2011 as compared with the relevant period of 2010 has increased by 0.5 percentage points of GDP, which was based by the growth of the tax base. Thus, for in January of the current year the real sector has received the financial result of 685.7 trillion rubles, which is by 56 per cent higher than its value for the corresponding period in 2010, whereas the share of profitable organizations in the total number of organizations in comparison with the relevant period of preceding year increased by 1.5 percentage points and amounted to about 63 per cent<sup>1</sup>.

*Personal income tax* revenue to the budget of expanded government in relative terms amounted to 2.8 per cent of GDP, which is by 0.1 percentage points of GDP lower than in the corresponding period of 2010. However, in nominal terms, revenue growth in 2011 was about 14 per cent. The growth of personal income tax in general is associated with the expansion of the tax base: the dynamics of an average monthly gross wage demonstrates growth against the level of 2010 both, in nominal and in real terms by 10.2 per cent and 0.6 per cent, respectively.<sup>2</sup>

Since 2011, the rate of *insurance contributions* to the extrabudgetary funds is 34 per cent against 26 per cent a year earlier. This growth of the rate has not affected small and medium businesses (SMEs), due to which, according to the Ministry of Finance, the budget will lose about 80-100 billion rubles per year. Any of the discussed options for further reducing the contribution rate for SMEs could be applied only at the expense of their compensation from other sources<sup>3</sup>.

1 According to the Federal State Statistics Service «On the financial performance of organizations in January 2011»

2 [http://www.gks.ru/bgd/free/B11\\_00/IssWWW.exe/Stg/dk01/5-0.htm](http://www.gks.ru/bgd/free/B11_00/IssWWW.exe/Stg/dk01/5-0.htm)

3 <http://www1.minfin.ru/ru/press/speech/index.php?id4=12260>

Dynamics in insurance premiums to the non-budgetary funds in 2011 will allow to assess the fiscal impact from the increase in the total insurance rates. There is a possibility that a significant effect will not be achieved due to the withdrawal of the tax base “to the shade”.

In general it can be noted that the level of the *tax burden* on the economy in January 2011 has increased by 0.6 percentage points of GDP as compared with the same period in 2010 and reached 29 per cent of GDP. In the medium term sources of increasing the tax burden on the economy could be: growth of excise rates on pure alcohol (the Ministry of Finance proposes to increase it 4-fold) and tobacco (proposed to increase 2-fold), the severance tax on gas (proposed to be increased 2-fold), the change in depreciation rates (proposed rate is 10 per cent instead of 30 per cent at present). In general, additional budget revenues of the budget in 2012-2014 can reach about 1.9 trillion rubles, and the majority of them will be formed by increasing the excise duty on alcohol and the severance tax on natural gas<sup>1</sup>.

Against the background of reduced revenue of the budget of expanded government, relative level of expenditures also demonstrates an explicit reduction: budget expenditures decreased by 1.2 percentage points of GDP (*Table 3*).

Table 3

EXECUTION OF THE BUDGET OF THE EXPANDED GOVERNMENT IN TERMS OF EXPENDITURES  
IN JANUARY 2011–2010, % OF THE GDP

	January 2011		January 2010		Change, p.p. of GDP
	RUR bn	% of GDP	RUR bn.	% of GDP	
Total budget expenditures	647.0	18.5	576.7	19.7	-1.2
Among them					
Federal issues	44.9	1.3	59.4	2.0	-0.7
Including expenditures associated with the servicing of federal and municipal debt	27.9	0.8	20.5	0.7	-0.1
National defense	23.2	0.7	27.1	0.9	-0.2
National defense and law enforcement	74.9	2.1	75.5	2.6	-0.5
National Economy	30.7	0.9	37.9	1.3	-0.4
Housing and public utilities	33.9	1.0	14.3	0.5	+0.5
Environmental protection	0.4	0.01	0.5	0.02	-0.01
Education	56.8	1.6	50.6	1.7	-0.1
Culture, cinematography and mass media*	17.3	0.5	10.2	0.4	+0.1
Health care and sports**	66.3	1.8	58.4	2.0	-0.2
Social policy	270.4	7.7	241.6	8.3	-0.6

\*,\*\* There are changes in the functional classification of budget expenditures in 2011: the articles “Culture, cinematography and mass media”, and “Healthcare and Physical Culture and Sports” are presented in separate budget lines.

Source: RF Treasury, Gaidar Institute estimates.

In varying degrees of reduction in relative terms, nearly all budget lines of expanded government were reduced, excluding «Housing and public utilities», the growth of which reached 0.5 per cent of GDP as compared with the same value in 2010 and “Culture, cinematography and mass media”, which has grown by 0.1 p.p..

The worst decline in public expenditures in relative terms was based on the reduced funding for «Federal issues « budget line - by 0.7 percentage points of GDP, for «Social policy» and «National defense and law enforcement” - by 0.5 - 0.6 percentage points of GDP.

RF federal budget execution within January-February 2011

According to the tentative estimates of the RF Ministry of Finance of the federal budget execution in January-February 2011, budget revenues amounted to 20.6 per cent of GDP, which is by 0.5

1 <http://www.rg.ru/2011/03/29/budjet.html>

percentage points of GDP lower than the indicator of the relevant period of 2010 (See Table 4). In absolute terms, the growth of federal budget revenues amounted to 200 bn rubles. In January 2011, the proceeds from asset management of the oil and gas funds for 2010 were credited to the budget in the total amount of 47.1 billion rubles. The total volume of oil and gas revenues in January-February 2011 amounted to 9.5% of GDP, which is by 0.1 percentage points of GDP is lower than in the same period of the last year.

Table 4

## BASIC INDICATORS OF THE RF FEDERAL BUDGET IN JANUARY-FEBRUARY 2010-2011

	January-February 2011		January-February 2010		Budget execution in % versus 2010 year estimates.	Change	
	RUR, bn	% GDP	RUR, bn	% GDP		RUR, bn	% GDP
Revenues, including:	1505.2	20.6	1308.3	21.1	17,0	+196,9	-0,5
Oil and gas	692.3	9.5	595.3	9.6	16,9	+97,0	-0,1
Contributions to the Reserve Fund and National Welfare Fund (Stabilization Fund)	0.0	0.0	26.5	0.4	–	-26,5	-0,4
Revenues, including:	1452.5	19.9	1477.8	23.9	13,6	-25,3	-4,0
Interest expenditures	49.9	0.7	35.9	0.6	12,8	+14,0	+0,1
Non-interest expenditures	1402.6	19.2	1441.9	23.3	13,7	+39,3	-4,1
Deficit / Surplus of the federal budget	+52.8	+0.7	-169.5	-2.7	2,9	+116,7	+3,4
Non-oil deficit	-639.6	-8.8	-764.8	-12.4	10,8	+125,2	+3,6
GDP estimates	7 310.0		6 190.0				

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

Preliminary estimates of the *federal budget in terms of expenditures* for January-February 2011 indicate a significant decrease in their volume by 4 percentage points of GDP against the value of January-February 2010.

The dramatic decline in expenditures is based on the slow rate of budget funds spending. On March 1, 2011 the ministries and departments reserved for targeted spending only 54.7 per cent of their annual limits. The Ministry of Finance is concerned about such a low expenditure rate in view of irregular budget spending. The key factors in the low dynamics of budget spending are delaying the relevant regulations approval by the government and the MMBF uncertainty (main manager of budgetary funds), related to the ongoing reform of budget institutions<sup>1</sup>.

In addition, in March information became available on the potential transfer of the reform in planning of public expenditures to a later period. Throughout 2010 there were active discussions on the need to reform the sector of public finance and the transition to the principle of program-targeted planning and execution of the federal budget. This approach suggests the budget presentation in the form of long-term target programs with target indicators, authorized persons, allowable amounts of funding. Transition to a new budgeting system is scheduled for 2012, and ministries are supposed to present draft versions of programs by April 15, 2011.

However, at the end of March, with high probability one can expect that the federal executive authorities fail to keep the established deadlines, and therefore further consideration and approval of the programs may be postponed to a later period. On the one hand, the delay in the preparation of long-term programs is associated with high political uncertainty in view of the forthcoming presidential elections and possible changes in the priorities of socio-economic policies of the new government, but on the other hand, further delay of the reform of the budgetary system provides a negative impact on the efficiency of public spending.

According to tentative results of budget execution for January-February 2011, the federal budget was executed with a surplus of 0.7 per cent of GDP against the deficit of 2.7 per cent of GDP in

1 <http://bujet.ru/article/121904.php>

the same period of 2010, the volume of non-oil deficit has significantly declined - by 3.6 percentage points of GDP as compared with the previous year and amounted to 8.8 per cent of GDP. However, in the coming months we can expect the federal budget execution with a significant deficit.

In general, in 2011, according to the basic parameters of the federal budget, the deficit will not exceed 3.7 per cent of GDP (with the average oil price of USD 75 per barrel.). At the same time, according to the estimates of Gaidar Institute experts, in case of sustained favorable external economic situation, when the average price of oil keeps at about USD 100 per barrel, one can expect a reduction of deficit to 2.4 per cent of GDP<sup>1</sup>. The key source of funding for the federal budget deficit remains the Reserve Fund. Overall, it is planned to allocate in 2011 from the Reserve Fund to finance the federal budget deficit 285 billion rubles. Some 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 March 1, 2011, the volume of Reserve Fund made 770.2 billion rubles (against 775.2 billion rubles as of January 1, 2011), the volume of the National Welfare Fund (NWF) has reduced to 2647.5 billion rubles (against 2695.5 billion rubles as of January 1, 2011).

By the middle of 2011 a Direct Investments Fund (DIF) is expected to be set up, designed to share risks with foreign investors in the financing of projects for modernization of the Russian economy. According to tentative estimates, the (DIF) will be established in the form of closed unit investment trust, which could amount to USD 10 billion. It is possible that for the formation of the fund NWF assets may be attracted.

The Direct Investments Fund will have some similarities with the existing since 2006 Investment fund, which is co-financing infrastructure projects with private investors participation. A distinctive feature of the DRF will be a mandatory participation of foreign capital; besides, the Fund can act as a co-investor in selected projects and other investment funds<sup>2</sup>.

However, meanwhile there is no clear understanding, which sectors of the domestic economy will be open to the infusion of foreign capital, i.e. those attractive to foreign investors without additional guarantees from the government (FEC, telecommunications, wholesale and retail trade), or less attractive, but at the same time badly in need in the inflow of capital for reconstruction and development. In our opinion, the value of a DIF for the modernization of economy will increasingly be dependant on its sectoral priorities. ●

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1 Estimates of Gaidar Institute experts as of 25.04.2011.

2 <http://www.bfm.ru/articles/2011/03/30/prezident-toropit-veb-s-suverennym-fondom-investicij.html#text>

## RUSSIAN BANKING SECTOR

S.Borisov

*In January of the current year the dynamics of the banking sector was traditionally based on the high volatility of the resource base: after the inflow of funds to “on demand” accounts in late 2010, the portfolio of deposits in early 2011 was dramatically reducing. Credit activity in January remained low due to the small number of working days in the month, and also due to aggressive sales of banking products in December. Profits of the banking sector in January is based more on interest yield, since the movement on the balance of reserves for loan losses is minimal.*

Table 1

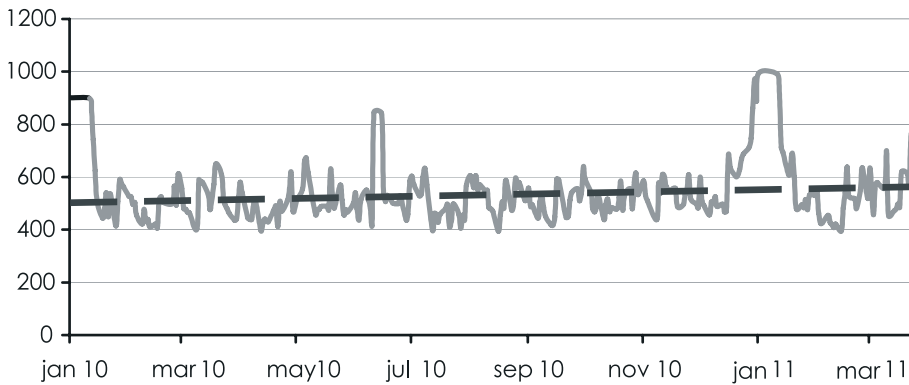
## MAIN INDICATORS OF THE RUSSIAN BANKING SYSTEM, RUR, BLN.

	As of 01.02.2010	As of 01.01.2011	As of 01.02.2011		
			Nominal	Growth since the start of the year. as %	Year-on- year growth. as %
Assets	29 196.2	33 804.6	33 207.4	-1.8	13.7
Loans to non-financial organizations	12 504.5	14 062.9	14 136.4	0.5	13.1
Loans to private individuals	3 545.5	4 084.8	4 080.6	-0.1	15.1
Loans to banks	3 037.9	2 921.1	2 803.0	-4.0	-7.7
Investments in bonds	3 641.7	4 419.9	4 424.8	0.1	21.5
Deposits with the CBR	1 124.2	325.7	322.2	-1.1%	-71.3
Banks' deposits	3 159.0	3 754.9	3 623.2	-3.5	14.7
Corporate deposits	5 118.3	6 035.6	5 435.9	-9.9	6.2
Private deposits	7 502.6	9 818.0	9 729.7	-0.9	29.7
Impairment reserves	2 108.7	2 192.0	2 198.5	0.3	4.3
Profit (in the respective year)	41.9	573.4	76.8		83.3

Source: the Bank of Russia.

In January activity of the banking sector traditionally declines. This is due, on the one hand, to finished in late December the New Year's eve «fair-sale» of the banking products, during which offers for the most favorable credit terms and deployment of funds appear in the market. Aggressive pre-New Year sales usually distract some part of potential January demand for bank services in both, corporate and retail banking segments. On the other hand, due to the long New Year holidays, the number of working days in the first calendar month of the year is reduced to 14, which prevents the companies to perform in full scope the monthly volumes. According to the RF Central Bank, the assets of the banking sector in January have been reduced by 597 billion rubles., or by 1.8% against the end of December 2010. However, the major factors in reducing the portfolio's assets were a decrease of interbanking crediting (-118 bn rub.) and current accounts of credit institutions with the Bank of Russia. The value of balances of commercial banks' correspondent accounts with the Bank of Russia reached its peak of 994 billion rubles by January 1, 2011 and declined sharply by the end of the month, having returned to the average volume of the second half of 2010 (*Fig. 1*).

The decrease in retail credit portfolio in January was negligible - only 4.8 billion rubles and even the corporate portfolio has grown by 73 billion rubles. In this case, the foreign currency of the loan portfolio decreased as legal, and by individuals. According to official figures, the growth of the ruble part of portfolio credits to both, legal persons and individuals amounted to 81 billion rubles, while the foreign currency part reduced by 13 billion rubles. The volume of credits in rubles issued to individual



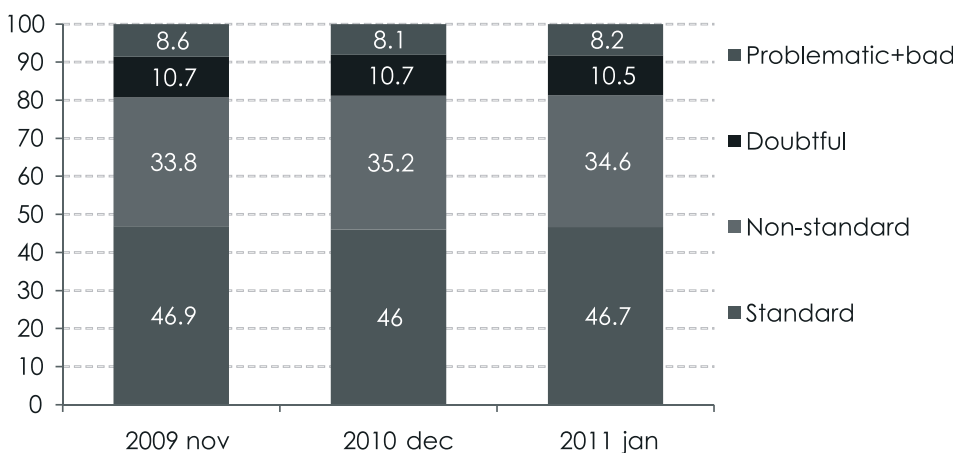
Source: the Bank of Russia  
 Fig. 1. The dynamics of bank balances on correspondent accounts with the Central Bank, RUR bn

residents, increased in January to 9 billion rubles together with reducing balances of foreign currency loans by 13 billion rubles. At the background of the ruble strengthening against the two-currency basket, foreign currency loans are becoming less in demand. The decline in the share of foreign currency loans in the credit portfolio to legal entities from September 2010 to January 2011 has reached 3.6 percentage points (from

25.1 to 21.5%), the dynamics in the retail loan portfolio is comparable - reduction is noted from 11 to 8.6% over 4 months.

At relatively low development of credit portfolio the share of overdue debt has remained practically unchanged: the share of overdue debt in corporate portfolio remains at the December level of 5.3%, in the retail portfolio it rose in January from 6.9% to 7%. The structure of credit portfolios of 30 largest Russian banks as broken down by category of loans in January 2011 has undergone minor changes: an increase in the share of standard credits (loans to the first category of quality with minimal risk) was accompanied by a comparable decrease in the share of loans of the second category. In January changes in the structure of the portfolio of 30 largest banks is based on the growth of the share of well-secured loans to non-financial institutions (Fig. 2).

From the perspective of the banks resource base, the most striking feature of January in the banking system is the growth of volatility in balances of deposits of individuals and non-financial organizations. According to the RF CB, the amount of borrowed funds of population has decreased in January by 88 billion rubles and corporate deposit portfolio has decreased over the same period by 599 billion rubles. It is worth noting that the reduction of the banks' resource base in the first calendar month is a natural follow-up of its peak growth in December. The substantial inflow of deposits at the end of the year was secured by the annual lump-sum benefits paid by the companies to the employees for the year performance. The major part of those funds have been accumulated in banks in the debit card accounts "on demand", and only a part of them remained in the banking system in the form of deposits for more than a month. Namely in that category of deposits up to 30 days, there



Source: the Bank of Russia  
 Fig. 2. Dynamics of Loans By Categories of Quality in the Credit Portfolio of Top 30 Largest Banks, as %.

was recorded the highest outflow of 170 billion rubles in January. Similarly, corporate deposit portfolio in January has decreased primarily due to a sharp decline in fund balances at the accounts of organizations "on demand" and accounts for up to 30 days (by 346 billion rubles) from such accounts the funds were addressed at the annual payments.

It is noteworthy that with the relatively quiet situation in the stock and

monetary markets, the first calendar month of the new year became the record in profitability for the Russian banks. According to the RF CB, in January the banks earned 77 billion rubles, what is by 83% more than the profit in the same period of 2010. Based on a relatively small (amounting to 6.5 billion rubles.) change in the reserves for possible loan losses, it can be concluded that the main factor of profitability in January became the bank's net interest income and comparable with the growth of loan portfolio increase of non-credit commissions. However, not all banks demonstrated a profit in January: the number of unprofitable banks increased from 81 at the end of 2010 to 193 as of February 1.

Below, we cite the most significant developments in the banking sector in January-February:

- From February 1, the standards of reserves for liabilities of credit institutions to non-resident legal entities in rubles and in foreign currency were increased from 2.5 to 3.5%, on liabilities to individuals and other liabilities of credit institutions in rubles and in foreign currencies – from 2.5 to 3.0%. Thus, the cost for banks borrowing overseas will increase more than the cost of raising funds in the country;

- The Bank of Russia intends to increase the effectiveness of provisional administrations in the banks, deprived of licenses through the expansion of authority of the Agency for Deposit Insurance members. It is proposed to authorize them in a legal way to have an access to bank secrecy and to perform enforcement functions of the CB agents on individual transactions. This will allow effectively to impeach transaction on withdrawal assets from the banks, and better to prepare for the introduction of the mechanism of transfer of assets and liabilities from the banks deprived of the licenses, to a healthy credit institution;

- Central Bank will strictly monitor the capitalization of banks. From April, the regulator will treat with suspicion in the use of illegal schemes in the capital increase or the withdrawal of assets in anticipation of loss of license with impossibility to reach capitalization to 180 million rubles, the banks, which do not discuss the issue of equity accumulation at their general meetings before summer. A special monitoring will be performed for such banks;

- The National Banking Council has agreed at its meeting the sale of 7.58% of the Sberbank shares by the Russian Central Bank. The process of reducing the state share in the banking sector continues;

- In March, the purchase transaction of OAO “Sberbank of Russia” of the largest player in the investment services market “Troika Dialog” was concluded. The largest Russian bank will acquire 100% of the company in two stages for the amount not less than USD 1 billion. ●

## RESIDENTIAL PROPERTY MARKET IN THE RUSSIAN FEDERATION

G.Zadonsky

In January-February 2011, 57,600 apartments with the total floorspace of 5.30 million sq. m were commissioned which figure is equal to 88.5% of that in the same period last year. In January 2011, the volume of the mortgage housing loans (MHL) amounted to RUR 20 billion which figure is 137% higher than the volume of the mortgage housing loans extended in January 2010. According to OAO AMHL forecasts, mortgage loans for the total amount of RUR 580–640 billion -- which figure exceeds the record-high level of mortgage lending in 2008-- will be extended in 2011.

According to the Rosstat's data, in February 2011 57,600 apartments with the total floorspace of 5.30 million sq. m which figure is equal to 88.5% of that in the same period last year were commissioned by entities of all the types of ownership. Of 2.6 million sq. m of housing commissioned in January 2011, individual developers accounted for 1.35 million sq. m or 90.1% of that in the same period last year.

According to the Rosstat's data, in 2010 the average actual cost of building of a square meter of floorspace of residential housing was over 50% higher than the average nation-wide level (*Table 1*) in the Sakhalin Region (RUR 52,555), the Murmansk Region (RUR 51,176), the Netets Autonomous Region (RUR 52,796), the Yamalo-Nenets Autonomous Region (RUR 61,442) and the Chukotka Autonomous Region (RUR 191,698).

Table 1

### THE AVERAGE ACTUAL COST OF BUILDING OF A SQUARE METER OF RESIDENTIAL HOUSING FLOORSPACE \*

	Total	In rural areas	In cities and urban townships
2009			
1 <sup>st</sup> quarter	28814	28597	28826
2 <sup>nd</sup> quarter	28763	29994	28673
I half year	28790	29358	28754
3 <sup>rd</sup> quarter	29294	28393	29338
January-September	29002	29011	29002
4 <sup>th</sup> quarter	31622	31169	31649
Year	30312	30111	30324
2010			
1 <sup>st</sup> quarter	31135	26383	31447
2 <sup>nd</sup> quarter	31253	34668	31066
I half year	31205	30962	31219
3 <sup>rd</sup> quarter	30326	28365	30438
January-September	30902	30085	30950
4 <sup>th</sup> quarter	32900	34803	32780
Year	31910	32552	31871

\* apartment houses without extensions, superstructures and incorporated premises and residential housing built by individual developers.

The source: The Rosstat's data.



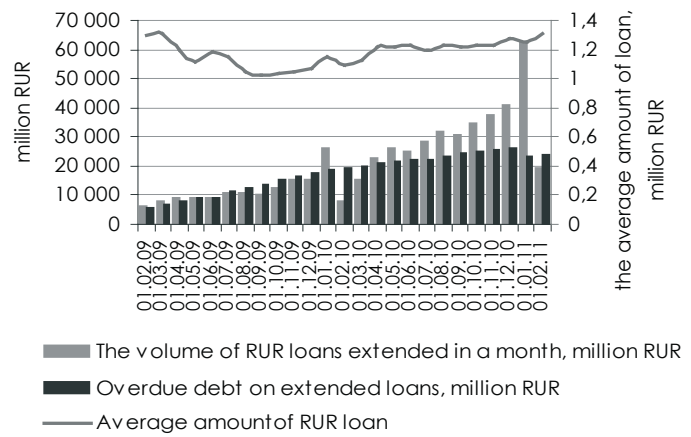
According to the data of the Central Bank of Russia, in January 2011 20,166 housing loans for the total amount of RUR 23.28 billion were extended including 15,041 mortgage housing loans for the total amount of RUR 20 billion (Fig. 1 and Fig. 2), which figure exceeds by 137% the volume of mortgage housing loans extended in January 2010. Growth in the volume of housing lending in January 2011 as compared to that in January 2010 is close to the year-on-year ratio of growth in the lending volume in 2010 to that of the previous year (a 149% growth in MHL) which factor is evidence of sustained growth in volumes of housing lending.

According to the AMHL forecast, if positive economic trends prevail 415,000 to 460,000 mortgage loans for the total amount of RUR 580 billion to RUR 640 billion will be extended in the year 2011 which figures exceed the record-high value registered during the peak of mortgage lending in 2008.

As of February 1, 2011, the average amount of RUR mortgage housing loan increased in a month to RUR 1.3 million (Fig.1), while that of mortgage loans in foreign currency decreased to RUR 4.18 million (Fig. 2). As of February 2011, the outstanding debt on RUR mortgage housing loans rose to RUR 952.85 billion, while that on mortgage loans in foreign currency amounted to RUR 173.82 billion. As of the same date, the overdue debt on mortgage housing loans amounted to RUR 41.67 billion (the overdue debt of RUR 23.87 billion on RUR mortgage loans (Fig.1) and that of RUR 17.81 billion on mortgage loans in foreign currency (Fig. 2)).

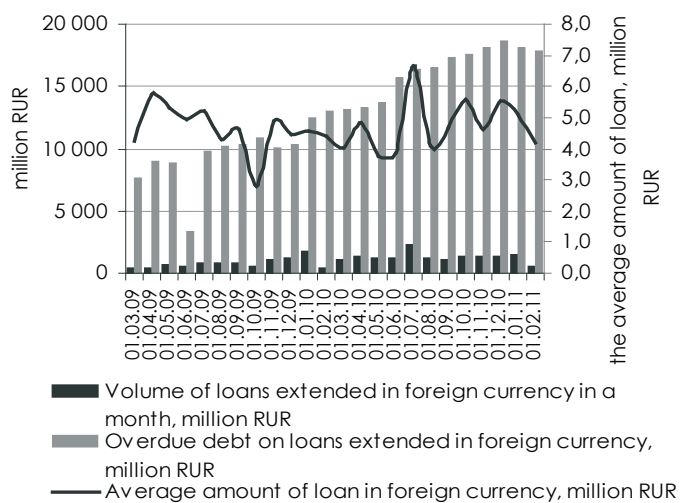
In 2009 and 2010, the overdue debt on mortgage housing loans in foreign currency exceeded several times over the volumes of loans extended in a month. The ratio of the overdue debt to the volume of loans in foreign currency extended in a month varies from 6.32 as of June 1, 2009 to 33.0 as of February 1, 2011. As of February 1, 2011, the overdue debt on mortgage housing loans in foreign currency as a percentage of the outstanding debt rose to 10.24%, while that in rubles remained at the level of 2.5% (Fig. 3).

As of February 1, 2011, according to the data of the Central Bank of Russia the debt on the defaulted mortgage housing loans (which are overdue for over 180 days) decreased to RUR



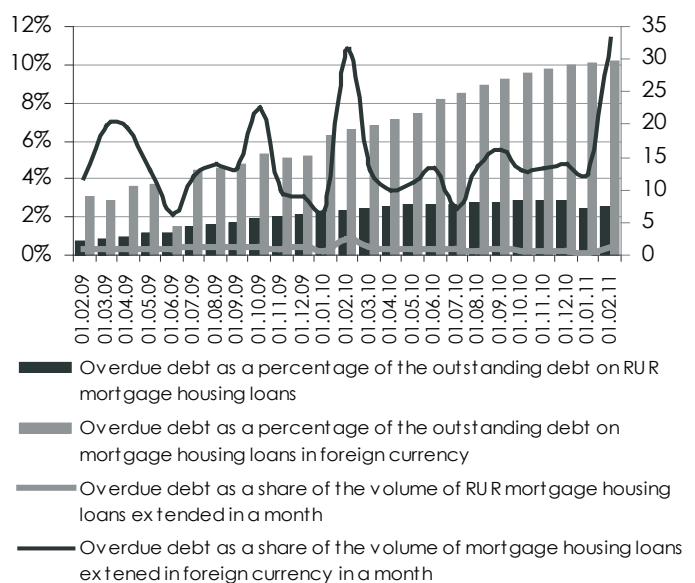
The source: The Rosstat's data

Fig. 1. Dynamics of granting of RUR mortgage housing loans



The source: On the basis of the data of the Central Bank of Russia.

Fig. 2 Dynamics of granting of mortgage housing loans in foreign currency



The source: on the basis of the data of the Central Bank of Russia.

Fig. 3. The dynamics of the overdue debt

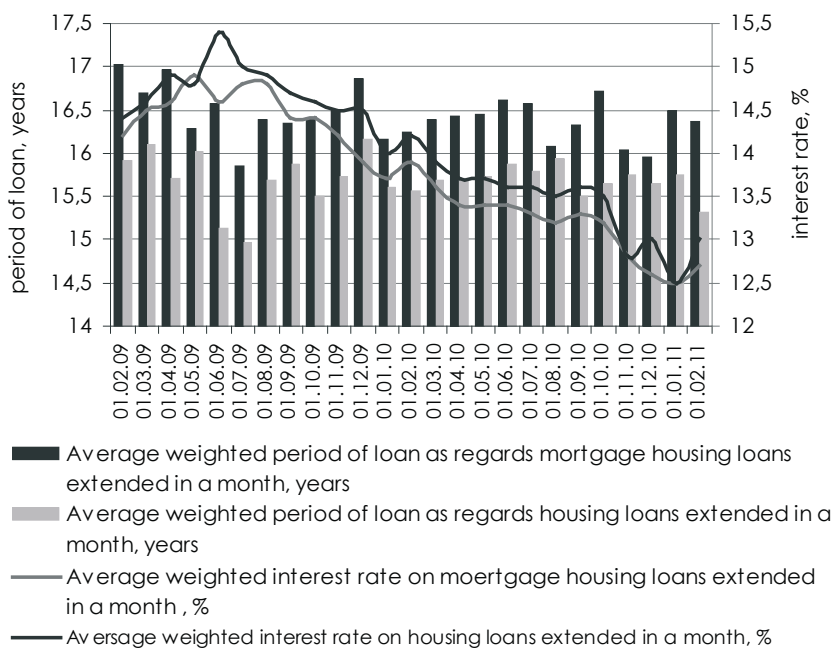
53,517 billion or 4.75% of the total amount of debt (*Table 2*), against RUR 57,681 billion or 5.11% as of January 1, 2011.

Table 2

## GROUPING OF THE DEBTS ON MORTGAGE HOUSING LOANS BY THE PERIOD OF OVERDUE PAYMENTS

	The total amount of debt on mortgage housing loans	Including							
		Without overdue payments		With payments overdue for 1 to 90 days		With payments overdue for 91 to 180 days		With payments overdue for over 180 days	
		Million RUR	% of the total amount of the debt	Million RUR	% of the total amount of the debt	Million RUR	% of the total amount of the debt	Million RUR	% of the total amount of the debt
2010 r.									
Feb 01	1 008 584	865 062	85.77	73526	7.29	17 650	1.75	52 346	5.19
Mar 01	1 005 758	859 521	85.46	75231	7.48	17 701	1.76	53 305	5.3
Apr 01	1 006 977	858 649	85.27	76933	7.64	17 723	1.76	53 672	5.33
May 01	1 013 821	867 424	85.56	74719	7.37	19 770	1.95	51 908	5.12
Jun 01	1 025 119	874 222	85.28	76166	7.43	18 862	1.84	55 869	5.45
Jul 01	1 033 902	883 986	85.50	76509	7.40	16 025	1.55	57 382	5.55
Aug 01	1 042 253	900 090	86.36	68580	6.58	15 738	1.51	57 845	5.55
Sept 01	1 056 075	905 478	85.74	74982	7.10	14 468	1.37	61 147	5.79
Oct 01	1 069 714	916 425	85.67	77126	7.21	14 013	1.31	62 150	5.81
Nov 01	1 086 347	941 971	86.71	67680	6.23	14 557	1.34	62 139	5.72
Dec 01	1 105 476	953 916	86.29	74730	6.76	14 371	1.3	62 459	5.65
2011									
Jan 01	1 128 788	991 415	87.83	66824	5.92	12 868	1.14	57 681	5.11
Feb 01	1 126 674	976 376	86.66	84500	7.50	12 281	1.09	53 517	4.75

The source: the data of the Central Bank of Russia.



The source: on the basis of the data of the Central Bank of Russia.

Fig.4. Average weighted periods of loan and interest rates on RUR loans extended within a month

Within a month, in January 2011 the average weighted interest rate on RUR mortgage housing loans and those in foreign currency amounted to 12.7% and 10.8%, respectively, while that on RUR housing loans and housing loans in foreign currency, to 13.0% and 10.8%, respectively. The average weighted period of loan as regards RUR mortgage housing loans and those in foreign currency extended within a month amounted to 16.4 years and 11.9 years, respectively, while that as regards RUR housing loans and housing loans in foreign currency, to 15.3 years and 10.3 years, respectively (*Fig. 4*).

As of January 1, 2011, the share of mortgage housing loans in foreign currency in the total

volume of loans extended within a month amounted to the mere 2.28%, which factor reflects the general trend towards declining of that share starting from November 2009; as of February 1 the above share rose to 2.7%.

In January-February 2011, the AMHL refinanced 3,346 mortgage housing loans for the total amount of RUR 3, 373,422 million with average weighted lending rate of 11.71%. The number of loans amounted to 59.02%, while the volume of refinancing, to 61.27% of the respective values (5,669 units and RUR 5, 506,072 million) of the same period last year. The average weighted lending rate rose 0.9% as compared to that in January-February 2010 (10.81%).

In March 2011, the Bank of Russia registered the issue of ZAO CB Deltacredit's 5-year mortgage bonds worth RUR 5 billion.

The Federal Financial Markets Agency registered two issues and a prospectus for issuing of bonds with mortgage-backed securities of GPB-Ipoteka Dva, a mortgage agent (the above institution is affiliated with GPB-Ipoteka Bank which is a subsidiary of Gasprombank) for the total amount of RUR 7 billion.

In February 2011, OAO AMHL placed at ZAO FB MICEX A17-series corporate bonds backed by state guarantees of the Russian Federation for the amount of RUR 8.0 billion by way of public offering. The total volume of the demand exceeded the supply volume by 20% and amounted to RUR 9.31 billion. The fixed rate of the coupon yield for the entire maturity of bonds is set at the level of 9.05% per annum (the yield to maturity amounts to 9.36% per annum).

In 2010, mortgage borrowers' responsibility` was insured by ten insurance companies with OAO VSK and OOO Rosgosstrakh being the leaders. According to the preliminary data of OAO Insurance Company AMHL, in 2010 over 700 loans for the total amount of over RUR 1 billion were extended with the borrower's responsibility insured. AMHL refinanced 291 such loans for the total amount of RUR 392 million. ●

## THE OIL AND GAS SECTOR

Yu.Bobylev

*The recovery of the global economy and recent developments in North Africa and the Middle East have resulted in substantial growth in global oil prices. In March, the price on the Brent oil amounted to nearly USD 115 a barrel. Due to tragic events in Japan, the Japanese import of energy resources may grow, and a number of countries may revise their energy policies towards restrained development of the nuclear power industry. As a result, there will be additional growth in the global demand in hydrocarbons, primarily, the natural gas which situation creates factors for growth in the import of Russian natural gas. The growing political uncertainty in North Africa and the Middle East may result in adjustment of the EU policy as regards diversification of sources of energy supplies and have a positive effect on Russia's position on the European energy market.*

The recovery of the global economy after the financial and economic crisis had a decisive effect of late on the situation in the global oil market. The main factors behind the price rises included the higher demand in oil determined by high economic growth rates of China, India and other Asian states, quite a restrained policy pursued by the OPEC as regards increase of oil production by its member-states, as well as sluggish growth in oil production outside the OPEC. The main portion of growth in oil production by OPEC counties was ensured by Nigeria and Saudi Arabia. Generally, in 2010 the OPEC production was higher than that in 2009, but much lower than the 2008 level. Also, the oil production by Norway and the UK in the North Sea kept falling. Due to the above factors, late last year the global oil price amounted to USD 90 a barrel, while in March 2011 the Brent oil price was close to the level of USD 115 a barrel. (Table 1 and 2).

Table 1

GLOBAL OIL PRICES IN THE 2008-2009 PERIOD, USD/A BARREL

	2008	2009	2010 1 <sup>st</sup> quarter	2010 2 <sup>nd</sup> quarter	2010 3 <sup>rd</sup> quarter	2010 4 <sup>th</sup> quarter	2010	2011 1 <sup>st</sup> quarter (estimate)
Brent oil price, the UK	97.7	61.9	76.7	78.7	76.4	86.8	79.6	104.8
Urals oil price, Russia	94.5	61.0	75.3	76.9	75.6	85.2	78.3	102.1

The source: IMF, OECD/IEA.

Table 2

AVERAGE MONTHLY GLOBAL PRICES ON OIL IN THE 2010-2011 PERIOD, USD/A BARREL.

	2010 Jan	2010 Mar	2010 Jun	2010 Sep	2010 Dec	2011 Jan	2011 Feb	2011 1-24 Mar
Brent oil price, the UK	76.2	78.9	74.9	77.8	91.4	96.5	103.8	114.2
Urals oil price, Russia	76.1	76.9	74.4	77.3	89.5	93.8	101.5	111.1

The source: IMF, OECD/IEA.

In Russia, after some decrease in oil production in 2008, growth in oil production renewed, though it was low (a 1.2% increase as compared to that in the previous year) (Table 3). Putting in operation of a number of new large deposits in the North of the European part of the country and in Western Siberia, as well as coming into effect of a number of such amendments to the tax code of the Russian Federation as are aimed at reduction of the tax burden on the oil sector, motivation of the extended development of the exploited deposits and development of new regions of production had a positive effect on the dynamics of oil production. As a result, in 2010 oil production in Russia amounted to 505 million tons which factor is the highest index in the entire period since 1991.

In 2011, growth in oil production fell dramatically; in January-February it amounted to the mere 0.5% as compared to the respective period last year. Such a situation points to a need of more active actions to be taken as regards development of new oil deposits in order to make up for a drop in oil production at the existing ones.

In 2010, the largest volume of oil was produced by Rosneft, LUKOIL, TNK-BP, Surgutneftegas and Gazprom. The above five oil companies accounted for nearly 75% of the total oil production in Russia. The mid-sized oil companies (Tatneft, Slavneft, Bashneft and Russneft) accounted for over 14% of the total production of oil. In 2010, operators of the agreement on production sharing produced about 3 % of the Russian oil. The share of other producers which included over 100 small oil-producing entities amounted to 8 %.

Reduction in growth rates of oil production in the past few years can be explained primarily by objective worsening of production conditions. Most deposits which are currently exploited have entered the phase of declining production, while new ones are, in most cases, characterized by inferior mining-and-geological and geographic parameters; development of such deposits requires higher capital, operating and transportation costs.

*Table 3*

PRODUCTION OF OIL, OIL PRODUCTS AND NATURAL GAS IN THE 2005-2011 PERIOD,  
% OF THE PREVIOUS YEAR

	2005	2006	2007	2008	2009	2010	2011 January - February
Oil, including gas condensate	102.2	102.1	102.1	99.3	101.2	102.1	100.5
Prime oil refining	106.2	105.7	103.8	103.2	99.6	105.5	103.3
Motor petrol	104.8	107.4	102.1	101.8	100.5	100.5	101.6
Diesel fuel	108.5	107.0	103.4	104.1	97.7	104.2	103.4
Residual fuel oil	105.8	104.5	105.2	101.9	100.8	108.5	103.4
Natural gas	100.5	102.4	99.2	101.7	87.9	111.4	99.6

*The source:* The Federal State Statistics Service.

In the past few years, growth rates of oil refining were higher than those of oil production which situation was determined primarily by higher growth rates of the export of oil products due to lower export duties on such products as compared to those on the crude oil. In 2005-2010 period, growth rates of primary oil refining amounted to 3.2% to 6.2% a year (except for 2009) with growth rates of oil production amounting to 1.2% to 2.2% a year (except for 2008). As a result, the share of oil refining in the oil production rose from 42.5% in 2004 to 49.4% in 2010. (*Table 4*). It is to be noted that in the past decade the processing depth did not actually rise and amounted to the mere 71.2%, which figure is fairly equal to the 2000 level (it is noteworthy that the processing depth in the leading industrial countries amounts to 90%–95%). In Russia, both the efficiency of oil processing and the quality of oil products are still much below the international standard.

*Table 4*

OIL PRODUCTION AND REFINING IN THE RUSSIAN FEDERATION IN THE 2005-2010 PERIOD.

	2005	2006	2007	2008	2009	2010
Oil production, including gas condensate, million tons	470.0	480.5	491.3	488.5	494.2	505.1
Primary oil refining, million tons	208	220	229.0	236.3	236.0	249.3
The share of oil refining in oil production, %	44.3	45.8	46.6	48.4	47.8	49.4
Depth of processing of oil stock, %	71.6	71.9	71.7	72.0	71.9	71.2

*The source:* The Federal State Statistics Service and the Ministry of Energy of Russia.

In 2010, the net export of oil and oil products grew significantly to 379.2 million tons which value is the record-high maximum for the Russian oil industry (*Table 5 and 6*). It is to be noted that the unit weight of the net export of oil and oil products in the oil production amounted to 75.1%. In 2010, the export of the crude oil amounted to 49.6% of production thereof. In 2010, the share of the export in production of the residual oil amounted to 92.7%, while that of diesel fuel, to 59.2%. In 2010, the export of motor petrol fell by 34.2%, while the share of it in production of motor petrol went down to 8.2% (for reference: in 1999 the share of the export in production of motor petrol amounted to 7.2%, while in 2005 and 2009 it amounted to 18.5% and 12.6%, respectively). Both the reduced fuel oil which is used in Europe as a primary product for subsequent processing and diesel fuel accounted for a larger part of the export of oil products. In 2010, the main portion of energy resources (89% of oil, 96% of oil products and 62% of natural gas) were exported outside the CIS.

Table 5

THE EXPORT OF OIL, OIL PRODUCTS AND NATURAL GAS FROM RUSSIA IN THE 2005-2010 PERIOD, % OF THE PREVIOUS YEAR

	2005	2006	2007	2008	2009	2010
Oil, total	98.4	98.0	104.0	94.0	101.8	101.2
including: to non-CIS states	99.1	98.0	104.8	92.6	102.9	106.1
To CIS states	94.9	98.0	99.4	102.6	95.4	72.6
Oil products, total	117.9	106.3	108.0	105.0	105.3	106.2
including: to non-CIS states	119.1	104.5	107.6	102.0	107.1	109.6
to CIS states	94.6	148.8	115.3	152.2	86.8	62.3
Natural gas, total	103.7	97.6	94.6	101.8	86.2	105.6

The source: The Federal State Statistics Service.

After a 13.8% reduction in the export of natural gas in 2009 due to a drop in the natural gas supplies to Europe, in 2010 the export of the natural gas increased as a result of growth in natural gas supplies to CIS states, however, it has failed to achieve the pre-crisis level so far.

Table 6

CORRELATION OF PRODUCTION, CONSUMPTION AND EXPORT OF OIL AND NATURAL GAS IN THE 2005-2010 PERIOD.

	2005	2006	2007	2008	2009	2010
<b>Oil, million tons</b>						
Production	470.0	480.5	491.3	488.5	494.2	505.1
Export, total	252.5	248.4	258.4	243.1	247.4	250.4
Export to non-CIS states	214.4	211.2	221.3	204.9	210.9	223.9
Export to CIS states	38.0	37.3	37.1	38.2	36.5	26.5
Net export	250.1	246.1	255.7	240.6	245.6	249.3
Domestic consumption	123.1	131.2	124.1	130.4	125.3	125.9
Net export as % of production	53.2	51.2	52.0	49.3	49.7	49.4
<b>Oil products, million tons</b>						
Export, total	97.0	103.5	111.8	117.9	124.4	132.2
Export to non-CIS states	93.1	97.7	105.1	107.6	115.4	126.6
Export to CIS states	3.9	5.8	6.7	10.3	9.0	5.6
Net export	96.8	103.2	111.5	117.5	123.3	129.9
Oil and oil products, million tons						
Net export of oil and oil products	346.9	349.3	367.2	358.1	368.9	379.2
Net export of oil and oil products as % of production of oil	73.8	72.7	74.7	73.3	74.6	75.1
<b>Natural gas, billion cubic meters</b>						
Production	636.0	656.2	654.1	664.9	596.4	665.5

Table 6, cont'd

	2005	2006	2007	2008	2009	2010
Export, total	207.3	202.8	191.9	195.4	168.4	177.8
Export to non-CIS states	159.8	161.8	154.4	158.4	120.5	107.4
Export to CIS states	47.5	41.0	37.5	37.0	47.9	70.4
Net export	199.6	195.3	184.5	187.5	160.1	173.5
Domestic consumption	436.4	460.9	469.6	477.4	436.3	492.0
Net export as % of production	31.4	29.8	28.2	28.2	26.8	26.1

*The source:* The Federal State Statistics Service, the Ministry of Energy of Russia, the Federal Customs Service and the author's calculations.

The analysis of the dynamics of the Russian oil export during a long run points to the fact that the oil sector has become more export-oriented as compared to the pre-reform period: if in 1990 the share of the net export of oil and oil products amounted to 47.7%, in 2010 it amounted to 75.1%. At the same time, it is to be remembered that the export orientation is related not only to growth in absolute volumes of the export, but also to a significant drop in domestic oil consumption due to market transformation of the Russian economy. Prior to the financial and economic crisis of 2008 and 2009, in a situation of rapid economic growth the volumes of domestic consumption of oil in Russia were quite stable which factor is evidence of a decrease in oil capacity of the Russian GDP.

The growth in global oil prices determined a significant increase in export revenues. In 2010, the aggregate revenues from the export of oil and main oil products (motor petrol, diesel fuel and residual oil) amounted to USD 193.9 billion (*Table. 7*). It can be noted for reference that the maximum level of the revenues from the oil export was registered in 2008 (USD 228.9 billion), while the minimum one (USD 14 billion), in a situation of falling global prices on oil in 1998.

Table 7

REVENUES FROM EXPORT OF OIL AND OIL PRODUCTS IN THE 2005-2010 PERIOD, BILLION USD.

	2005	2006	2007	2008	2009	2010
Revenues from export of oil and main oil products	112.4	140.0	164.9	228.9	141.2	193.9

*The source:* Calculated on the basis of the data of the Federal State Statistics Service.

Tragic events in Japan and developments in North Africa and the Middle East are likely to have a significant effect both on the global energy market and demand in Russian energy resources. As a result of the earthquake and tsunami, Japan experiences serious problems with its nuclear power industry, primarily, at the Fukushima-1 Nuclear Power Plant. Accidents took place at three other Japanese nuclear power plants as well. As a result, the Fukushima-1 Nuclear Power will be closed down, while restoring of other damaged nuclear power stations may require quite a long period of time. According to the CERA data, the damaged capacities of the nuclear power plant used to produce nearly 8% of the total power production in Japan. To make up for the loss of the above capacities, Japan has to increase the import of energy resources, primarily, the condensed natural gas. Due to growth in imports of the natural gas to Japan and EU states where operation of several old nuclear power plants have been suspended of late, spot prices on natural gas are expected to go up. According to evaluations of the Energy Research Institute of the Russian Academy of Sciences, with all the market factors taken into account spot prices on natural gas may rise 20% to 30% in the near future. Due to developments in Japan, a number of countries may revise their energy policy towards restrained development of nuclear power industry and preservation of a moratorium on building of new nuclear power plants. Such a situation will result in additional growth in demand in hydrocarbons, primarily, the natural gas. As a result, the above factors will contribute to growth in export of natural gas from Russia and strengthening of its competitive position in the European market.

Though developments in North Africa and the Middle East had an effect on the current growth in global prices on oil, they affected so far only those countries which are not major exporters of oil and natural gas. For instance, Libya accounts for 2% of the global production of oil and the loss of the Libyan export of oil may be compensated in the near future by growth in the oil production in other OPEC states, primarily, Saudi Arabia which has substantial reserve capacities. At the same time, growing political instability in North Africa and the Middle East is likely to result in adjustment of the EU policy as regards diversification of sources of energy supplies and have a favorable effect on Russia's position on the European energy market. ●



## THE YEAR 2010: RESULTS IN THE EDUCATION SYSTEM

T.Klyachko

*In 2010, a fundamentally new situation started to be formed in the system of vocational education: whereas the system of non-higher vocational education was seriously affected by the economic crisis the system of higher education took advantage of it. Also, the preschool education benefited from the crisis while the general education was among the losers. It appears that such processes will have a considerable impact on the post-crisis development of the system of education and in the long-term prospect negatively affect the standard of education.*

It is believed that both the education system and the social sphere were not much affected by the economic crisis: budget financing was growing, non-commercial enrollment to establishments of higher education decreased insignificantly and prices on paid education at higher school were frozen, while those students who received education loans were assisted by the government to live through hard times.

However, in 2010 budget financing of the education system kept decreasing in **real** terms; such a trend started in 2009. Households' education expenses whose volume in 2009 was preserved at the level of 2008 started to fall somewhat in 2010 (*Fig. 1*).

In the 2009–2010 period, reduction of budgetary expenses on education amounted in real terms to 4.2%.

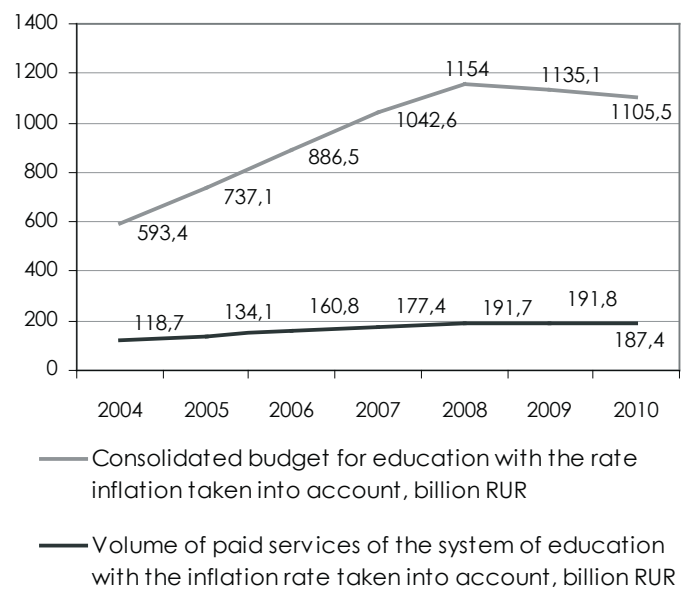
Such a reduction in contingents of students as could justify the above decrease in budget financing continued at many levels of the system of education, but it was not that intense as before.

As regards general (formal) education, the number of students at state-run and municipal schools fell by 0.1% and 0.3% in 2010 and in the period of the past two years, respectively.

As regards the basic vocational education (BVE), the number of students there decreased by 5% and 12% in 2010 and in the period of the past two years, respectively. However, it is to be remembered that institutions of BVE and those of secondary vocational education (SVE) have actively been merged of late, and for that reason a number of BVE students is accounted for in the SVE system. In addition to that, in 2010 the contingent of BVE amounted to over 4% of the total number of students in the system of preschool, general and vocational education whose training is financed by means of budgetary funds.

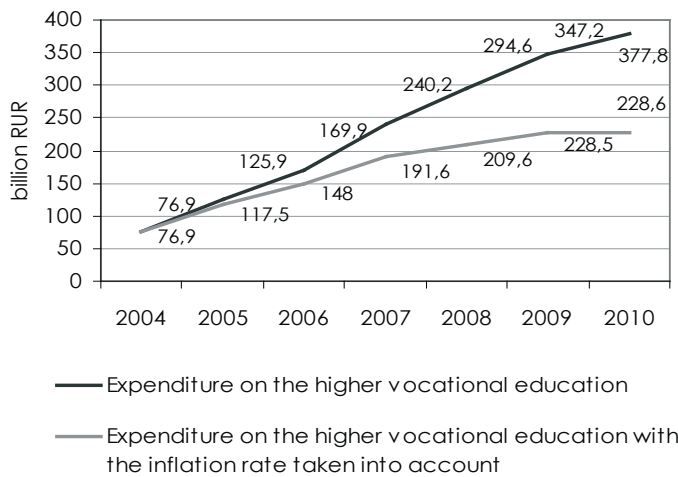
In 2010, in the secondary vocational education the total number of students at state-run and municipal educational establishments fell by 1.2%, but the share of 'budget' students rose by 1.0%. Thus, the reduction in the number of students took place at the expense of students who paid for their education.

In the 2009–2010 period, the number of students at state-run and municipal institutions of higher education was decreasing intensively: in 2008 there were 6,214,800 students at such institutions, while in 2010 their number amounted to 5,848,700 or 94.1%. Thus, in the past two years the student contingent of state-run institutions of higher education has decreased by 5.9%. It is to

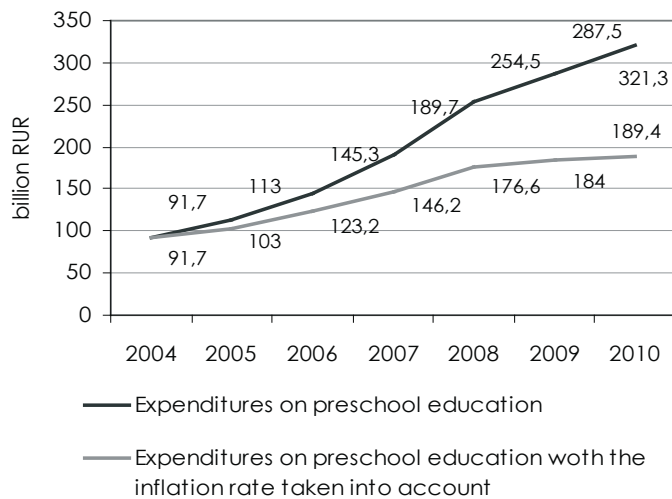


*The source:* The Federal Treasury and Rosstat.

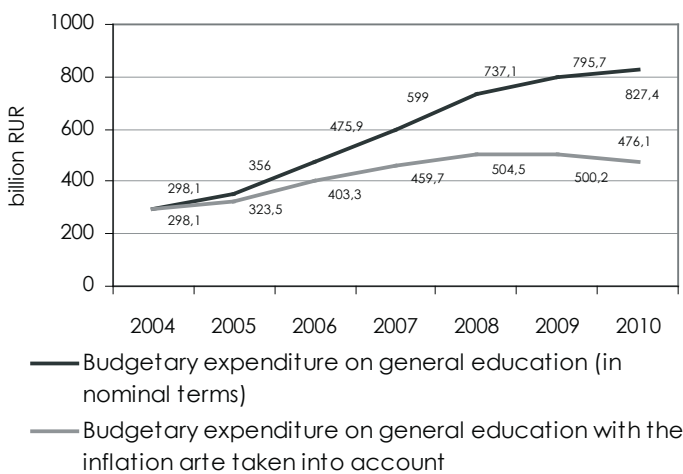
*Fig. 1. Expenditures of the consolidated budget and households on education with the inflation rate taken into account in the 2004–2010 period.*



The source: The Federal Treasury and Rosstat.  
 Fig.2. Budgetary expenses on the higher education and postgraduate vocational education in nominal terms with the inflation rate taken into account



The source: The Federal Treasury and Rosstat.  
 Fig. 3. Budgetary expenses on preschool education in nominal terms and with the inflation rate taken into account.



The source: The Federal Treasury and Rosstat.  
 Fig.4. Budgetary expenses on the general (school) education in nominal terms with the inflation rate taken into account.

be noted that the 'budget' contingent shrank by 4.3%. At the same time, in 2009 budget financing of the system of higher education was growing in real terms, while in 2010 it did not decrease. (Fig. 2).

Despite all the debates regarding the excessive number of students of higher education establishments and «shedding»<sup>1</sup> of the higher education, budgetary funds were reallocated in favor of the system of higher education during the crisis years.

Another beneficiary of reallocation of budgetary funds was the preschool education; real budget financing of the above education rose by 7% during the economic crisis (Fig. 3). It is to be noted that during that period the number of children at institutions of preschool education increased by 4.8%.

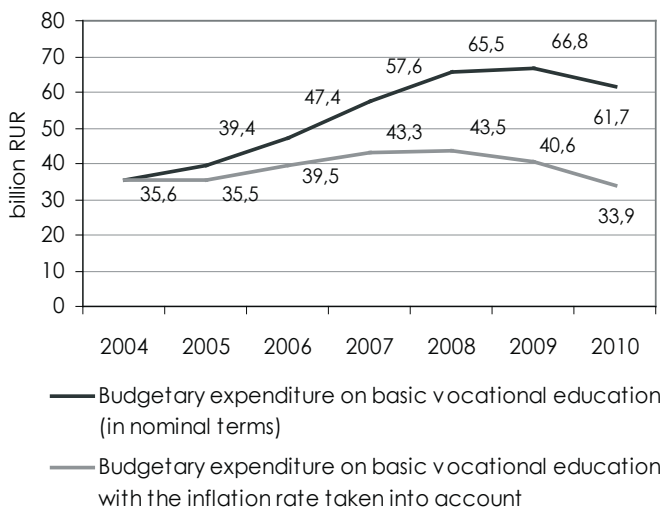
The general (school) education, as well as basic education and secondary vocational education were worst hit by the crisis (Fig. 4-6).

In the 2009-2010 period, budgetary expenses on the general education fell in real terms by 5.6%. It is to be noted that the largest drop of 4.8% was registered in 2010.

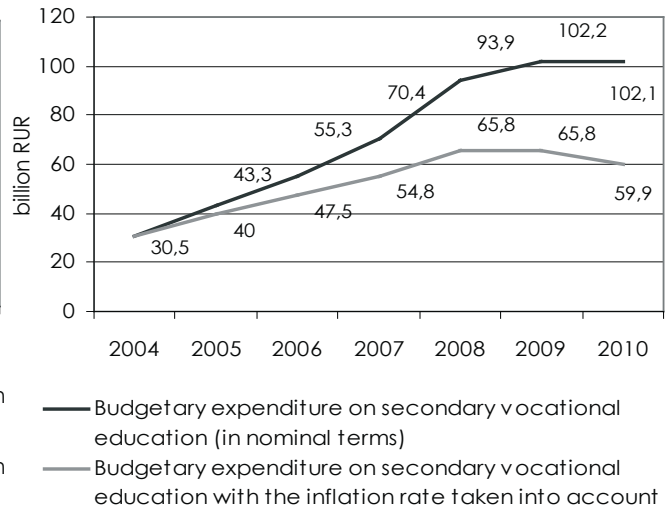
As regards the basic vocational education (BVE), the dynamics of budgetary expenses reflected the following two processes: firstly, changes in the expenses proper and, secondly, integration of institutions of BVE and those of SVE in such a way that budgetary expenses on BVE are accounted for in the SVE system (as in case with the number of students). Due to the above, real budgetary expenses on BVE may actually be higher than those taken from the data of the Federal Treasury (Fig. 5).

A drop in budgetary expenses on BVE in nominal terms took place only in 2010 and accounted to 7.6%, while that in real terms began in 2009 and exceeded 22.1% in the past two years. However, a portion of the above drop in expenses on BVE, particularly in 2010, should be attributed to the speed-up of restructuring of the segment on the non-higher vocational education and the above integration of state-run and municipal institutions of BVE and SVE in order to ensure higher efficiency of budget spending during the economic crisis.

1 The term was coined by Ya. I. Kuzminov, Rector of the National Research University Higher School of Economics.



The source: The Federal Treasury and Rosstat.  
 Fig. 5. Budgetary expenses on BVE in nominal terms and with the inflation rate taken into account



The source: The Federal Treasury and Rosstat.  
 Fig. 6. Budgetary expenses on SVE in nominal terms with the inflation rate taken into account

As regards the SVE system, during the period of the crisis budget financing demonstrated stabilization in nominal terms and a drop of nearly 9% in real terms (Fig. 6).

Generally, the BVE-SVE system as a whole was badly hit by the crisis; budget financing of the above system decreased in real terms by 10.0%.

Thus, in 2010 a fundamentally new situation started to take shape in the system of vocational education: whereas non-higher vocational education was badly hit by the economic crisis, the system of higher education took advantage of it. Another beneficiary was the preschool education, while the general education turned out to be the loser. It appears that the above processes will have a considerable impact on the post-crisis development of the system of education and in the long-term prospect negatively affect the standard of the above system. ●

## AN OVERVIEW OF THE RF GOVERNMENT'S RESOLUTION

I.Tolmacheva

*In March, the RF Government introduced the following alterations into existing legislation: a new procedure for State accreditation of educational establishments and research organizations and a new procedure for licensing the educational activity were approved; the subsistence norm for the population of Russia was established for Q IV 2010.*

1. THE RESOLUTION 'ON APPROVING THE PROVISION ON STATE ACCREDITATION OF EDUCATIONAL ESTABLISHMENTS AND RESEARCH ORGANIZATIONS' of 21 March 2011, No 184.

A new procedure for State accreditation is introduced for the educational establishments that implement educational programs, to which federal state educational standards or federal state requirements are to be applied; and for research organizations that implement postgraduate professional training programs and (or) supplementary professional training programs, to which federal state educational requirements are to be applied. The accreditation is to be effectuated by the Federal Service for Supervision in the Sphere of Education and Science (*Rosobrnadzor*) or a regional body of executive authority to which certain RF powers in the sphere of education have been delegated. The Resolution contains provisions concerning, in particular, an expert's estimation of the accreditation procedure, the procedure for the creation and operation of the accreditation board, the procedure for the issuance of a State accreditation certificate, etc.

During the procedure of State accreditation of an organizations, the following expert's estimations should be performed:

- a) an expert's estimation of the conformity of the content and quality of the curricula submitted by a given organization for State accreditation with the federal state educational standards or federal state requirements;
- b) an expert's estimation of the indices of the activity of an educational establishment necessary for determining its type and category.

It is established that State accreditation of an educational establishment or research organization that has been issued a State accreditation certificate prior to 1 January 2011 should take place no earlier than 1 year before the expiry of that certificate.

2. 'ON APPROVING THE PROVISION ON LICENSING THE EDUCATIONAL ACTIVITY' of 16 March 2011, No 174

A new procedure for licensing educational activity is established. The approved Provision, which is issued in order to further elaborate Federal Law of 8 November 2010, No 293-FZ, 'On Introducing Alterations in Some Legislative Acts of the Russian Federation in Connection with the Improvement of Control and Supervisory Functions and Optimization of State Services in the Sphere of Education', introduces the procedure for licensing the educational activity of educational establishments, research organizations, and other organizations whose structural subdivisions implement professional training programs.

The Provision, however, does not apply to the following entities:

- educational establishments that operate under the jurisdiction of the RF External Intelligence Service (RF SVR), the RF Federal Security Service (RF FSB), the RF Federal Protective Service (RF FSO), and those establishments whose curricula contain information classified as state secret;
  - educational establishments that independently develop their educational standards and requirements;
  - non-state educational establishments operating in the territory of the Skolkovo Innovation Center.

The licensing of the educational activity is performed by the Federal Service for Supervision in the Sphere of Education and Science (*Rosobrnadzor*) or a regional body of executive authority of

a RF subject to which the powers of the Russian Federation in the sphere of education have been delegated.

The Provision determines the necessary requirements and conditions for obtaining a license, the list of documents that must be submitted in order to obtain or to renew the document confirming the existence of a relevant license, the procedure for supervising a licensee's compliance with the licensing requirements and conditions.

Simultaneously, Resolution of the RF Government of 31 March 2009, No 277, 'On Approving the Provision on the Licensing of Educational Activities', with the alterations introduced thereto by Resolution of the RF Government of 24 September 2010, No 749, is recognized to be null and void.

**3. THE RESOLUTION 'ON ESTABLISHING THE SUBSISTENCE NORMS PER CAPITA AND BY THE SOCIO-DEMOGRAPHIC GROUPS OF THE POPULATION GENERALLY ACROSS THE RUSSIAN FEDERATION FOR THE QUARTER IV OF 2010' of 24 March 2011, No 197**

In the fourth quarter of 2010, the subsistence norms across Russia are established to be as follows: per capita – 5,902 Rb; for the employable population – 6,367 Rb; for pensioners – 4,683 Rb; for minors – 5,709 Rb. By comparison with the previous quarter, the subsistence level has been raised. In Q III 2010, it was as follows: per capita – 5,707 Rb; for the employable population – 6,159 Rb; for pensioners – 4,532 Rb; for minors – 5,510 Rb.

The level is adjusted every quarter on the basis of the size of the consumer basket and *Rosstat's* data on the levels of consumer prices for foodstuffs, non-food commodities and services, as well as the cost of mandatory payments and fees. ●

## AN OVERVIEW OF THE RF GOVERNMENT'S MEETINGS IN FEBRUARY–MARCH 2011

M. Goldin

*Among the issues and questions considered at the meetings of the Government Presidium of the Russian Federation in February and March of 2011, one may note a draft of the order to be issued by the RF Government concerning the Protocol concluded between the RF Government and the Government of the Republic of Belarus for the purpose of terminating the existing international agreements on issues of indirect taxation; a draft law envisaging the postponement of the mandatory installation of gas meters from 1 January 2012 to 1 January 2015; the definition and expansion of the list of payments and compensations to be made exempt from personal income tax (PIT) in accordance with Article 217 of the RF TC; the size of standard deductions granted in accordance with Subitem 4 of Item 1 of Article 218 of the RF TC to those taxpayers who have children in their care; the list of grounds for bringing to responsibility, in accordance with Article 15.25 of the RF, those guilty of having violated existing currency legislation and the acts issued by currency regulation agencies.*

At the meeting of the RF Government Presidium held on **10 February**, a draft of the Government's order concerning the Protocol between the RF Government and the Government of the Republic of Belarus on the termination of the international agreements devoted to issues of indirect taxation was considered.

As of the present moment, the procedure for applying indirect taxes in bilateral trade between Russia and Belarus is regulated by *The Agreement on the Principles of Levying Indirect Taxes on Export and Import of Goods, Performance of Work, and the Rendering of Services within the Customs Union* (of 25 January 2008), as well as by *The Protocol on the Procedure for Levying Indirect Taxes and the Mechanism of Control over the Payment of These Taxes in Connection with the Export and Import of Goods Across the Customs Union* (of 11 December 2009) based on that agreement; and by *The Protocol on the Procedure for Levying Indirect Taxes on the Performance of Work and the Rendering of Services Within the Customs Union* (of 11 December 2009). As a result of the coming into force of the aforesaid documents, the bilateral international agreements on issues of indirect taxation currently applied in bilateral trade must be recognized to be null and void. At the same time, those agreements contain no provisions concerning the parties' withdrawal from the agreements. In order to resolve the newly arising legal collision, it has become necessary to sign a special intergovernmental protocol on the termination of those agreements.

The draft of the Protocol was approved by the RF Government, and then confirmed by Regulation of the RF Government of 12 February 2011, No 174-r.

At its meeting on **17 February 2011**, the RF Government Presidium considered a draft of the Federal Law 'On the Introduction of Alterations in the Federal Law "On Energy Saving and Improvement of Energy Cost-Effectiveness, and the Introduction of Alterations in Some Legislative Acts of the Russian Federation"'.

The draft law envisages the postponement of the mandatory installation of gas meters from 1 January 2012 to 1 January 2015 in regard to the owners of residential buildings and premises in multi-apartment residential buildings, as well as the owners of dachas or garden houses that have been put in operation as of the day of entry into force of the Federal Law 'On Energy Saving and Improvement of Energy Cost-Effectiveness, and the Introduction of Alterations in Some Legislative Acts of the Russian Federation'.

At the meeting of the RF Government Presidium held on 1 March, a draft of the Federal Law 'On the Introduction of Alterations in Article 217 of Part Two of the Tax Code (TC) of the Russian Federation' was considered.

By this draft law, the provision concerning the exemption from personal income tax (PIT) of 'other payments and compensations payable in accordance with existing legislation' has been withdrawn from Item 1 of Article 217 of the RF TC. This wording of Item 1 of Article 217 of the RF TC has been giving rise to disputes between tax agents and taxpayers as to whether certain payments and/or compensations that have been paid by employers to their employees should be categorized as 'other payments and compensations payable in accordance with existing legislation' in the sense suggested by Item 1 of Article 217 of the RF TC.

Thus, in its Letter of 4 June 2009, No 03-04-07-01/190, the RF Ministry of Finance insisted that the exemption from taxation of any other types of payments that were not directly specified in Article 217 of the RF TC, and in particular, in Item 1 of that article, was possible only through extending the existing list of tax-exempt incomes. However, the **Presidium** of the RF Supreme Arbitration Court, in its Ruling of 8 June 2010, No 1798/10, pointed out that PIT was not to be levied on the amount of payment to cover the days of additional leave granted to one of the working parents for the purpose of caring for their disabled children in accordance with Article 262 of the RF Labor Code, because that payment represents a form of state support due to the fact that each day of the additional leave is covered by the resources of the Social Insurance Fund of the Russian Federation in the procedure established by federal laws.

With the coming into force of the alterations introduced in Item 1 of Article 217 of the RF TC, the problem represented by the possibility of equivocal interpretations with regard to the issue as to which payments and compensations should indeed be exempt from PIT will be eliminated. Exemption will be granted only with regard to the payments and compensations directly listed in Article 217 of the RF TC. In this connection, the wording of Item 2 of Article 217 of the RF TC has also been altered; besides, that Article is augmented by two new Subitems 1<sup>1</sup> and 8<sup>2</sup>, and a new paragraph (No 12) has been introduced in Item 3, whereby it is envisaged that a number of socially important payments and compensations should be made exempt from the personal income tax.

In particular, the following payments are now tax-exempt:

- monthly compensations assigned and paid to physical persons during the leave granted for the period of caring for a child until it reaches the age of 3 years;
- social benefit to cover the cost of burial, or compensation of the cost of burial services;
- the amounts of state social aid and social support covered by the resources of the federal budget, the budgets of RF subjects, local budgets and state off-budget funds in accordance with federal laws, the RF President's edicts, resolutions of the RF Government, laws of RF subjects, decisions adopted by the representative bodies of local self-government; and some other types of payments.

The draft law was approved and submitted to the RF State Duma.

Besides, at its meeting on 1 **March 2001**, the **RF Government Presidium considered** a draft of the Federal Law '**On the Introduction of Alterations in Article 218 of Part Two of the Tax Code of the Russian Federation and on Recognizing Some Provisions of Legislative Acts of the Russian Federation to Be Null and Void**'.

By that draft law, the standard tax deduction to be granted in accordance with Subitem 4 of Item 1 of Article 218 of the RF TC to parents, a parent's spouse, guardians, custodians, adoptive parents, or an adoptive parent's spouse was differentiated, and its size increased. The standard deduction will be granted to those taxpayers who care for:

- one child – a tax deduction in the amount of 1,000 Rb for each month of a tax period;
- two children – in the amount of 2,400 Rb for each month of a tax period;
- three children – in the amount of 5,400 Rb for each month of a tax period;
- four or more children – in the amount of 3,000 Rb for each month of a tax period for the fourth child and each of the subsequently born children.

At its meeting on **17 March 2011**, the RF Government Presidium approved the draft of the Federal Law 'On the Introduction of Alterations in the Code on Administrative Violations (CoAV) of the Russian Federation and Federal Law of 22 June 2007, No 116-FZ, 'On the Introduction of Alterations in the Code on Administrative Violations of the Russian Federation in the Part of Altering the Method of Expressing the Money Fine Imposed for Administrative Violations' (elaborated by the RF Ministry of Finance).

The draft law was confirmed and submitted to the RF State Duma.

By Article 15.25 of the Code on Administrative Violations (RF CoAV), a list of violations of currency legislation and the acts issued by currency regulation agencies is established. As shown by our analysis of the judicial practices currently existing in the sphere of execution of legislation on administrative violations, Article 15.25 of the RF CoAV still lacks some important points, and so a number of activities do not entail any administrative responsibility. In particular, this applies to the following activities:

- receipt of cash from non-residents in payment for goods, work, services;
- settlements during currency operations between a resident and non-resident without the use of a bank account;
- purchase and sale of foreign currency outside of specifically authorized banks;
- transaction between a resident and non-resident involving a loan denominated in foreign currency, which is carried out bypassing an account at a specifically authorized bank;
- export from RF territory of cash denominated in foreign or RF currency in amounts in excess of 10,000 USD.

In this connection, as stated in the explanatory note to the draft federal law, ‘the draft law envisages a more precisely defined list of illegal, guilty activities (acts or failures to act) of citizens, officials and legal entities, as envisaged in Part 1 of Article 15.25 of the RF CoAV, so that incompliance with the requirements of currency legislation when carrying out the afore-listed operations should create clearly formulated constituent elements of a law violation, which will ensure an effective law enforcement practice when effectuating currency control’.

Since the newly introduced amendments have established administrative responsibility for some new types of law violations, for which no such responsibility was previously envisaged, the draft law also envisages a delay of 90 days, from the day of its official publication, for the entry into force of the relevant federal law. ●



## AN OVERVIEW OF THE NORMATIVE DOCUMENTS ON TAXATION ISSUES ADOPTED IN FEBRUARY AND MARCH 2011

A. Anisimova

1. Federal budget deficit has resulted in the recent emergence of two trends in the financial sphere (a phenomenon which was quite an expected one, though). The first trend is reflected in the attempts made by various ministries and departments, in a situation of a general shortage of resources, to achieve their distribution in their own favor at the legislative level through acquiring the right to create special targeted funds secured by some separate sources of income. The second trend can be seen in the toughening conditions for allocating federal budget funding to satisfy the needs of some or other economic subjects. Attempts to split the federal budget and to distribute the sources of centralized government resources among different targeted funds (for social welfare, road maintenance, and environmental protection) were also made in the past. That trend was especially strong in the initial phase of economic reforms, when the budget was weak. Practical experience has demonstrated the inefficiency of such an approach. Dispersion of financial sources among numerous funds and the pinning down of the specific directions for spending the available resources by specially adopted separate laws deprives the State of any opportunity to operatively manage its finances over a year and dramatically narrows the base for forming the state budget for a next financial year. The situation of the 1990s was improved to the better, among other things, by implementing the coordinated tax and budget reforms aimed at centralizing the revenue base of the State. In the wake of the general consequences of the 2009 financial crisis and the weakening state budget (which happens in spite of the high oil prices) we can now observe yet another wave of newly created separate funds with their own sources of revenues legislatively consolidated to them. The first step in that direction was the replacement, in 2010, of the single social tax (SST) by a system of insurance contributions (which essentially are not contributions at all, having preserved all the specific features of the abolished tax; only the right to administer the revenues during the reform has now been transferred to the funds). On 25 March 2011, the RF State Duma adopted a law concerning the creation of road funds in Russia. On March 2011, a draft of the normative act on environmental funds was submitted for consideration by the RF State Duma of the RF Federal Assembly. In our opinion, such state funds could be created within the framework of spending the centralized resources from the state budget, without legislatively consolidating to them any separate revenue bases.

The second trend consists in changing the conditions for allocating budget resources. The ongoing budget reform is followed by a gradual replacement of the predominantly dotation-based budget financing mechanism by budget subsidizing. The fundamental difference between these two methods is that direct budget allocations are part of a centralized planning system (the State decides to do something on its own, and so resources are allocated to this purpose with detailed specification of the directions of spending, as well as of the corresponding norms, rates, timelines, and so on), while subsidizing represents a form of project-based financing (the State orders certain services and/or work and allocates the relevant resources to a contractor who has been selected on the basis of a tender). This trend reflects the gradual adaptation of Russia's budgetary system to functioning in conditions of a developing market. Restricted by the objectively existing limitations to the possibility to withdraw resources from the economy in the form of taxes and other mandatory payments, the State tries to find the most adequate methods of distributing the mobilized resources. Regrettably, the existing discrepancies between budget and tax legislation in some cases give rise to distortions in the tax load imposed on market participants which, in our opinion, may result in eliminating any competition between different categories of them. Such violations must be properly identified and eliminated in due time. Let us now discuss one concrete example.

Within the framework of Federal law of 7 March 2011, No 23-FZ, whereby alterations aimed at providing support to small and medium-sized businesses were introduced in the RF TC, essentially

the same scheme of government support was implemented as that which had previously been applied in order to create incentives for unemployed citizens who launched their own business to create additional jobs funded from the budgetary system's resources. In particular, it was allowed to include in incomes the budget funding received by a company in the amount of the actual expenditures incurred over a tax period (this applies to individual entrepreneurs and regular organizations, as well as to the organizations operating under special tax regimes – see Item 3 of Article 223, Item 4.1 of Article 271, Item 2.1 of Article 273, Item 5.1 of Article 346.5, and Item 1 of Article 346.17 of the RF TC). Those funding that has not been spent over a given tax period must be reflected as part of taxable incomes. Thus, on the face of it, it appears that a new form of providing state financial aid to individual economic subjects has emerged – the permission to recognize received subsidies as incomes in the amount of actual expenditures, while the unused part of subsidies becomes taxable. However, a more detailed reviewing of that scheme gives rise to some questions. Subsidies are granted from the budget. If subsidies are spent on other purposes, this represents a violation of budget legislation because it is non-targeted use of budget resources. The resources thus used must be confiscated and returned to the budget. If the RF TC is augmented by a provision whereby the unused amounts of subsidies are levied by tax, the result may be an unjustified growth of the tax load, because a special tax regime is thus created for those monies. Under the general rules, tax must be paid on any income received as a result of economic activity. If later on the monies spent on untargeted purposes are withdrawn in accordance with budget legislation rules, the taxpayer's incomes are adjusted in that part, thus diminishing the taxation base. However, if a separate tax regime is established by the RF TC for incomes received in the form of non-targeted use of subsidies, in an event of a withdrawal of such monies into the budget, a special resolution of the judicial instances concerning the procedure for excluding them from the income tax base may be required.

The alterations introduced in the RF TC with regard to financial aid received by small and medium-sized businesses from the budget are not linked in any formal way to the implementation of government programs. Thus, it is not clear if the participation in a government program (and on which conditions – on the basis of a tender or not) is going to be the necessary requirement for the granting of financial aid from the budget to organizations belonging to the private sector. In any event, we believe that the appearance of a special provision in the RF TC stipulating that budget funding can be allocated to an organization not for its participation in a government program but simply because it belongs to the category of small and medium-sized businesses should be regarded as an alarming manifestation of a deteriorating situation faced by such entities and the necessity to provide them with budget financing to ensure their survival (given the fact that such businesses are entitled to preferential tax regimes, this means that tax exemptions alone are not sufficient even for the functioning per se of small and medium-sized enterprises in Russia).

Evidently, subsidies in the form of financial aid provided to small and medium-sized businesses represent an attempt to ensure relatively equal opportunities for all the economic subjects operating in the national economy (state corporations; big, small and medium-sized enterprises; and regional and local budgets) to get government aid to cover their investments. This conclusion is indirectly confirmed by the fact that, simultaneously with the introduction of those alterations in the RF TC, the RF Government, by its Resolution of 11 March 2011, No 160, extended until the end of the year 2011 its previous Resolution of 14 December 2010, No 1017, concerning the procedure for granting the government guarantees of the Russian Federation for credits or bond loans attracted by legal entities selected in the procedure established by the RF Government for the implementation of investment projects. In an event of non-targeted spending of credits granted against RF guarantees, their total amounts (100 %) will be repaid by the borrowers through applying right of regress.

The procedure for granting subsidies to RF subjects and bodies of local self-government from the centralized federal fund for the purpose of making investments was also somewhat modified. In response to the recent redistribution of resources between the levels of the budgetary system in favor of the federal budget as a result of growing prices for mineral resources coupled with the federal budget deficit, the rules for the transfer of funding earmarked for investment projects from the federal budget to regional and local budgets were also toughened.

The RF Government, by its Resolution of 7 November 2008, No 815, approved the Rules for granting budget allocations from the Investment Fund of the Russian Federation in the form of

subsidies to the budgets of subjects of the Russian Federation for co-financing capital construction projects, or from the budgets of subjects of the Russian Federation to local budgets for co-financing capital construction projects, on the basis of budget revenue and expenditure adopted for a given financial year and an agreement between the federal body of executive authority and a regional body of executive authority. By Resolution of 11 March 2011, No 159, these Rules were rather significantly adjusted, and so now the aforesaid agreements must envisage the responsibility of the supreme executive body of state authority of a subject of the Russian Federation (or a body of local self-government) to repay the subsidized money in the event of termination of a relevant project's implementation for reasons of its participants' failure to fulfill or improper fulfillment of their responsibilities assumed under an investment agreement. Thus, within the framework of the relationship between the federal center and a RF subject, or a RF subject and a body of local self-government, the same terms are de facto established for earmarking the resources of the federal budget for investments as those established for state corporations and big commercial entities. RF subjects and local authorities are required to repay in full the sums of subsidies received by them if those monies were spent on uncoordinated purposes (i.e., 100 % of unauthorized expenditures).

In our opinion, the wording of the provision that has been newly introduced in the RF TC in order to regulate the taxation of subsidies that remained unspent or were improperly spent by small and medium-sized businesses, should be further elaborated along similar lines in order to eliminate the existing gap between tax and budget legislations, bearing in mind that in all instances of non-targeted use of budget resources the loaned money must be repaid in full (100 %).

2. The department-based approach in the struggle for resources in a situation of budget deficit manifests itself in the way the ministries and departments have been changing the generally applied principles of levying taxes on the incomes received by economic subjects within the framework of the overall effective scheme for mandatory payments, being guided primarily by the economic interests of their subordinated structures (state-owned or licensed). This can be illustrated by one example. By Federal Law No 24-FZ of 7 March 2011, the text of the RF TC (in the wording approved by Federal Law of 24 July 2007, No 216-FZ) was augmented by some alterations. These alterations are in the main well-substantiated, being aimed at eliminating double taxation when levying the personal income tax (PIT) on the monies paid under agreements of voluntary long-term life and pension insurance.

However, the situation that resulted in the emergence of double taxation is rather remarkable.

It must be explained that, when tax is levied on the incomes of physical persons when they are insured by third parties, it is possible to apply two schemes: either to tax insurance contributions, or to tax the sums paid by way of insurance compensation. Prior to 2008, voluntary life and pension insurance was taxed by applying the former scheme of PIT payment. As a result, when an insurance event occurred, the insured person received the compensation in full, without the need to pay any tax on it. This is the most 'benevolent' scheme, because an insurance event represents, as a rule, either a tragic accident or retirement. In 2008, however, the scheme was altered. The reasons for that are evident. When PIT is levied on the sum of insurance contributions paid under a voluntary insurance agreement to an insurance company or a non-governmental pension fund, the money is instantly transferred to the budget. But if PIT is paid on the sum of insurance compensation, all the money will be kept by the insurer until an insurance event occurs. Since voluntary insurance is based on commercial principles, its profitability is essential. This means that the aggregate sum of insurance contributions, as a rule, will exceed the sum of insurance payments. Thus it follows that an insurance organization or fund will actually keep an amount of money equal to the size of PIT presumably to be levied on the difference between the amount of insurance contributions and insurance payments. We believe that the lawmakers have made a political mistake by supporting the alterations introduced in the scheme for levying PIT on voluntary life and pension insurance contributions. The deduction of PIT from insurance compensations (paid to insured persons) instead of insurance contributions (paid by employers) will be conducive to public dissatisfaction with the government's tax policy (in particular, with regard to PIT).

3. By Letter of the RF Federal Tax Service (FTS) of 24 February 2011, No KE-4-3/2952@, the RF FTS once again stated its standpoint concerning the procedure for the division, for the purposes of levying profits tax, of companies' expenditures into those linked to production (direct expenditures) and those linked to the sale of their product (indirect expenditures). In accordance with the RF TC, a taxpayer should independently determine the list of direct expenditures, i.e., those associated directly with the production of products (or the performance of work, or the provision of services), and then consolidate that list in the company's accounting policy for the purposes of taxation. The tax agency makes attempts to impose rigid regulation on the division of expenditures into direct and indirect ones. Thus, the RF FTS has come to the conclusion that the mechanism for distinguishing between expenditures on the production of products and expenditures on the sale of products must be based on economically substantiated indices that are determined by technological processes. A taxpayer, according to the RF FTS, may, for the purposes of taxation, place certain expenditures linked to the production of commodities (or the performance of work or the provision of services) in the category of indirect expenditures only when it is really impossible to categorize these as direct expenditures on the basis of economically substantiated indices.

The RF FTS refers to the Ruling issued by the RF Supreme Arbitration Court (SAC) on 13 May 2010, No VAS-5306/10. However, in our opinion, the RF SAC is more flexible in its conclusions than the RF FTS.

The essence of the problem is that the RF TC was initially oriented towards protecting entrepreneurs, as much as possible, from officials' arbitrary actions. The granting of the right to independently divide expenditures into direct and indirect ones by no means implies that the aggregate tax load on businesses should be diminished. Taxpayers are only granted the opportunity to manage the formation of their tax base – for example, to write off certain expenditures earlier and thus diminish the tax base. Indirect expenditures are written off immediately, and direct expenditures – only after the sale of certain products. We believe that in the current budget deficit situation the RF FTS is trying to strictly regulate the existing rules in order to ensure proper formation of a current tax base. Regrettably, any tax administering that is not based on the principles established by the RF TC will inevitably result in further worsening of the already troubled investment climate. ●

## CHANGES IN THE NORMATIVE BASE OF THE BUDGETARY PROCESS

M.Goldin

*In March 2011, the rules for granting subsidies to the budgets of RF subjects for the purpose of co-financing capital construction projects were augmented by an additional provision envisaging the responsibility to repay the monies granted to them.*

By Resolution of the RF Government of 11 March 2011, No 159, 'On the Introduction of Alterations Into the Rules for Granting Budget Allocations from the Investment Fund of the Russian Federation in the Form of Subsidies to the Budgets of RF Subjects for Co-financing Capital Construction Projects Involving State Property of RF Subjects, the Budget Investments into Which are Made from the Budgets of RF Subjects, Or for Granting the Corresponding Subsidies from the Budgets of RF Subjects to Local Budgets for Co-financing Capital Construction Projects Involving Municipal Property, the Budget Investments into Which are Made from the Local Budgets' it was established that an agreement concerning the granting of subsidies to the budgets of RF subjects for co-financing capital construction projects should contain, as one of the conditions thereof, the responsibility to repay the sums thus granted in an event of the project participants' failure to fulfil, or improper fulfillment of their obligations.

It should be reminded that, in accordance with the Rules for granting budget allocations from the Investment Fund of the Russian Federation to the budgets of RF subjects for the purposes of co-financing capital construction projects that involve state (or municipal) property (approved by Resolution of the RF Government of 7 November 2008, No 815), the subsidies earmarked for co-financing capital construction projects are to be granted on the basis of an agreement concluded by the supreme executive body of a RF subject with the federal body of executive authority empowered to be the principal manager of federal budget resources in coordination with the RF Ministry for Regional Development (RF Minregion).

The Rules establish requirements for the content of the aforesaid agreement. In particular, the agreement must contain a list of the capital construction projects to be co-financed by means of granting subsidies; and determine the sum to be earmarked in the budget of a RF subject (or a local budget) for financing such projects. Now, as has been pointed out earlier, one more condition is added to the agreement concerning the granting of subsidies to the budgets of RF subjects, namely that the agreement must also envisage the responsibility of the supreme executive body of a RF subject to repay the sum granted to it in an event of the project participants' failure to fulfil, or improper fulfillment of their obligations assumed under an investment project (in regard to projects of regional or local importance). ●