

## RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES 04'2009

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## BASIC DEVELOPMENTS AND TRENDS

*In April, an updated national budget for 2009 has been adopted. Despite the crisis, it is not foreseen to cut down public expenditures. To finance the budget deficit, it is planned to spend three-quarters of the Reserve Fund, which reflects a challenging confidence of the Russian authorities, that the crisis will be overcome in a short term. The Russian President Dmitry Medvedev's democratic approach is getting extended. There were repeated allusions to his commitment to pursue democratic policy and moreover, for the first time within his Presidency term, a practical step in this direction was made in the framework of a high-profile criminal case: one of the Yukos employees, S. Bakhmina, mother of an infant, has been discharged from confinement. Nevertheless, an opposite trend is also observed. Thus, the State Duma has adopted in a second reading a shocking edition of the law on the right to dismiss the elected Heads of Municipalities by the decision of local government deputies, based on a wide range of reasons. The debate on such amendments has demonstrated the major controversy between supporters and opponents of those innovations not only in regard to local governments, but in terms of principles of the government system in general.*

*In the I-st quarter of 2009, the GDP made 90.5 per cent of the volume of the relevant period of the preceding year, i.e. the decline has exceeded the earlier estimates of the Ministry of Economic Development. Macroeconomic situation in early 2009 was developing under the impact of the simultaneous reduction of domestic and external markets, based on a cumulative effect of the low national business activity and the reduced income per capita. Within January-March 2009, the decline of investments in fixed assets has amounted to 15,0 per cent, the retail trade turnover has decreased by 1,1 per cent and real income of population has declined by 2.3 per cent. Unfavorable trends in the international trade, developed in the IV-th quarter of 2008, continued to provide negative effect on the economy in the I-st quarter of the current year.*

*Due to the restricted access to the national statistics, the surveys among business enterprises during the crisis become both, efficient and reliable source of information on the actual situation in the real sector. IET regular survey has demonstrated that in April, according to the estimates of enterprises, there were no significant changes in the level of output and demand in the industrial sector, which is practically unchanged since the beginning of the year. Enterprises' expectations for prompt recovery in demand and output level have not been realized. The industrial sector is preparing for the new reduction in demand, output and sell prices in the coming months. In April, an access to credits has been improved, but paying capacity of enterprises has reduced.*

*As of the March results, the RF CPI amounted to 1.3 per cent, which is slightly higher against the relevant period of preceding year. The volume of foreign currency reserves remained practically unchanged, having made by the end of the month USD 383.9 bln. RUR real effective exchange rate has grown by 3.3 per cent and as of the results of the I-st quarter, it has declined to 11.9 per cent. Within the I-st quarter of 2009, the external corporate debt has declined by USD 29 bln, i.e., by 6.4 per cent, having reached USD 423 bln at the end of the quarter. The value of the two-currency basket, for the first time since July of 2008, has decreased, amounting to RUR 38.93. Since April 24, for the first time since summer of 2007, the refinancing rate was reduced to 12.5 per cent per annum. At the same time, interest rates on credits and deposits of commercial banks in the RF Central bank were reduced as well.*

*Positive response of international investors to the plan on the global economy recovery, developed during the summit of the «big twenty» governments, positive macroeconomic news from the USA and successful financial performance of a number of international companies, reduced interest rate of the ECB to 1.25 per cent per annum, as well as the RF Government approval of measures to support the national financial and labor markets, stabilization of the national currency have contributed to the growth of the Russian stock market. Herewith, positive trends were particularly expressed in the stock market, where the investors' activity has increased by 22 per cent, as well as in quotations of all «blue chips» shares. Indicators of recovery were observed in the domestic corporate bond market. The activity of investors in the secondary bond market has also significantly increased.*

*Herewith, the volumes of issued and refinanced mortgages are getting reduced, while the interest rates are growing. The Agency for Restructuring of Mortgage Credits is intended to provide support to about 100 thousand of borrowers in the current year. 23,4 thousand of individuals have been allowed to use the mother's capital to pay off credits, in the amount of RUR 6.3 bln.*

*At an extended meeting of the Board of the RF Ministry of Finance on April 14, 2009, the Minister of Finance Alexey Kudrin has pointed out to the need to reduce budget expenditures in 2010. In the near future the RF Ministry of Finance will prepare a draft on basic trends of budget policy for 2010 and for the planned period of 2011 and 2012.*

*In late March – early April significant amendments were introduced in economic legislation: the procedure for the appointment of the RF Subjects Heads has been modified; inventory of assets, in which insurance premiums can be invested to finance the funded part of labor pensions has been updated, a new procedure for educational activity licensing has been adopted and the refinancing rate of the Bank of Russia has been reduced. ●*

**THE POLITICO-ECONOMIC RESULTS OF APRIL 2009**

S.Zhavoronkov

*In April, Russia adopted a new state budget for the year 2009 where, despite the current crisis, no cutting of government expenditures was envisaged. The budget deficit was planned to be financed from the reserve fund, three-quarters of which was to be spent for this purpose – the fact that reveals the authorities' dangerous confidence that the crisis phenomena will be quickly overcome. RF President Dmitrii Medvedev intensified his rhetoric, which now included numerous hints as to his reputed adherence to democratic norms. Moreover, for the first time during his presidency, Medvedev even made a concrete step in this direction within the framework of one of the loudest criminal cases, when he released from detention one of the former Yukos employees, S. Bakhmina, the mother of a recently born baby. At the same time, a reverse trend also continued to manifest itself. Thus, the State Duma adopted in the second reading a scandalous version of a law vesting local deputies with the right to remove from office the elected heads of municipal formations, with a broad range of grounds for removal having been established. United Russia's candidate A. Pakhomov won a landslide victory in the crucial election for Sochi mayor, leaving all his rivals from the opposition far behind. However, the election was marred by a scandal that involved regulated early voting on a massive scale.*

In April, maybe for the first time during the current presidency, D. Medvedev's rhetoric was aimed at a liberal audience. Medvedev conducted a social problems round table at the Institute of Contemporary Development (INSOR). Previously, the Institute, where Medvedev nominally holds the post of Chairman of the Supervisory Council, had been ignored by the President, while his Administration had been repeatedly criticizing INSOR for such "high-sounding nonsense" as producing reports on the need for gradual democratization. Medvedev also had a meeting with members of the Council on Civil Society (which included a number of prominent human-rights activists known for their criticism of the authorities). And finally, Medvedev gave an interview to the independent Novaia Gazeta ["New Newspaper"]. However, in this interview Medvedev did not say anything that could be interpreted as smacking of trailblazing, and preferred to stick instead to his habitual evasiveness void of any concrete promises. The Novaia Gazeta's uncomfortable questions – on the second "Khodarkovskii case", on elections being turned into a farce, on censorship, and on the President's attitude to democracy and United Russia – were, in fact, left without any answers, while Medvedev's words that for him, as a President, by contrast with analysts, "there can be no freedom of commenting", sounded rather dubiously.

It seems that the Russian authorities by now have already understood that talk alone has become insufficient. In April, the authorities made a crucial decision, which had long been insisted upon by human-rights activists and the public. This decision – also the first of its kind to be taken during the first year of D. Medvedev's presidential term – was passed by the Preobrazhenskii court in Moscow, which ruled that the appeal for parole of S. Bakhmina, the former Yukos lawyer convicted for stealing shares in Tomskneft and tax evasion, should be satisfied. Bakhmina was arrested in 2004, and sentenced to 7 years of deprivation of freedom in 2006. In 2008, she was already due for parole and started to appeal for it, initially with no success. In late 2008, Bakhmina gave birth to a child, and lodged a parole appeal to D. Medvedev, but the appeal mysteriously got lost, and its author followed suit, while representatives of the power structures started to give rather

confused explanations concerning her ever changing whereabouts. From the very beginning, the “Bakhmina case” was seen as a symbol of Russian judicial arbitrariness, because Bakhmina had been a rank and file employee of Yukos, and her duties had been such that she simply could not participate in any strategic decision making. Also, Bakhmina had not been concerned with any political activities whatsoever.

Further keeping Bakhmina in detention could have become detrimental to D. Medvedev’s reputation, because it was senseless in all respects but one – it served as a proof of the Russian authorities’ infallibility. In this case, it was impossible for them to refer to any independent court of justice, etc, because the decision to parole a convict was, and is, within the competence of the RF President. As a result, Bakhmina’s release from detention was, after all, carried out by a court ruling (apparently in order not to create an impression that Medvedev acted in defiance of the judicial authorities or of his own predecessor). However, it is still too early to affirm that humanism has carried the day: first, we should become truly convinced that Bakhmina is not being forced to give evidence and testimony against M. Khodarkovskii (one of the charges brought against him has to do with the same old story with Tomskneft).

April saw the denouement of the highly emotional campaign for mayor election in Sochi (as the previous mayor had resigned before the expiry of his term in office, the election campaign was completed outside of the framework of a single day of voting). As far as the Russian authorities were concerned, the Sochi election was highly important: among the contestants for the post of mayor was B. Nemtsov, a Sochi native and an opposition politician; while the general situation in Sochi (tensions caused by the town’s preparation for the Olympic Games, the endless parade of mayors recommended from above, coming out of the blue and quick to resign) had been creating an atmosphere of intrigue. Bearing in mind United Russia’s loss of popularity, which had been clearly demonstrated at the March elections, the authorities decided to show its ability to win an election carried out on a competitive basis; in the case of Sochi this task was made easier for them due to the considerable resources they were able to concentrate there<sup>1</sup>. The authorities managed to prove their mettle – with the voters’ turnout being low (about 40 %), the acting city mayor, United Russia’s candidate A. Pakhomov, won in the first round with 76 % of the vote. B. Nemtsov finished up with 13.6 % of the vote, while the CPRF candidate Yu. Dzaganina finished third with 6.7 % (the rest of the candidates were merely symbolic – they had not conducted any electioneering activities and practically failed to collect any votes). However, the election was marred with one scandalous flaw – the amount of voters who cast their vote early amounted to nearly 10 % of the registered electorate, or to one-quarter of those who actually took part in the voting; equally suspicious is the fact that all of them voted for Pakhomov<sup>2</sup>. It turned out that Pakhomov should have won even without the tactic of early voting being applied, but this outcome could not have been predicted in advance. Nevertheless, the Sochi election can indeed be characterized as a step forward – however small; because there an opposition candidate was, at least, not disqualified but duly registered.

At the same time, April witnessed some events of a directly opposite nature.

The RF State Duma adopted in the second reading a draft law to the effect that deputies of municipal representative bodies should enjoy the right to remove mayors from office on a broad range of grounds. This procedure can be initiated by one-third of deputies of a local assembly or by the head of a RF subject. It is curious that, when considering this issue,

1 There was only one election which took place in parallel with that in Sochi – the early election of the Vladikavkaz City Assembly, which contrasted sharply with the situation in March when elections of mayors and legislatures had simultaneously been held in a score of constituencies.

2 The procedure of early voting makes it technically impossible to prevent vote rigging, if one or other election commission should decide to resort to such trickst.

the State Duma even ignored the objections voiced by the All-Russian public association “The Russian Federation Council on Local Self-Government” (VSMS) functioning under the aegis of United Russia. In his turn, Prime Minister V. Putin went even further and mentioned the proposal that mayors of regional capitals should be directly appointed by the governors. By the way, among those fully responsible for the emergence of this draft law there is D. Medvedev himself, because formally it was he who had introduced the draft document into the State Duma. Although it is true that, in the past, mayors could also be removed from office without consulting the voter – through the initiation of criminal cases against them, this draft law essentially broadens the opportunities for exerting pressure on mayors to surrender the considerable resources available to them on the municipal level.

In April, Dubai police produced a sensational report on the course of the investigation of the attempt on the life of Sulim Yamadaev, former commander of the Vostok battalion, a special forces unit of the Main Intelligence Directorate (GRU). Yamadaev, an ardent opponent of R. Kadyrov, was hit by gunmen on 28 March. Most likely, he was killed on the spot (although his relatives affirm that he has survived). The Dubai authorities arrested several persons and put out international arrest warrants for several others, including the closest associate of R. Kadyrov and member of the RF State Duma, A. Delimkhanov. Meanwhile, Kadyrov made a number of strange statements resembling a confession of guilt: in particular, he announced that Sulim Yamadaev had been involved in the murder of Kadyrov Sr.<sup>1</sup> In fact, Russia is again facing a situation resembling the Litvinenko affair.

RF Prime Minister V. Putin addressed the State Duma with a report on the 2008 performance. According to him, the coming year will be “very difficult”. One of the objectives was formulated by the Prime Minister as follows: “...to preserve the key enterprises... to accelerate the transition to knowledge-based economy... We must not simply maintain the domestic demand, but also implement major projects to start creating an infrastructure for the future”.

Among the achievements of the Government mentioned in the report, special emphasis was placed on the prevention of a collapse of the banking system; the preservation of people’s savings in Russian banks; the prevention of a paralysis of settlements between enterprises; and the smooth devaluation of the national currency.

Putin expressed his confidence that in the nearest future there will be an increase in bank credit, a drop in the rate of inflation, and a fall in the Central Bank’s interest rate.

In April, the RF State Duma approved a new federal budget for the year 2009 (the three-year budget adopted last year had been annulled because of the crisis, and the country had returned to one-year budgets). It is noteworthy that the preparation of the new budget itself was repeatedly postponed. The most surprising result was the planned increase in the federal budget’s expenditure (by more than 7 %) taking place against the background of a significant fall in revenue (by more than 38 %). The budget deficit of 3 trillion rubles (or more than 7 % of GDP) will be fully covered at the expense of the Reserve Fund, three-quarters of which will be spent for this purpose.

Cuts were made in almost all the expenditures excepting those on social policy, inter-budget transfers, the housing and communal utilities complex, and “the national economy”. At the same time, the growth of transfers to the regions and of the expenditures on the housing and communal utilities complex is quite understandable, for these expenditures are called to compensate for the considerable loss in income suffered by regional budgets, and to keep afloat the financing of social mandates. As regards the expenditures

<sup>1</sup> Previously, R. Kadyrov had affirmed that the murder of Akhmad Kadyrov was perpetrated by the armed Islamist underground, and that its last surviving organizers were all eliminated in 2006-7.

on the “national economy”, which were increased more than two-fold (by more than 1,700 billion rubles), their reasonability is open to doubt – and even more so because they are not properly itemized (they were distributed only by branch, with almost one-third of the expenditures within these budget items being mysteriously denoted as “other issues”).

Judging from the structure of the new budget and from the Russian authorities’ determination to spend the Reserve Fund, it appears likely that they are expecting hydrocarbon prices to sharply rise over the coming year, thus significantly increasing the budget’s revenue. Such a strategy can be dangerous, because hydrocarbon prices are not only prone to fluctuations in some periods, but also to periods of considerable stability.

In April 2009, rumors of one noteworthy transaction finally came true. The joint-stock financial company AFK Sistema bought out the enterprises of the Bashkirian fuel and energy complex for 2.5 billion USD. Prior to this deal, Sistema owned the blocking parcels of shares in six companies. The Board of Directors of Basneft discontinued the powers of its general director Ural Rakhimov, son of Bashkortostan President Murtaza Rakhimov. Thus, control over the Bashkirian fuel and energy complex passed to V. Evtushenkov’s corporation, which signified yet another achievement for the latter (a month ago a representative of Sistema was appointed head of Aeroflot). And still earlier, the Federal Tax Service had withdrawn its legal actions demanding that shares in the companies of the Bashkirian fuel and energy complex should be withdrawn (in 2003, the Bashkortostan authorities had passed these shares, virtually free of charge, to Ural Rakhimov’s structures, which resulted in a succession of lawsuits).

In April, after several years of being at loggerheads with his superiors, the deputy head of the RF Federal Service for Natural Resources Supervision (Rosprirodnadzor), Oleg Mitvol, announced his resignation. He made public his plans to get engaged in voluntary work as head of the interregional ecological movement “Green Initiative”. Mitvol also promised to take part in elections, on the next single day of voting in October<sup>1</sup>. Thus, it cannot be ruled out that we might see the birth of yet another political project.

April also saw the retirement of the head of the Main Intelligence Directorate of the RF Armed Forces General Staff, V. Korabelnikov. He was replaced in this position by his first deputy, A. Shliakhturov. Although formally Korabelnikov retired on age grounds, and he was awarded a decoration, experts saw his retirement as a continuation of the ongoing reshuffle at the RF Ministry of Defense, caused by the general lack of loyalty towards the current Minister of Defense, a civilian, on the part of the generals. ●

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1 Bearing in mind that only political parties enjoy the right to participate in regional party-list elections, it is not very clear whether the case in point is the creation of a party or simply an episodic standing as candidate in one of the majoritarian electoral districts.

## INFLATION AND MONETARY POLICY

N.Luksha

*As of March results, the CPI in Russia amounted to 1.3 per cent, slightly higher than in the relevant period of the preceding year. The volume of foreign currency reserves remained practically unchanged, by the end of the month it amounted to USD 383.9 bln. The real effective ruble exchange rate has increased by 3.3 per cent, and as of the results of the I-st quarter of 2009 it's decrease made 11.9 per cent. Within the I-st quarter of 2009, the external corporate debt has decreased by USD 29 bln, or by 6.4 per cent, having reached USD 423 bln by the end of the quarter. The value of the two-currency basket has been decreased for the first time since July 2008, amounting RUR 38.93.*

On March 27, the Bank of Russia has informed a modification in the estimates of mandatory reserves for banks. A month later, it was decided to extend the deadlines of a stage-by-stage increase in the existing standards of mandatory reserves. On April 10, the Central Bank has decided to temporarily increase credit limits on unsecured credit. On April 17, the RF Central Bank has amended the requirements to the direct REPO operations. Since April 24, for the first time since summer 2007 the refinancing rate was reduced to 12.5 per annum. At the same time, the interest rates on loans and deposits of commercial banks with the RF Central Bank were reduced.

The consumer price index in March made 1.3 percent (against 1.2 per cent in the March of preceding year) (See Fig. 1). The greatest input in prices growth in March, like in preceding month, was made by food products (+1.7 per cent). The utmost growth rates were observed for granulated sugar (+6.4 per cent), fruit and vegetables (+4.5 per cent), as well as for fish and seafood (+2.8 per cent) and for pasta (+2.3 per cent). Herewith, in March there was further reduction in sunflower oil and eggs prices: within the month they have downgraded by 2.9 per cent and 1.5 per cent, accordingly, on average countrywide.

In March, growth was observed also about non-food items, which prices have increased by 1.4 per cent. As in preceding months, the highest growth rates were noted for medicines (+5.3 per cent). The fast growing rates were noted for cleaning detergents (+3.1 per cent) and tobacco (+3 per cent). The price for gasoline was further downgrading (-2.5 per cent).

The growth of prices for commercial services has declined, having amounted as of month results to 0,6 per cent (against 1,4 per cent in February, 2009). The utmost growth was noted in prices for telecommunication services (+2.4 per cent), medical services and cultural institutions services (by 1.4 per cent). Prices for international tourism have declined by 0.4 per cent.

Therefore, as of March results, the growth rate of consumer prices in Russia continued to slow down, having only slightly overrating the relevant indicator of preceding year. The inflation decline, as in the preceding month, was due to a significant (more than two-fold) reduction in the rate of growth in prices in the sector of commercial services. Monetary supply decrease and consumer demand decline, caused by the reduced real disposable income (which, according to January-February results, fell down by 7.2 per cent per annum) have also become the important factors of the growth rate decline. Apparently, those factors will be decisive in April as well, when, according to our estimation, inflation rate will be lower, than in March.



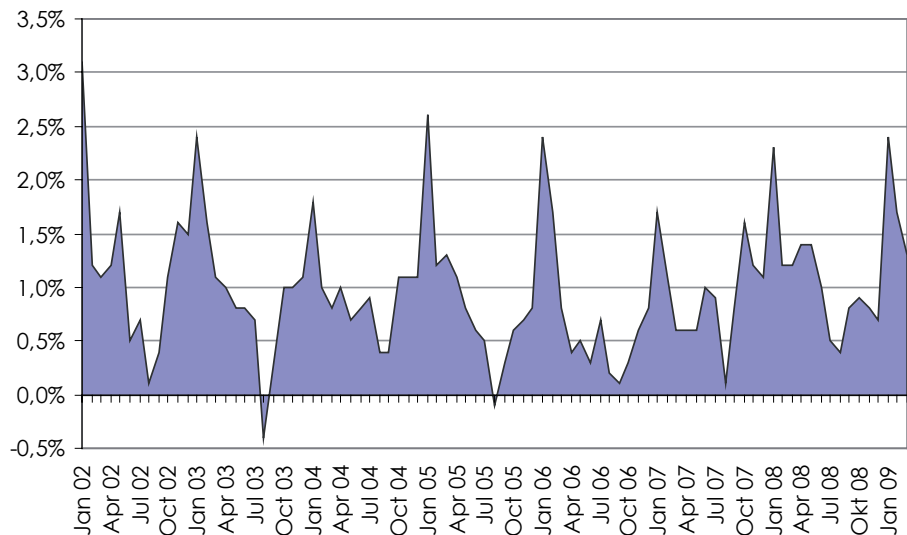
The CPI<sup>1</sup> in March 2009 made 1.4 per cent (versus 1.1 per cent in the relevant period of preceding year).

As of March 2009 results, the monetary base (in broad definition<sup>2</sup>) has been declined less than by 1 per cent and amounted to RUR 4.2988 trillion. As of March 1, 2009 the volume of the monetary base in a broad definition reached RUR 4331,0 bln Let us consider the dynamics of the monetary base in broad definition by components.

As of April 1, 2009, cash in circulation with regard to the fund balances in credit organizations made RUR 3.7 trillion (1.1 per cent decline against March 1), correspondent accounts of credit organizations in the Bank of Russia made RUR 431.7 billion (-4.5 per cent), mandatory reserves made RUR 33.3 billion (+6.7 per cent), banks' deposits in the Bank of Russia made RUR 163.4 billion (+19.2 per cent), the value of shares of the Bank of Russia with credit organizations made RUR 12.4 billion (+3.33 per cent).

Within March 2009, growth of excessive reserves of commercial banks continued<sup>3</sup>, its index has risen up by RUR 6.4 bln or by 1.1 per cent. As within the preceding month, the bank deposits in the RF Central Bank have demonstrated the highest growth. Reduction of correspondent accounts can be regarded as insignificant. According to V. Goreglyad, the Auditor of the RF Accounts Chamber, the situation with the bank liquidity has stabilized. In confirmation to his words, there should be mentioned the lowest levels of direct REPO auctions, as well as the fact, that monetary market rates within the last weeks of March were sustained below the 10 per cent per annum for overnight loans.

Nevertheless, it is a bit early to talk about welfare in the banking sector. Only in March, eight licenses were withdrawn from the banks, and all in all, since the beginning of the crisis, dozens of credit organizations were deprived of licenses. Moreover, the debt in arrears is still growing: according to different estimates, it amounts from 8 to 10 per cent<sup>4</sup>. It should be noted, that the world crisis level is considered as 10 per cent. In this regard, RUR 550 bln will be allocated from the budget to support the banking sector. In addition, the Bank of Russia has prepared the proposals on the public capital investment in the first category banks.



Source: Russian Statistical Agency

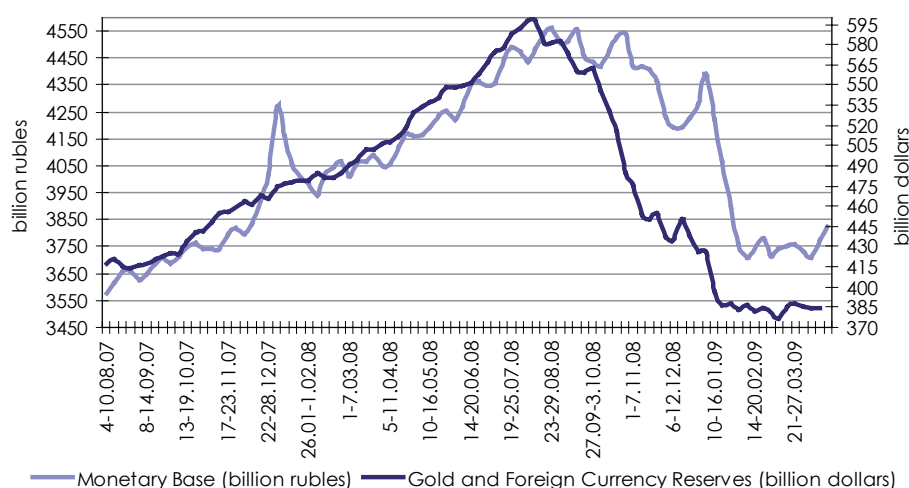
Fig. 1 The Growth Rate of the CPI in 2002–2008 (% per month)

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

2 The RF monetary base in broad terms with no regard to the cash issued by the Bank of Russia and the balance of Compulsory Reserve Accounts on credit organizations in national currency, deposited in the Bank of Russia, taking into account the assets of correspondent accounts and bank deposits, allocated in the Bank of Russia.

3 The excessive reserves of commercial banks with the RF CB refers is the amount of correspondent accounts of commercial banks, their deposits with the RF CB and the CB bonds of commercial banks.

4 According to the former first Vice-Chairman of CB S. Alexashenko, the level of arrears varies between 8-8,5 per cent, and by the Minister of Finance A. Kudrin and head of the Savings Bank of G. Gref, it exceeded 10 per cent. And Standard & Poor's believes that now it is around 15 per cent.



Source: RF Central Bank

Fig. 2 Changes in the Monetary Base and in the Gold and Foreign Currency Reserves in 2007–2008

The reduction of the volume of cash in circulation in March by 1.1 per cent and mandatory reserves growth by 6.7 per cent has led to the decline of the monetary base in narrow definition (cash+ mandatory reserves)<sup>1</sup> by 1 per cent (see Fig. 2). Herewith, the volume of the Central Bank foreign currency reserves has been practically unchanged, having made as of April 1, 2009 USD 383.9 bln, what is three times less that in the preceding quarter.

In March, the decrease of the volume of cash in circulation by 1.1 per cent and increase of required reserves by 6.7 per cent had led to reduction of monetary base in narrow definition (cash plus the required reserves) by 1 per cent (see Fig. 2). Herewith, the volume of international reserves of the Central Bank of Russia in March, remained almost unchanged, amounting to USD 383.9 bln on April 1, 2009. In general, within the I-st quarter gold reserves decreased by 10.1 per cent, which is three times lower than within the previous quarter.

According to the Central Bank of Russia, in the I-st quarter 2009, net outflow of capital amounted to USD 38.8 bln. The net capital outflow from Russia in March 2009, was slightly higher, than the relevant indicator of February (which according to A.Ulyukaev, Deputy Chairman of the Bank of Russia, was equal to USD 4.5 bln), what was probably based the schedule of payments under international bank loans. Nevertheless, the volume of exported capital within February-March was many-fold less, than the January indicator ( USD 29 bln). As per the Central Bank of Russia estimates, in the forthcoming months, the net outflow of capital will vary virtually around zero, but by the end of the year it will amount to USD 70 bln.

In March the growth of RUR real effective exchange rate made 3.3per cent. The index of real effective exchange rate amounted to 115.3<sup>2</sup> (see Fig. 3). In general, for the I-st quarter of 2009, RUR real effective exchange rate of to foreign currencies has declined by 11.9 per cent.

As of March results, the official rates of USD and Euro against RUR have declined. The USD rate has declined from RUR 35.7 to RUR 34.01, or by 4.7 per cent. The rate of Euro by the end of March declined from RUR 45.35 to RUR 44.94, or by 0.9 per cent. As a result, within the preceding month, in regard to the two-currency basket RUR has increased by RUR 1,13, while the value of the two-currency basket<sup>3</sup> has declined to RUR 38.93. For the

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 CBR.

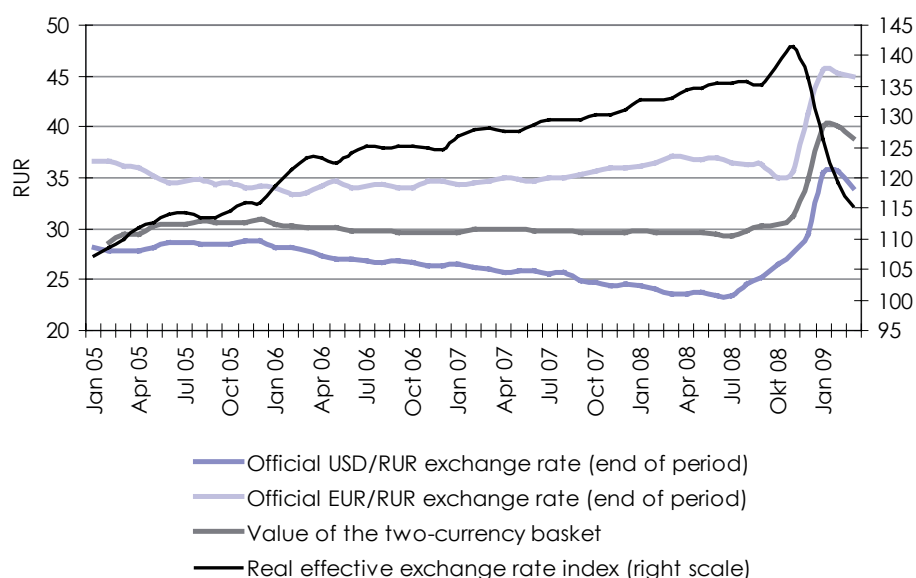
2 The level of 2002 is taken for 100.

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

second consecutive month, in the framework of foreign exchange intervention, the Bank of Russia has carried out net purchases in the amount of USD 3.6 bln and Euro 189.9 mln.

According to the RF Central Bank, as of April 1, 2009, the aggregate external debt of Russian banks and companies amounted to USD 423 bln (See fig. 4). Within the I-st quarter of 2009, the corporate debt has declined by USD 29 bln, or by 6.4 per cent. In particular, within this period the debt of banks has decreased by 11.2 per cent and amounted to USD 147.5 bln, and loans of companies declined by 3.6 per cent, amounting to USD 275.5 bln. In the I-st quarter of the current year, the rate of banking and corporate loans redemption has declined by more than 1.5-fold, as compared with the preceding quarter, which is, nevertheless, consistent with the schedule of external debt payments.

On April 23, 2009 the Bank of Russia has published an updated schedule for the forthcoming payments of external debt (See Table 1.). It allows to assess the scope of corporate debt restructuring. Restructuring primarily has affected the amount of debt: in 2009 the total external debt (both, public and business) increased from USD 117.1 bln to USD 128 bln. In view of restructuring, the major payments of the banks' external debt in 2009 will be made in the IV quarter of 2009, while non-financial sector repayments are deferred for the period after 2010. It should be noted, that interest rates on external debt have been insignificantly changed as a result of restructuring.



Source: RF Central Bank, author's estimates

Fig. 3 Indicators of Ruble's Exchange Rate Dynamics

Table 1

SCHEDULE FOR THE RF EXTERNAL DEBT REDEMPTION AS OF JANUARY 1, 2009 (USD BLN)

	2009				2010				Over 2 years	Non-scheduled debt
	Q I	Q II	Q III	Q IV	Q I	Q II	Q III	Q IV		
Banks:	16.5	13	15.4	15.4	6	9.5	4.8	6.9	88.1	26.4
Basic debt	14.3	11	13.6	13.8	4.5	8.1	3.5	5.7	65.1	26.4
Interest	2.2	2	1.8	1.6	1.5	1.4	1.3	1.2	23	-
Others:	24.3	19.7	17	25.3	13.5	14.3	13.5	18.1	203.5	6.1
Basic debt	20.4	16	13.6	21.6	10.4	11.4	10.9	15.4	159.9	6.1
Interest	3.9	3.7	3.4	3.7	3.1	2.9	2.6	2.7	43.6	-
Total:	40.8	32.7	32.4	40.7	19.5	23.8	18.3	25	291.6	32.5

Source: RF Central Bank, authors' estimates

On March 27, 2009 the Bank of Russia has informed of a modification in the estimates of mandatory reserves for banks. According to this decision, participation of state of public corporations in the authorized capitals of legal entities will not be regarded as a basis for

uniting those entities in a group of borrowers for the purpose to estimate the maximum risk per one borrower or a group of related borrowers (H6). As a result, in particular, such major banks as «Globex», Svyaz-Bank, Russian Bank for Development (RosBR) and Roseximbank, the shareholders of which is the Development Bank Public Corporation, will not be regarded as a group of related borrowers. This decision of the Bank of Russia is aimed at mitigation of regulation terms in the financial crisis situation, when implementation of the standard credit risk terms becomes rather difficult for the banks.

Moreover, the RF Central Bank has established the risk factor of 50 per cent for the credit requirements to JSCs, meeting the criteria of natural monopolies and included in Section 2 of the List of Strategic Enterprises, providing that the securities of the companies are included in the Lombard List. This amendment will be beneficial, especially for the largest banks, such as Sberbank and VTB Bank, which are the most active creditors of the strategic enterprises. The growing overdue debt of those banks, and therefore, the need to make greater contributions to the reserves, results in the reduced capital. Amendment in the method of the standard assessment will reduce risks and improve the capital of the banks.

On April 10, 2009 the Board of Directors of the Bank of Russia has decided to increase temporarily credit limits on unsecured credits. This decision is applied to credit institutions related to the Categories 1-3, which corresponds to the International long-term credit rated no lower than B-on the classification of S&P and Fitch rating agencies and no lower than B3 according Moody classification. By the end of March, approximately 126 credit institutions were consistent with that criterion. To meet the requirements of the RF Central Bank, the banks should also submit for approval of the owners the issue of reorganization in the form of a merger or acquisition and to report to the Bank of Russia. Finally, those credit organizations should have contracts, in which the lenders stipulate their demands for early execution in case of the events, provided by the restructuring. This measure is aimed at supporting the reorganization and consolidation of the Russian banking sector. The need for such a decision was prompted by growing arrears on loans.

This is not the first step in the RF Central Bank policy for stimulating the processes of mergers and acquisitions of credit institutions. For example, in February there were adopted amendments to the Federal Law, which required banks to increase the authorized capital, bringing it up to RUR 180 mln. In addition, in February, the RF Central Bank has reduced the time frames for the documents turnover on registration of a new credit organization as a result of a merger, as well as has significantly reduced the list of documents, required for registration. Raising of the minimum capital from RUR 90 mln in 2010 up to RUR 180 mln in 2012 also demonstrates the inevitability of banking consolidation.

On April 17, 2009, the RF Central Bank has informed of the amendment to the direct REPO transactions procedure. According to this decision, since May 1, 2009, the operations of direct REPO transactions at a fixed rate for a period of one week are suspended. In addition, since the same day, when setting up a clipping rate at the opening of direct REPO auction for a period of 1 day, applications, filed at the rate exceeding or equal to the fixed REPO rate (which currently makes 12 per cent) will not be included in the limit amount of this auction. Herewith, the applications mentioned above will be covered in full. Therefore, the volume of liquidity, provided to the banking system will be getting further reduced. In the context of a satisfactory situation with liquidity in the banking market, as well as to avoid inflation, the measure seems to be justified.

On April 23, 2009 the Bank of Russia decided to reduce the refinancing rate by 0.5 percentage points to 12,5 per cent per annum. This is the first decrease in the refinancing rate after a series of upgrades, that began on February 4, 2008, when it was raised for the first

time within nearly 10 years. In addition, from April 24, the RF Central Bank has reduced interest rates for credit and deposit operations.

Due to the fact, that the refinancing rate is the base interest rate for all credit operations of the Central Bank, the amendment resulted in relevant decrease in other interest rates of the RF Central Bank (see Table. 2).

Table 2

RF CENTRAL BANK INTEREST RATE FOR CREDIT OPERATIONS

Credit type	Interest rate (% per annum)	
	Before amendment	After amendment
Overnight	13	12,5
Credit, secured by assets or warranty	12 - up to 90 calendar days; 12,5 - from 91 to 180 calendar days	11,5 - up to 90 calendar days 12 - from 91 to 180 calendar days

Source: RF Central Bank

In addition, the interest rate for overnight transactions of «foreign currency swap» (its ruble part) was reduced by 0.5 percentage points to 12.5 per cent per annum, while the rates on direct REPO operations for a period of 1 day and for a period of 7 days were also reduced by 0.5 percentage points to 11.5 per cent per annum. RF CB has also reduced the rate by 0,5 percentage points on deposits: deposits, made under standard conditions of «tom next», «spot next» and «on demand» - up to 7.25 per cent per annum, «one-week» and «spot-week» rates were reduced to 7.75 per cent per annum. Fixed rates on lombard credits for any term have been reduced from 12 per cent to 11.5 per cent per annum. Herewith, the Bank of Russia has lowered the rates on liquidity, provided through the auctions:

- Operations of direct REPO:
  - o for a period of 1 day - from 10 per cent to 9.5 per cent per annum;
  - o for a period of 7 days - from 10,5 per cent to 10 per cent per annum;
  - o for a period of 90 days - from 11,5 per cent to 11 per cent per annum;
  - o for 6 months - from 12.25 per cent to 11.75 per cent per annum;
  - o for a period of 12 months - from 12.75 per cent to 12.25 per cent per annum;
- Lombard credits:
  - o for a period of 14 calendar days - from 10,5 per cent to 10 per cent per annum;
  - o for a period of 3 months - from 11.5 per cent to 11 per cents per annum;
  - o for 6 months - from 12.25 per cent to 11.75 per cent per annum;
  - o for a period of 12 months - from 12.75 per cent to 12.25 per cent per annum.

Interest rates reduction was possible, on the one hand, due to the deceleration of inflationary pressure in the economy. Thus, from April 1 to 20, the growth of consumer prices made 0.6 per cent, which is almost twice lower, than the relevant indicator of preceding year, while the accumulated inflation rate remained actually equal and amounted to 6 per cent per annum. On the other hand, the devaluation expectations have been changed, which is confirmed by both, the dynamics in individual and business deposits structure (the share of foreign currency deposits has expressly decreased), and the net purchases of foreign currency by the RF Central Bank (i.e., the offer exceeds the demand for foreign currency). At the current moment, Russian banks are not experiencing problems with liquidity, so this measure is aimed at reduction of the cost of credits for non-financial sector (today the share of credits of the Central Bank amounts to 13 per cent or more in the liabilities to the banking system, while large banks' share accounts up to 30 per cent). However, there is still no reason to expect the reduction of rates on loans to the banks, as

the latter include still rather high credit risks in the interest rate. Nevertheless, having reduced the refinancing rate, the Central bank has demonstrated to the market participants, that the refinancing rate is not going to be upgraded in the short term. This decision also indicates a softening in monetary policy.

Together with the interest rates decrease, the Board of Directors of the Bank of Russia has decided to extend the terms of a stepwise increase of mandatory reserves limits. It should be reminded, that on Jan. 19, 2009, due to a difficult situation in the financial sector, caused by the financial crisis, the RF CB has postponed the deadlines for extension of currently effective limits to May 1, 2009 (the planned increase was up to 1,5 per cent) and to June 1, 2009 planned increase is up to 2,5 per cent). According to the new order of the Central Bank, those standards will be increased stepwise by 0,5 per cent: from May 1, 2009 - up to 1 per cent, and from June 1 - up to 1,5 per cent, from July 1 - up to 2 per cent and from August 1 – up to 2,5 per cent. In our opinion, the decision to extend mandatory deductions to FOR stepwise is based on the growing arrears of banks. In addition, the sharp upgrading of mandatory deductions to FOR could cause further reduction of credits to the real sector. ●

**FINANCIAL MARKETS<sup>1</sup>**

N.Burkova, E.Khudko

*The positive response of international investors to the plan to the world economy recovery, developed during the summit of the Governments of the «big twenty», positive macroeconomic news from the United States and financial results of several international companies, EU Central Bank reducing the refinancing rate to 1.25 per cent per annum, as well as approval by the Government of the Russian Federation measures to support financial markets and national labor market, strengthening of the national currency have contributed to the growth of the Russian stock market. However, information about the forthcoming bankruptcy of the largest American automotive producers General Motors Corp. and Chrysler as a result of rejection of their crisis recovery plans by the U.S. Government, net losses of the U.S. bank Morgan Stanley in the first quarter of 2009 and raising the level of unemployment in the United States, as well as the increased inflation in Russia and a significant reduction in net profit of OAO «Gazprom» and «Sberbank of Russia» in 2008 have restricted the growth rate of the Russian financial market. Herewith, those positive trends were especially expressed in the stock market, where the active investors has grown by 22 per cent, and the quotations of shares of all «blue chips» have increased. The signs of recovery of domestic corporate bond market were observed. The activity of investors has significantly increased in the secondary corporate bond market. Adverse effects were an increase in the number cancelled bond issues and sustained large number of defaults.*

**Government Securities Market**

Within April, the information on a reduced internal and external national debt of the Russian federation by 1.7 per cent and 6.4 per cent within the first quarter, RUR rate stabilization, on the one hand, and inflation growth, negative situation with liquidity, as well as deteriorated situation with liquidity due to a regular tax payment schedule extensive offer of Minfin Federal Bonds, and on the other hand, have resulted in the declined dynamics of the Russian foreign currency securities yields. Ruble-denominated government bond market in April, like a month earlier, was also marked by a moderately positive dynamics against the background of optimistic expectations of the investors.

As of April 26, the Russian Eurobonds RUS-30 yield to maturity has decreased as compared with the level of March 23 from 8.72 to 8.53 per cent per annum (by 2.07 per cent), RUS-28 – from 9.44 per cent to 8.63 per cent per annum (by 8.58 per cent), RUS-18 – from 7.25 to 5.75 per cent per annum (by 20.69 per cent) and RUS-10 from 5.21 per cent to 2.82 per cent per annum (by 26.68 per cent). As of the same date, the upgrading trend was observed in the yields of external currency debt bonds. Thus, the yield to redemption of the seventh tranche of external currency debt bonds has grown from 4.93 to 5.01 per cent per annum (by 1.61 per cent) (see Figs 1-2).

Within the period from March 24 to April 26 the total turnover of the OFZ secondary market amounted to approximately RUR 12.13 billion with an average daily turnover of RUR 0.51 billion (about RUR 8.96 billion with an average daily turnover of RUR 0.47 bil-

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

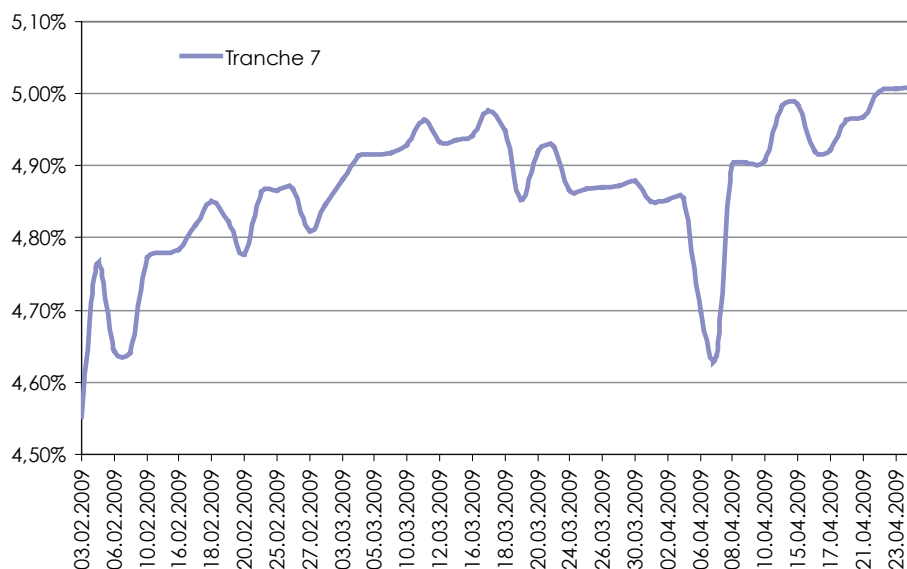


Fig. 1 Minfin bonds' yields to maturity in February – April 2009

lion in March), what corresponds to the growth of an average monthly turnover over 8.5 per cent.

Within March 24 – April 26, after the absence of auctions in preceding period (February 24 – March 23), there were three auctions on additional OFZ placement (25064 series). Thus, an auction on additional placement of OFZ series 25064 was held on April 15 for the amount of RUR 1 billion, actual placement volume reached RUR 0.86

bln (i.e., 86 per cent of the issue) with an average weighted yield of 12.05 per cent per annum. On April 17 there took place an auction on additional OFZ series 25064 placement for the amount of RUR 2 bln, actual placement volume reached RUR 1.37 bln (i.e., 68.5 per cent of the issue) with an average weighted yield of 12.39 per cent. Moreover, on April 22 there was an auction on additional OFZ of the same series 25064 for the amount of RUR 2.94 bln, actual placement volume reached RUR 0.34 (i.e., 11.56 per cent of the issue) with an average weighted yield of 12.49 per cent per annum.

As of April 26, the OFZ market amounted to RUR 1132.42 bln at face value and to RUR 1818.43 bln at market value. The duration of the GKO-OFZ market portfolio was 1791.22 days, having decreased (by 64.27 days) as compared with preceding month (as of March 23).

## Stock market

### *Stock market situation*

Positive trends in the external world markets, based on the decisions of the «big twenty» governments to encourage the global economy, upgrading quotations of the global oil prices and increasing global stock

indices have contributed to an upsurge of the Russian financial market in April. Moreover,, the actions of the Russian Government to support the national financial and labor markets (in particular, reducing the refinancing rate from April 24 to 12.5 per cent per annum and additional subventions from the federal budget to support the labor market of the RF Subjects in the amount of RUR 2.5 billion), strength-

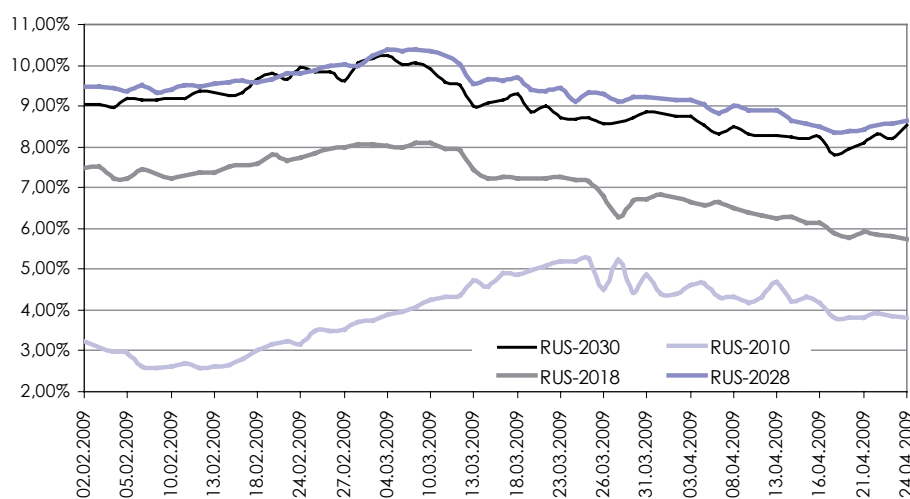


Fig. 2 Yields to maturity of the Russian Eurobonds with maturity in 2010, 2018, 2028 and 2030 in February – April 2009



ening of the national currency, the disclosure of financial performance of a number of major Russian companies have also provided positive effect on investors' expectations and contributed to the improvement of the situation in the domestic market.

All those factors have urged the upgrading of the most liquid securities in the Russian stock markets (by 10-20 per cent on average), as well as the majority of MICEX and RTS market stock indices growth as of the month results (See Table 1)..

Throughout April, a general growing dynamics was observed in the Russian stock market (Fig. 3). Herewith, there were short-term corrective trends in the MICEX index. The minimum value the MICEX index has reached on April 2, having downgraded to 787.2 points (646.79 points in the preceding month). The maximum value the MICEX index has reached on April 17, having reached 932.90 points (849.82 per cent points in the preceding month).

In general, within the period from March 24 to April 26, the MICEX index has significantly grown by 13 per cent, what makes about 107.2 points in absolute terms (within the year, from April 27, 2008 to April 26, 2009, the MICEX index has downgraded by 55 per cent). Over the same period the turnover of trades in shares, included in the MICEX index, made about RUR 1 144.42 bln at an average daily turnover of RUR 47.68 bln against RUR 743.30 billion with an average daily turnover of RUR 39.12 billion in the preceding period). Therefore, the investors' daily activity in the stock market in April has increased as compared with the preceding month nearly by 22 per cent. The indicators of maximum and minimum daily turnover in the market trades in April made, accordingly, RUR 78.14 bln as of April 14), and RUR 32.42 bln (on April 1).

As of the month results (from March 24 through April 26), all "blue chips" securities have shown an upgrading trend. The leaders of the upgrading rates were "Mosenergo", the value of which shares has increased by 78.64 per cent and 72.89 per cent. Some lower growing rates were observed about the shares of GMK "Nornickel" (by 19.89 per cent), "Sberbank of Russia", (18.79 per cent), LUKOIL and Gazprom and "VTB Bank" shares, accordingly. Some lower growing rates were observed about the shares of "Tatneft" (by 55.25 per cent), and "Rosneft" (by 49.81 per cent). They were followed by the shares of "Surgutneftegas" (by 31.96 per cent), "Gazprom Neft" (by 30.07 per cent) LUKOIL (by 12.63 per cent) and "Gazprom" (by 12.53 per cent). The least growth was observed about the shares of "Rostelecom" (by 8.63 per cent) and "Rostelecom" (by 8.63 per cent) (See Fig. 4).

In April the MICEX turnover leaders were: "Sberbank of Russia" (38.03 per cent of the total turnover), "Gazprom" (21.78 per cent of the total turnover), "LUKOIL" (8.27 per cent), GMK "Nornickel" (7.75 per cent), and "Rosneft" (4.58 per cent). Herewith, the significant growth in transactions with the «Sberbank of Russia» equities has grown twice as compared with preceding period, What has led to further upgrading of "Sberbank of Russia" quotations as a leader of MICEX stock market turnover. It should be noted, that the reduction

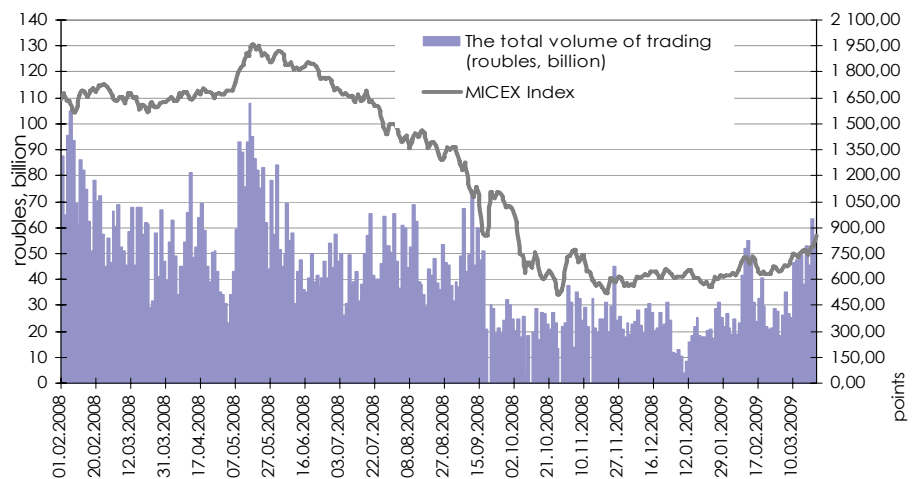


Fig. 3. Dynamics of MICEX Index and trading volume

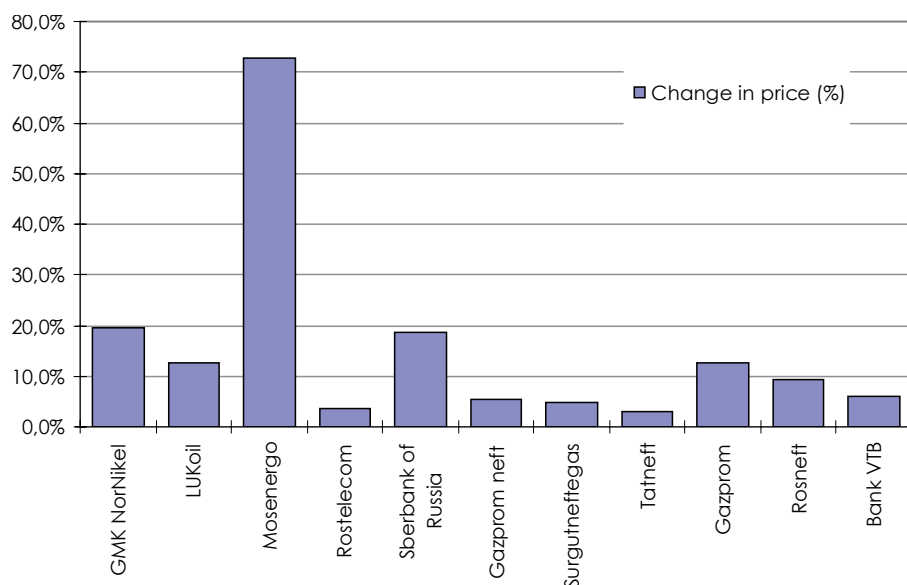


Fig. 4. Dynamics of the Russian Blue Chips from March 24 to April 26, 2009

in trading volume of «Gazprom» shares, among other things, was the reduced net income of «Gazprom» in accordance with the Russian accounting standards in 2008 has decreased twice as compared with 2007 (to RUR 173 billion). Total share of transactions with the above five companies' equities ("blue chips") made about 80.42 per cent (all "blue chips" – 87.03 per cent) of the gross turnover in the MICEX stock market in the period from March 24 to April

26.

According to MICEX information, as of March 26, the top five leaders of the domestic stock market in terms of capitalization, estimated on monthly average results, were: "Gazprom" – RUR 2 925.1 bln (RUR 2 708,01 bln in March), "Rosneft" – RUR 1 448.88 bln (RUR 1 173.37 bln in preceding month), "LUKOIL" - RUR 1 074.92 bln (RUR 1 015.62 bln in preceding month), "Surgutneftegas" - RUR 863.7 bln (RUR 690.76 bln in preceding month) and "Sberbank of Russia" - RUR 458.29 bln (against RUR 327.91 bln).

#### *Futures and Options Market*

In April, the activity of investors in the short-term MICEX market has decreased by 17 per cent as compared with the preceding month. Thus, in the period from March 24 through April 26 the total turnover in the MICEX futures market made approximately RUR 48.73 bln (3101 of transactions, 1.27 mln of contracts), against approximately RUR 59.18 bln (2,080 transactions, 1.53 mln of contracts) in March. Herewith, the largest volume of trading in April as a month earlier, was observed in the futures RUR/USD, amounting to RUR 44.02 billion (230 transactions, 1.52 mln of contracts). Herewith, prices of futures contracts, concluded in the current month in RUR/USD in the short-term MICEX market were made within 34- 34.5 for April, 34-35 RUR/USD for June, 34.5-35 RUR/USD for July, 35.4–35.8 RUR/USD for September, 36–37 RUR/USD for December and 36–39 RUR/USD for September 2009. Thus, we can conclude that investors' expectations regarding the growth of the dollar rate over the months have downgraded by RUR 1-3 as compared with the preceding month. The greatest number of transactions (2,157) within the month was made with commodity futures, the volume of trades in which has reached RUR 4.36 billion. for interest rates An adverse situation was noted at RTS FORTS futures market, where the investors' activity in April has significantly grown as compared with the preceding month. Thus, in the period from March 24 through April 26 the total turnover in the RTS futures and options market made approximately RUR 1,079.58 bln (6,497 of transactions, 43.45 mln contracts) against about RUR 733.44 bln (4,844 of transactions, 29.77 mln of contracts) in March. Like before, futures enjoyed the greatest demand: the volume of trades in the period under review made RUR 1,048.47 billion (6,436.94 thousand of transactions, 40.95 mln of contracts). Herewith, prices of futures contracts, concluded in RUR/USD futures

in the RTS FORTS for the second quarter of 2009 were within 34-34.8 RUR/USD, for the third quarter – RUR/USD 35-36 and for the fourth quarter within 36-37 RUR/USD.

while the average RTS index in the second quarter was estimated at 620-680 points and within 600-680 points in the third quarter. 55.69 of transactions, 1.05 mln of contracts). The maximum daily turnover in the short-term RTS futures market made RUR 53.29 billion in March (as of March 19), and minimum was RUR 26.44 bln. on March 2). Therefore, investors' expectations in regard to the growth of the dollar rate over the next six months have declined RUR 2 by on average versus the preceding month. The value of RTS index was assessed for the second quarter mainly in the range of 700-800 points, for the third quarter – at the rate of 700-780 points and for the fourth quarter - at 730-790 points. Options enjoyed far lower demand; the turnover amounted to about RUR 31.11 bln (60.29 transactions, 2.49 mln of contracts). The maximum daily turnover in the RTS futures market made RUR 61.94 billion in April (as of April 14), and minimum RUR 24.70 bln. (on April 13).

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

In April the Russian financial market dynamics, as a month earlier, was dependant on the situation in the world financial markets, characterized mainly by an upgrading trend, urged by optimistic investors' behavior, based on measures, taken by governments of a number of countries against financial crisis, upgrading oil prices, positive financial performance information, disclosed by some largest global companies, as well as optimistic macroeconomic news from the USA. Among the basic positive factors of the global market situation, affecting the Russian market, one should mention:

- publication of positive macroeconomic news from the United States (in particular on the grown sales of new homes and larger volume of orders for durable goods), as well as a statement Barack Obama, the US President, on the sustainability of the US financial system at the end of March;
- information of British bank Barclays Plc, as well as the German bank Deutsche Bank, that there is no need to attract additional capital;
- implementation of the plan for recovery of the global economy as a result of the summit of «big twenty» (held on April 2), in particular, expansion of control over the activity of hedge funds and the allocation of anti-crisis package amounting to USD 1 trillion by IMF and the World Bank;
- UK Ministry decision to guarantee credit funding to the Royal Bank of Scotland Group and a number of banks to encourage the renewal of credits issuance;
- increased net profit of the US bank Goldman Sachs as of the 1-st quarter of 2008-2009 fiscal year by 13 per cent to US USD 1.66 billion, as compared with the 1-st quarter of 2007-2008 fiscal year;
- plans of Japan government to extend public expenditures for the suppression of the countrywide crisis планы;
- global oil price upgrading (over USD 50 per barrel) in the first half of April;
- reduction of the interest rate by the European Central Bank to 1.25 per cent per annum.

However, the following events hindered growth of the global financial markets within the month:

- U.S. government rejection the anti-crisis plans of automobile manufacturers General Motors and Chrysler, and failure to provide them additional financial support, as well dismissal of the General Motors Head;
- information on the reduction of US banks Bank of America and J.P.Morgan Chase financial performance in March 2009 ;

- information on the net losses of American bank Morgan Stanley in the 1-th quarter of 2009 in the amount of USD 177 million dollars (versus USD 1.41 billion profit a year earlier);
- Bank of China profit reduction in the fourth quarter of the fiscal year by 58 per cent;
- unemployment growth in the USA in March;
- global oil price reduction (lower than USD 50 per barrel) in late March and the first half of April.

All those factors urged the upgrading dynamics in the major global stock market indices. Herewith, despite the general volatility in global indices, observed in April as compared with the indicators of the beginning of 2009, the indices demonstrated a general growth. Thus, the market indices of developing countries were characterized by growth (basically by 5-15 per cent), while in the US and European markets those indices were demonstrating lower growth rate by 4-10 per cent (See Table 1 and Fig. 5).

Table 1

DYNAMICS OF THE GLOBAL STOCK INDICES (AS OF APRIL 26, 2009)

Index	Ticker	Value	Dynamics within the month(%) <sup>1</sup>	Dynamics since the year beginning(%) <sup>2</sup>
MICEX (Russia)	MICEXINDEXCF	922.99	13.21	48.98
RTS (Russia)	RTSI	831.41	15.29	31.58
Dow Jones Industrial (USA) Average (USA )	DJI	8 076.29	3.86	-7.98
NASDAQ Composite (USA)	NASD	1 694.29	9.65	7.44
S&P 500 (USA)	SPX	866.23	6.16	-4.10
FTSE 100 (UK)	FTSE	4 155.99	6.60	-6.27
DAX-30 (Germany)	DAX	4 674.32	11.20	-2.82
CAC-40 (France)	CAC	3 102.85	9.23	-3.58
Swiss Market (Switzerland)	SSMI	5 113.05	4.94	-7.62
Nikkei-225 (Japan)	NIKKEI	8 707.99	0.94	-1.71
Bovespa (Brasil)	BUSP	46 771.79	11.61	24.56
IPC (Mexico)	IPC	22 582.17	11.16	0.90
IPSA (Chile)	IPSA	2 680.31	5.20	12.79
Straits Times (Singapore)	STI	1 852.85	6.14	5.18
Seoul Composite (South Korea)	KS11	1 354.10	9.42	20.42
ISE National-100 (Turkey)	XU100	29 675.55	15.48	10.47
BSE 30 (India)	BSE	11 329.05	12.74	17.43
Shanghai Composite (China)	SSEC	2 448.60	3.12	34.48
Morgan Stanley Emerging Markets Free Index	EFM	516.95	9.40	12.96

\* Versus indices of March 27, 2009

## Corporate news

### ОАО «VTB Bank»

In late March – early April, in the framework of support to the Russian regions, VTB Bank has provided credit to the Administration of Tomsk Region in the amount of RUR 1.56 billion for the term up to one year (for the purpose to execute the regional budget expenditure commitments of the social significance) and RUR 700 million to Kostroma Region (to finance the budget deficit), RUR 1 billion Penza Region for up to one year (for funding priority budget expenditures, affecting social stability in the Region), RUR 2.29 billion to Ryazan Region (to finance the local budget deficit).

Moreover, on April 6, VTB Bank in the framework of cooperation development with the retail trade networks has allocated credit limit to the group of companies «Dixy» in the amount of RUR 1.5 billion up to one year to refinance existing debt and to replenish working capital. On April 23, in the framework of government support to the automotive industry, VTB Bank has provided to OAO «AvtoVAZ» funding of EUR 4 billion and on

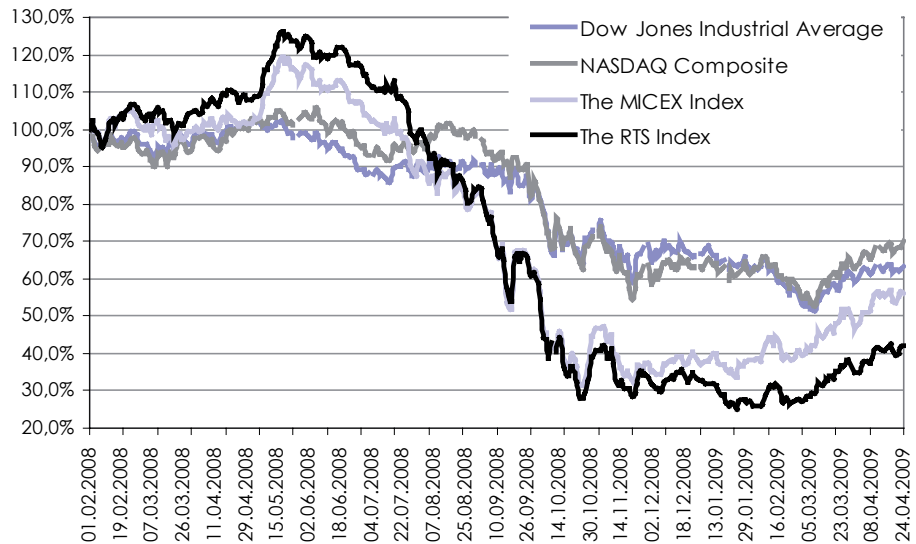


Fig. 5. Dynamics of the main USA and Russian stock indices (in % to the date 01.02.2008)

April 24 provided credit limit to JSC «Avtopribor» manufacture, amounting to RUR 500 million, valid for 2 years for replenishment of their working capital.

On April 3, VTB Bank has disclosed unconsolidated financial reporting, developed under RAS, for March 2009: the Bank's assets amounted to RUR 2 723 billion; net profit for the first quarter of 2009 made RUR 1.99 billion (versus RUR 16.8 billion in the first two months of 2009). Reduced profit in March was mainly attributable to increased contributions to the reserves for the risk of losses on loans, as well as the negative estimates of foreign currency rates in view of RUR strengthening against USD.

On April 23, VTB Bank has disclosed unaudited financial reporting, developed in accordance with IFRS for 2008: net profit accounted to USD 212 million, as compared with USD 1.5 billion in 2007, the credit portfolio has been extended by 50.3 per cent to USD 90.2 billion.

In addition, on April 7, VTB Bank has purchased from AFK «System» shares of JSC «Sistema-Gals», constituting 19.5 per cent of the authorized capital, valued RUR 30 rubles each and received a call-option to purchase shares for 30 per share, from JSC «Gals Finance», constituting 31.5 per cent of the authorized capital of JSC «Sistema-Gals». VTB Bank will be entitled to use the option upon approval of regulatory authorities. In case of the option utilization, VTB Bank share in the authorized capital of «Sistema-Gals» will amount to 51 per cent. JSC Sistema will be the owner of about 20 per cent of the shares of the company. At the same time, the parties have agreed the terms of restructuring the debts of «Sistema-Gals».

*OAO «Gazprom»*

On April 7, OAO «Gazprom» has the option to acquire 20 per cent of shares in OAO «Gazprom Neft». As a result of the agreement, «Gazprom» share in OAO «Gazprom Neft» has reached 95.68 per cent. The transaction value amounted to about USD 4.1 billion (to finance the transaction, «Gazprom» has attracted a number of credits from the Russian banks).

*OAO «Gazprom Neft»*

On April 15, OAO «Gazprom Neft» has disclosed the consolidated financial reporting for the 2008 under the US GAAP standards: revenues increased by 52 per cent to USD 33 075

million (USD 21,767 million in 2007), net profit has grown by 12 per cent to USD 4 658 million (against 4,143 million in 2007); EBITDA amounted to USD 7 965 million, as compared with USD 6, 236 million in 2007 (+28 per cent).

On April 21, OAO «Gazprom Neft» has placed an inaugural issue with a ten-year yield to redemption, series 04, with the total nominal value of RUR 10 billion (organized by the OAO «Gazprombank» and OOO «Renaissance Capital - Financial Consultant»; the emitter agent was GPB OAO). The coupon value was 16.70 per cent per annum for the term of 182 days.

On April 22, OAO «Gazprom Neft» has purchased in Italy a production plant for oils and lubricants (Chevron Italia S.p.A in Barry). On April 22, OAO «Gazprom Neft» has started start to sell oil products in St. Petersburg International Commodities and Raw Materials Stock Exchange. In future it is planned to provide petroleum products for sale on a regular basis.

In addition, on April 23, OAO «Gazprom Neft» has acquired a minority package in Sibir Energy. The purchase is made at a price of 500 pence per share. After completion of the transaction, OAO «Gazprom Neft» will consolidate over 16 per cent share in Sibir Energy.

#### *OAO «LUKOIL»*

On April 7, OAO «LUKOIL» has disclosed consolidated financial reporting for the 2008 under US GAAP standards: net profit has decreased by 3.9 per cent and amounted to USD 9 144 million, EBITDA has grown by 1.1 per cent and amounted to USD 15 552 million.

On April 16, OAO «LUKOIL» has early repaid credit in the amount of Euro 400 million from their own funds. The credit was attracted in November 2008 under the guarantee of OAO «LUKOIL» to partially finance the acquisition of 49 per cent shares in the ISAB refinery complex (Priolo, Sicily, Italy).

On April 20, OAO «LUKOIL» and OAO «AvtoVAZ» have signed the agreement on technical cooperation and partnership between the companies in 2009-2012. The agreement, in particular, provided, that OAO «AvtoVAZ» will purchase oil products, lubricants and special liquids, produced by OAO «LUKOIL» at the price, estimated as per market indices.

#### *HK «Rosneft»*

On March 31, NK «Rosneft», and the Ministry of Transport of the Russian Federation have entered into two agreements on cooperation. The first agreement provides for cooperation aimed at improving the road facilities and development of road service. The second agreement covers cooperation in regard to civil aviation fuel.

On April 10, NK «Rosneft» and AK «Transneft» have signed a bilateral agreement on oil supplies to China in order to implement the Agreement between the Government of the Russian Federation and the Chinese Government on cooperation in the oil industry. Also on 10 April NK «Rosneft» has early repaid from its own funds a credit in the amount of USD 577 million raised in the 4-th quarter of 2008 from Vnesheconombank.

#### *OAO «Rostelecom»*

On April 2, OAO «Rostelecom» has disclosed audited reporting for 2008 as per the RAS: revenues amounted to RUR 63,201.7 million.; net profit made RUR 7,072.0 million; OIBDA (revenues less expenses on regular activities without accounting for depreciation), compared with 2007 has increased by 19.7 per cent to RUR 14,312.8 million, profitability as per OIBDA made 22.6 per cent. On April 21, the Board of Directors of OAO «Rostelecom» has advised on dividends for 2008: on the preferred shares - RUR 2.9124 per share, on the ordinary shares - RUR 1.9410

per share. The total amount of dividend payments OAO «Rostelecom» for 2008 amounted to RUR 2 121.6 million (or 30 per cent of net profit).

#### *«Sberbank of Russia»*

On March 27 «Sberbank of Russia», in the framework of General Agreement on the opening of a revolving credit line, sined on October 31, 2007 has provided a credit to OAO «AK «Transneft» for about RUR 12,894 million. Credit funds are allocated for construction of the pipeline system «East Siberia - Pacific Ocean», which is designed for transporting oil from Siberian oil fields to a promising market in the Asia-Pacific region.

Also on March 27, «Sberbank of Russia», OOO «Sberbank Capital» and the Capital Group have informed they have signed agreements for restructure the loan of Capital Group, totaling over USD 400 million. On March 30, «Sberbank of Russia» has signed a credit agreement with FGUP «M.V. Khrunichev GKNPTS» on the opening of non-revolving credit line to get the government subsidy.

On April 21, «Sberbank of Russia» started to provide minor credits to small businesses. A minor credit is provided up to RUR 1 million for up to two years under the security of an individual - the owner of the business, and the term for making the decision on credit granting is reduced to two days.

On April 22, «Sberbank of Russia» has disclosed the financial results the 1-st quarter of 2009 under RAS: assets increased by 0.4 per cent to RUR 6,750 billion; net profit amounted to RUR 0.3 billion (RUR 36.1 billion as of the 1-st quarter of 2008). On April 24, «Sberbank of Russia» has provided to OAO «Gazprom» credit in the amount of USD 3 billion for the term of 5 years for the purpose of financing the acquisition of 20 per cent share in OAO «Gazprom Neft».

#### *OAO «Surgutneftegas»*

On April 9, OAO «Surgutneftegas» has completed the transaction to acquire 21.2 per cent share in Hungarian company Magyar Olaj-es Gazipari Nyilvanosan Mukodo Reszve-nytarsasag («MOL») from OMV Group in the framework of the agreement, signed between the companies on March 30, 2009

#### *OAO «Tatneft»*

On March 26, the Board of Directors of OAO «Tatneft», summarized the financial and economic activity results for 2008: profit before tax amounted to RUR 50 billion.

### **Corporate bonds market**

In April, after a short reduction in the first quarter, the volume of the domestic corporate bond market in Russia (as per nominal value of securities in circulation) has grown after and made RUR 1,692.0 billion, which is by 1.7 per cent more than the similar indicator of preceding month. Within the period from March 24 through April 23 there were concluded by 29.4 thousand of transactions with corporate bonds in MICEX, totaling to RUR 29.3 billion. (as compared with 29.4 thousand transactions for the total amount of RUR 34.3 bln from February 24 through March 23 of the current year)<sup>1</sup>, what is the confirmation of the investors' activity growth in the security market. For the third month in succession the index of corporate bonds IFX-Cbonds was growing again in the Russian market is growing, in the period from March 25 through April 23 the increase has made nearly by 6 points (or 2.9 per cent), having reached the maximum level since September of the last year. Here-

1 As per «Finmarket» information agency Илo

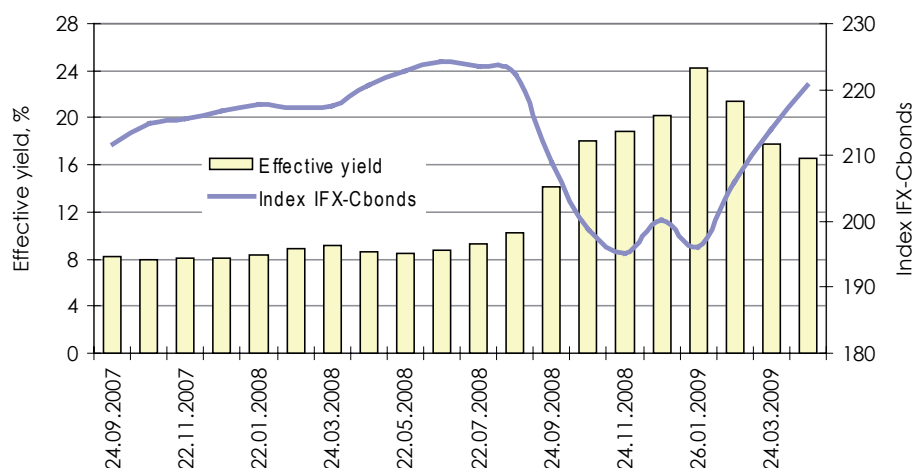


Fig. 6. Russian corporate securities index and average weighted yield dynamics<sup>1</sup>

with, the effective bonds yield has significantly decreased (from 17.22 per cent to 16.57 per cent), which is the minimum value within the last six months. (Fig. 6). The duration of corporate bonds market portfolio as of April 23 has reduced again and made was 41 days, what is 23 days less as compared with the late March of the current year (See Fig.6).

In April, the total number and amount of the registered corporate bonds issues has significantly increased. In the period from March 25 to April 23, there were recorded 12 issues of corporate bonds, totaling to RUR 78.98 billion, (as compared with that, from February 25 to March 24, seven issues totaling to RUR 21.5 billion were recorded). The bulk of the registered corporate bond issues was made by the two series of bonds, issued by OOO “VympelComInvest” for the total amount of RUR 30 billion and four series of long-term, secured by mortgage of OAO “Housing Mortgage Credits Agency” for the amount of RUR 28 billion.

In April the number and volume of corporate bond issues has grown again. In the period from March 25 through April 23 there were placed 11 issues for the amount of RUR 46.9 bln. (within the period from February 25 to March 24 only 7 bonds placement was made for the amount of RUR 1 billion) (See Fig.7). In the period under review, the large bond issues were placed by OAO «Russian Railways» (one series of bonds for the total amount of RUR 15 billion) and OAO “Gazprom Neft” (one series of bonds for the amount of RUR 10 billion),

as well as one emitter, OAO “System-Galls” has placed two inaugural bond issues. It is worth mentioning, that OAO “Russian Railways” has placed already three bonds issues in the last two months for the amount of RUR 45 bln .

In April a growth trend was noted in the number of issues, recognized invalid due to non-placement of any security. In the period from March 25 through April 23 the Federal Statistical Service

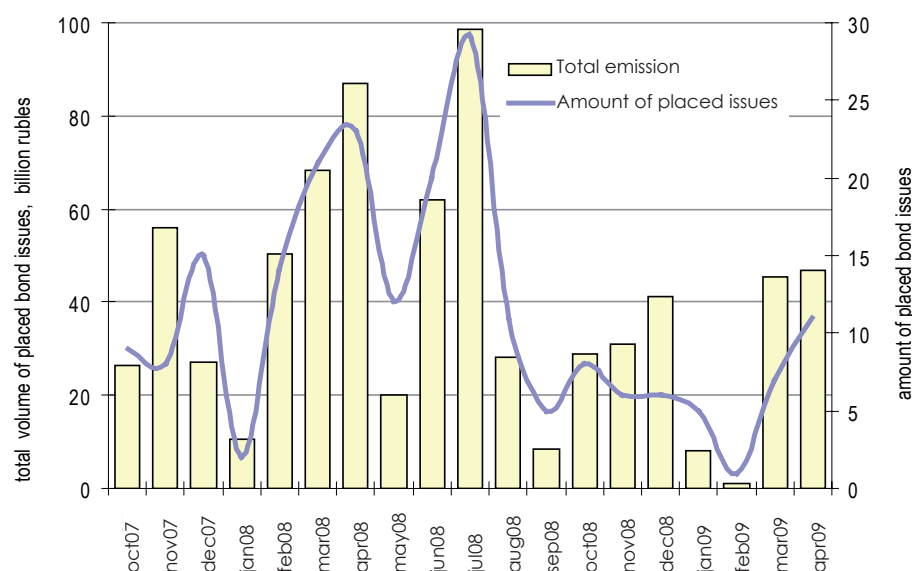


Fig. 7. Corporate securities primary placement dynamics<sup>2</sup>

1 As per Cbonds company data.  
2 As per Cbonds information



for Financial Markets of Russia has recognized as invalid six issues of corporate bonds, offered for public placement (versus four placements within February 25 – March 24). Within March 25 through April 23, only eleven emitters out of thirteen have redeemed the bonded loans totaling to RUR 10.3 billion, including OAO “AVTOVAZ” redemption of two series of the stock market bonds in the amount of RUR 2 billion. Two more emitters have announced a technical default on repayment of their bonds, totaling to RUR 3.0 billion. In May 2009 thirteen issues of corporate bonds redemption for the amount of RUR 15.2 bln is expected.

In April, like in preceding months, a large amount of defaults and delayed performance of obligations (technical default) was recorded, though there was a trend to their number decrease. From March 25 through April 23 the default on offer (bonds redemption) was announced by two emitters (within February 24 to March 24 there were three emitters) and five emitters have failed to repay the coupon yield (there were eight of those in the preceding period). There were no real defaults in redemption of the bonds in the period under review. ●

## REAL ECONOMY SECTOR: TRENDS AND FACTORS

O.Izryadnova

*In the 1<sup>st</sup> quarter 2009 the GDP was 90.5% of the level of the corresponding period of the previous year and the recession turned out to be deeper than it was expected according to the estimations by the Ministry for Economic Development published earlier. In the 1<sup>st</sup> quarter 2009 the reduction in the volumes of the investments in fixed assets made 15.0%, of the industrial production – 14.7% and retail trade turnover – 1.1%. The Ministry for Economic Development corrected the forecast indices for 2009: GDP will decrease by 6.0% as compared with 2008.*

According to the preliminary estimations of the Ministry for Economic Development the GDP in the 1<sup>st</sup> quarter 2009 will decrease by 9.5%. At the beginning of 2009 the macroeconomic situation was formed under the influence of the simultaneous contraction of the external and the internal market accounted for by the accumulated effect of the factors of low business activity of the domestic business and of the contraction of the monetary incomes of the population. Over January-March 2009 contraction of the investments in fixed assets made 15.0%, of the retail trade turnover – 1.1%, of the real incomes of the population – 2.3%. The unfavorable trends of the external economic activity formed in the 4<sup>th</sup> quarter 2008 continued to exert a negative influence on the situation in the economy in the 1<sup>st</sup> quarter of 2009.

Table 1

PRODUCTION INDICES BY KINDS OF ECONOMIC ACTIVITIES IN 1<sup>ST</sup> QUARTER OF 2007-2009,  
AS PERCENTAGE TO THE CORRESPONDING PERIOD OF PREVIOUS YEAR

	2007	2008	2009
Industry	107.2	106.2	85.7
Minerals extraction	104.0	100.7	96.2
fossil fuels extraction	103.8	102.7	100.4
minerals extraction, excluding fossil fuels	107.9	92.2	96.2
Processing industries	114.5	108.7	79.2
foodstuffs production, including beverages and tobacco	113.7	106.4	96.7
textile and sewing industry	110.8	102.6	78.8
leather, leather goods and footwear production	118.7	106.6	83.0
timber processing and wooden goods production	111.0	115.6	70.8
pulp-and-paper production, publishing and printing	110.8	107.8	82.0
coke and oil products production	106.0	105.0	96.3
chemistry production	110.6	103.7	77.6
rubber and plastic goods production	124.1	130.4	82.7
other non-metal mineral goods production	125.8	108.6	67.8
metallurgy production and production of finished metal goods	108.2	108.6	72.3
machinery and equipment production	126.0	116.4	74.3
electric, electronic and optical equipment production	123.7	93.3	56.6
transport vehicles and equipment production	116.4	114.4	64.5
other production	112.9	118.6	79.3
Electricity, gas and water production and distribution	93.3	105.6	94.9

Source: Federal State Statistics Service

Economic dynamic this year was defined by the decrease of the rates in practically all kinds of economic activities. Over January-March the recession in the production made 14.3%, being 3.8% in minerals extraction and 20.8% in the processing industries. The absolute decrease in production output volumes defined the contraction of the demand for the services of the natural monopolies. The volume of freight turnover reduced by 18.6%, the railway transport turnover decreasing by 25.8%, the electricity, gas and water production and distribution – by 5.1%, electricity production decreasing by 5.7%, natural gas production – by 14.7%.

As a result of the change in the situation at the external markets and the contraction of the internal demand at a number of enterprises of the timber complex production and shipping of goods was interrupted. As a result in January-March 2009 the volume of the timber processing and production of wooden goods made 70.8% of the index of the previous year, and the volume pulp-and-paper production, publishing and printing made 82.0%.

Production of chemistry industry reduced by 22.4% as compared with January-March 2008, the recession in the production of fertilizers aggravating to 26.7%. The reduction in the production of the pharmaceutical industry by 16.9% versus the first quarter of 2008 is especially worrying.

In the situation when the share of the Russian medications at the market makes 20-25% according to various estimation, and the production of a number of medication highly depends on the supplies of substances by foreign producers, reduction of medications import by 2.8% in January-February of the current year, and of the pharmaceutical production by 11.1% versus the corresponding periods of 2008, defined negative background for the domestic pharmaceutical industry.

Index of the production of the construction materials over two months of the current year made 66.2% versus January-February 2008, cement production – 61.5%, concrete constructions – 66.4% under the influence of the contraction of the workload in construction by 18.8%.

The decrease in the volumes of the metallurgy production by 28.4% in January-March 2009 as compared with the corresponding period of the previous year and in the volumes of metal goods production – by 26.4% is accounted for by the contraction of the demand of the internal market and the contraction of the export supplies. The demand of the internal market for metals and metal goods is not provided by the development rates of such metal-consuming productions as machine-building, defense, construction, fuel and energy complexes. Index of machinery and equipment production made 74.3%, of transport vehicles and equipment production – 64.5%, of electric, electronic and optic equipment production – 56.6%. Besides the situation in metallurgy was aggravated by the contraction of the demand from the production of construction materials. Under the influence of the drop in the workload in construction by 19.7% versus the 1<sup>st</sup> quarter 2008 the output of the reinforced concrete construction decreased by 42.8%.

A considerable decrease in the promising projects in constructions, curtailment of programs on modernization and technical re-equipment and contraction of the consumer demand continue to have a negative effect on the dynamics of the machine-building complex.

In the production of machinery and equipment, the production of mechanical equipment growing by 17.3% versus the 1<sup>st</sup> quarter of 2008 (due to the output of the turbines for power industry), the output of machine tools and equipment for metallurgy and extractive industries reduced by nearly 2/3, of machinery and equipment for agriculture and forestry – by 29.9%, production of household appliances – by 23.7%.

The recession in the production of transport vehicles and equipment is defined by an unexampled contraction in the output of the motor vehicles, trailers and semi-trailers

– 37.5% of the level of the 1<sup>st</sup> quarter of 2008. In the 1<sup>st</sup> quarter of 2009 the output of trucks made 24.6% as compared with the corresponding period of the previous year and of passenger cars – 37.1%. Such a large-scale contraction of production concerned all the market of material and technical resources through the system of interbranch connections and had an exceedingly negative effect on the nature of employment in the processing industries on the whole.

Contraction of the consumer demand, shortage of liquid funds necessary for the purchase of the raw materials, high cost of credit resources as the main factors for the sharp decrease of the productions of the consumer complex have been in effect since the second half of 2008. In January-March 2009 the index of textile and sewing production made 78.8%, leather, leather goods and footwear production – 83.0%, foodstuffs production – 96.7% of the corresponding period of the previous year. Taking into account the fact that during past three years the proportion of the domestically produced goods in the structure of the resources of the retail trade turnover has been decreasing systematically, and made 55% in 2008, the reduction of the foodstuffs and non-food goods production against the background of the strengthening of the trend for the reduction of import of foodstuffs and raw materials for their production – by 7.1%, of sewing goods and footwear – by 14.8% in March 2009 as compared with the corresponding period of the previous year will have a negative influence on the functioning of the retail market.

The general situation of the crisis is characterized by a rapid growth of the unemployment against the background of the decrease of the level of wages. In the 1<sup>st</sup> quarter 2009 the number of the employed in the economy reduced by approximately 2.2 million of people as compared with the corresponding period of the previous year and made 67.6 million of people. The total number of the unemployed classified in accordance with the methodology of the International Labor Organization made 7.1 million of people in the 1<sup>st</sup> quarter of 2009 or 9.5% of the economically active population. The number of the officially registered unemployed in the state employment services made 2177 thousand of people in the 1<sup>st</sup> quarter of 2009, having increased by 930 thousand of people as compared with the 3<sup>rd</sup> quarter 2008.

The situation at the labor market is aggravated by the influence of such negative factors as low interprofessional mobility, contraction of the possibilities for secondary and informal employment. Besides, a part-time employment has been increasing because of the employees being transferred to the regime of part-time employment and forced holidays. According to the data of the monitoring conducted by the Ministry for Health Care and Social Development of the Russian Federation, just over the period from February, 26 to March 4, 2009 more than 4400 declared a part of their employees being transferred to the regime of part-time employment, and forced holidays. The total number of such employees made 1072.1 thousand of people. The alternative for the employment is the registered unemployment. Taking into account the increase in the maximum value of the unemployment benefit, a part of the unemployed employees leave the labor market. As a result of the 1<sup>st</sup> quarter of the current year the level of the registered unemployment made 2.9% against 2.7% in February and 2.3% in January. In the 1<sup>st</sup> quarter 2009 1.9 million of people received the unemployment benefit.

The tension coefficient (number of unemployed citizens registered at the state employment services per one vacant post) has increase from 1.5 in February 2008 to 2.7 in February of the current year. The demand for the employees declared by the employers to the state employment services reduced by 289 thousand of people by the end of February as compared with the similar month of the last year, the number of vacant positions being 875 thousand of people at the end of February 2009.

Under existing trends the Ministry for Economic Development corrected the forecast figures for 2009: the volume of the industrial production is estimated to be at the level of 89.9% of the figure of 2008, the investments in fixed assets – 78.9%. under such conditions the GDP will reduce by 6.0% as compared with 2008. The forecast for the growth of prices remains at 13%.

## RUSSIAN INDUSTRY IN APRIL 2009

S.Tsukhlo

*Stabilization of the rates of demand and output increase disappointed the industry. The hopes for quick stabilization were not justified – the industry is again getting ready for the increase in the demand and output growth rates and the decrease of sales prices. The emotional reaction after the harsh landing of the first months of the crisis is replaced by sober judgment and attempts to forecast the “life after the crisis. In April credits availability has grown and the capacity to pay for them – lowered.*

### March Statistics

Data of the Federal State Statistics Service again do not allow estimating the dynamics of the Russian industry. On the one hand, in March 2009 there was 13.9% less production made than in March 2008 but in February the result was a bit better: the decrease on the previous year made 13.2%. However the difference in the number of working days and the fact that 2008 was a leap year complicate the comparison. Another problem is the “effect of the base”: in March 2008 the production increased by 6.4% versus the growth of 3.2% in February 2008. In March of the current year, according to the calculations of the Center for Macroeconomic Analysis and Short-Term Forecasting (CMASTF), the decrease in the index of average daily production was 16.9%. In February 2009 the decrease was equal to 16.1%. The recession has obviously deepened. On the other hand, exclusion of the effect of the base made CMASTF estimate the decrease in the average daily production index to be 14.4% in March 2009. This means that the recession has alleviated as compared with February.

Exclusion of the seasonal and calendar factors made by CMASTF demonstrates the growth of production in March by 1% versus February 2009. And in February the production went up by 3.8% as on January. Thus, the conclusion of the experts is that the recovery of the production volumes continued in March though it was weaker than in February.

### Demand: Factors, Forecast and Satisfaction

The decrease in the demand for the industrial production in April continued, but with less intensity than in March. The improvement of the sales decrease rates (according to the initial data) made 5 points (improvement of 7 points in March and of 32 points in February). The change in the dynamics of sales occurred due to the reduction in the proportion of the answers “decreased” and the corresponding growth of the answers “did not change”. Whereas in February the proportion of the latter responses was 45%, in April it went up to 55%. Before the crisis this index fluctuated within 60-65%, and the crisis minimum is 30% (December 2008). Only 12% of enterprises report on the growth of production in February-April. However the exclusion of the seasonality demonstrates the stabilization of the demand decrease rates in four last months. In other words, since January the sales of the industrial goods has been decreasing at the constant rate – there have been no changes (either positive or negative), despite the calls and actions of the government to stimulate the demand. However the stabilization of the situation can itself be regarded as a success under the existing conditions.

At the level of the branches of the industry the positive trends in sales dynamics were registered (after exclusion of seasonality) only in chemistry industry, where the decrease

in the demand ceased in April. In other sectors the reduction goes on, and is most intensive in the industry of construction materials production, foodstuffs production and machine-building industry.

The forecasts for the changes in the demand returned to the level of December-January. The industry has lost the hope to slow-down the decrease in sales, which evolved in February-March, and is again getting ready for the rise in demand contraction rates.

The lack of appreciable progress in the dynamics of sales and the growth of pessimism in the forecasts made the enterprises correct their estimations for the satisfaction with the volumes. In April the proportion of the responses "normal" reduced by 5 points at once after the stabilization at the level of 23% during four previous months. As a result in April the satisfaction with the demand dropped to the figures which have been the worst since March 1999. This is primarily due to the metallurgy industry (decrease of 16 points), foodstuffs industry (of 9 points) and the machine-building industry (6 points).

### **Output and Prices**

In April initial (before the exclusion of seasonality) data demonstrated the slow-down in the growth of output to +1 balance points versus +11 in March. The exclusion of seasonality (and, consequently, obtaining of the figures compared by the time) demonstrates the stabilization of the production decrease rates at practically the same level (-17...-15) since January. Thus, the intensity of the changes in the output, as well as that of the demand has not been subjected to significant changes since the beginning of the year.

On the whole the industry quite distinctly connects the changes in its production to the changes in the demand. At microlevel the production followed the demand most closely in November-December 2008. Then 80% of the enterprises reported the same dynamics of production and demand. There has not been such a close connection between the demand and the output since the start of the monitoring in 1993. By April 2009 the figure lowered to 62%, which is even worse than the average figure for the pre-crisis a year and a half. The proportion of the enterprises at which the changes in the output anticipates the changes in the demand has increased from 15% in November 2008 to 30% in April 2009. It seems that the industry has counted on making a quick way out of the drop at the end of 2008 and started to increase the production in advance, which was a mistake.

The change in the enterprises' production plans testifies this thesis. In April the industry significantly corrected the production plans for the next two months: the supposed rate of the decrease in the production worsened by 7 points at once and returned to the level of December-January. Microcalculations demonstrate that the euphoria of two preceding months, which resulted in the gap between the production plans and the demand forecasts, is disappearing. In April 77% of the enterprises planned their output in accordance with the demand forecasts. There were only 72% of such in April. The highest coincidence of the supposed change in the demand and the output for the whole period of the monitoring (88%) was also registered in December 2008.

Absence of positive trends in the dynamics of the demand makes the enterprises again turn to the price tools in the competition for customers. In April the industry decreased the prices at the same rate as in January 2009. The biggest drop of the sales prices was registered in ferrous metallurgy, industry of construction materials, machine-building and foodstuffs production.

Price plans of the enterprises also were considerably corrected in April. After 2 months of hopes for the increase in prices the enterprises had to plan their decrease or slower growth. Such a reconsideration of the price policy did not occur only in chemistry industry, machine-building and timber industry.

### Obstacles for Industrial Growth

The dynamics of obstacles for production growth in the Russian industry demonstrates that the emotional reaction of the first months of the crisis gives the way to the sober judgment and the attempts to forecast “the life after the crisis”. One can so interpret the absence of the growth or even the decrease in the frequency of citation of the crisis obstacles for the increase in the output and the stop of decreasing or even the increase in the frequency of non-crisis obstacles citation.

Low demand, which plummeted to the first place in the rating of obstacles in January 2009, did not change its limiting influence on the Russian industry and remained at the level of 67% of citations. Certainly it retained the first place and exceeded by more than two times the result of a year ago. Then the insufficient demand was considered an obstacle by 30% of enterprises. The second place, considerably behinds the leader, is shared by three obstacles: “uncertainty of the current economic situation and its prospects” (45% of citations), “lack of liquid funds” (44% in April, 45% in January 2009 and 50% in October 2008) and “low export demand” (42%, 35% and 22%, correspondingly). The liquid funds, which is the most popular (at least by the level of its discussion) of these obstacles, is now less worrying than a half a year ago, when the banks reduced dramatically the credits for the industry. The fifth place is held by the non-payments of consumers, cited at 38%. The influence of this obstacle also decreased over the past quarter. It is the ferrous metallurgy (454% of enterprises), machine-building (41%) and light industry (40%) that suffer most from this phenomenon, which was nearly forgotten in 2003-2008.

Russian non-crisis obstacles for the production growth (equipment, staff, problems with import) also stabilized after a sharp drop in October 2008 and January 2009. Now import is an obstacle for 15% of enterprises versus 13% in January 2009 and 31% in July 2008 (the latter figure being the absolute maximum). It is most frequently cited in the ferrous metallurgy (29%), foodstuffs production (24%) and machine-building industry (19%). The lack of equipment and staff prevents 13% of enterprises from increasing the output in the 2<sup>nd</sup> quarter of 2009. At the same time the shortage of machine tools and equipment was minimal (for the past ten years) in the 1<sup>st</sup> quarter of the current year (9%), while the frequency of citation of the shortage of staff decreased by only 3 points after the drop of 28 points a quarter ago. The latter testifies that the industry seems to be busy with the problem of labor efficiency. In fact a year ago the labor efficiency was considered as low by 28% of enterprises, whole at present – by 54%. The figure has nearly doubled.

### Stocks of Finished Products

Estimations of stocks of finished goods worsened by 4 points in April and returned to the level of December-January, which have been the worst months of the crisis by this index.

The weakening of hopes to improve the dynamics of the sales and the sudden reconsideration of the production plans of enterprises have definitely affected this subjective but quite sensitive indicator of the situation. However, the worst estimations of the stocks during this crisis (27 points) are far from the maximum of the first half of 90-ies. In 1993-1994 the industry let the excessive finished stocks plummet to 40-47 points but it has learned its lesson and decreased the level of the local maximum every sales crisis that followed. The industry derived the benefit from the lesson.

In April the worsening of the general estimations of finished stocks was mainly due to metallurgy, machine-building, industry of construction materials and foodstuffs industry.

### Credits

In April the availability of credits for the industrial enterprises went up by 8 points and currently is equal to 31%. In December 2008 this figure was 17% (which is the absolute



minimum for all the period of monitoring since 2000). The change in the crediting policy of banks, however, concerned mainly very large (more than 1000 employees) enterprises, whose normal access to the borrowed funds went up to 36%. Small-and medium-scale enterprises (up to 250 employees) have not felt any changes so far, in contrast: only 13% of producers of this category had normal access to credits in April as compared with 16-17% in December-February.

The growth of the availability of credits concerned all the branches of industry, except the light industry. The absolute levels, however, differ by nearly three times. Whereas in the metallurgy, chemistry industry and foodstuffs production 41-45% of the enterprises have normal access to credits, in timber industry and industry of construction materials production there are only 16% such. The banks are willing to give credits only to 30% of machine-building factories and 24% of foodstuffs production enterprises.

The possibilities to pay for the credits in the industry decreased by 5 points over the month and now make 53% of the total number of enterprises having credits. The highest paying capacity is characteristic for foodstuffs production (81% of enterprises), metallurgy industry (78%) and light industry (75%). ●

## FOREIGN TRADE

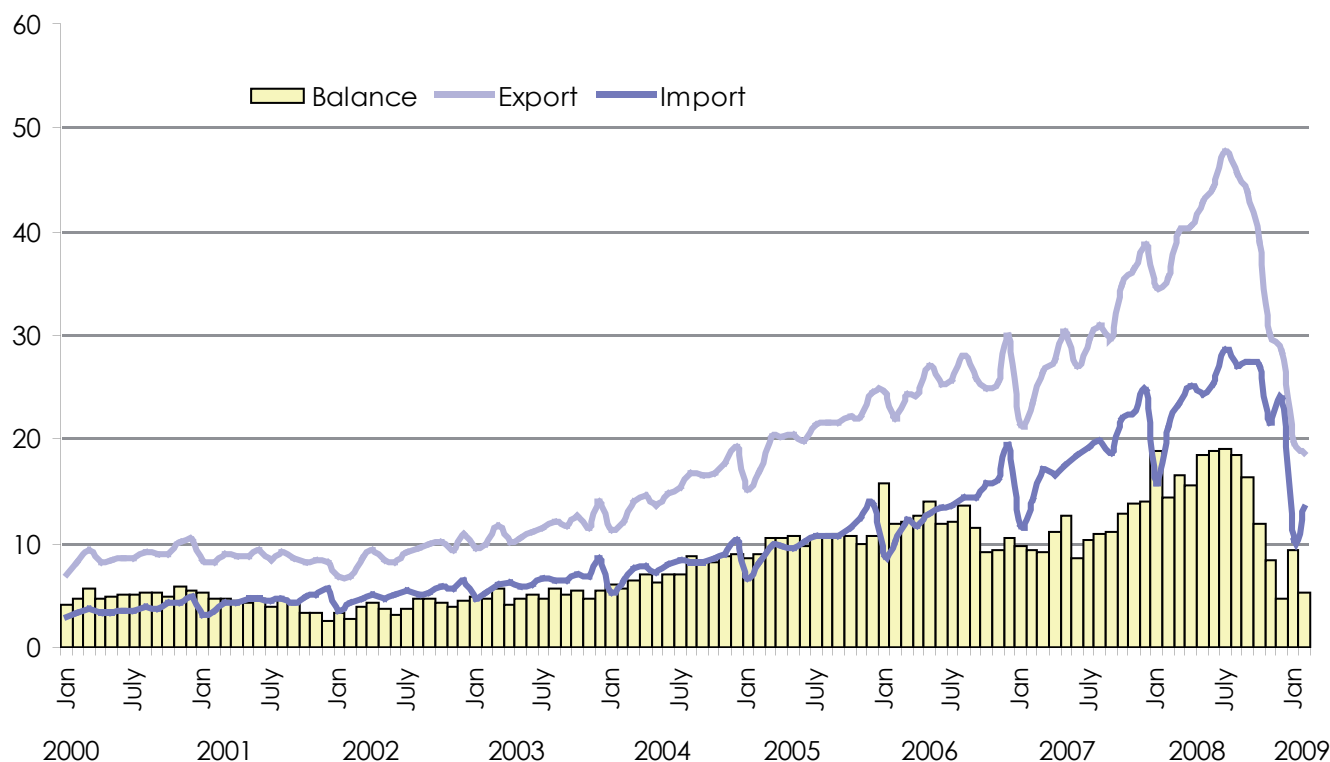
N.Volovik

*The worsening of the situation at the world market and the drop of the solvent demand inside the country resulted in a considerable reduction of the main indices of the Russian foreign trade at the beginning of 2009.*

*In order to protect Russian enterprises assembling liquid crystals television sets, starting with May import duty rates for liquid crystals television sets will be increased by one and a half times – from 10 to 15%.*

In February 2009 the Russian foreign trade turnover calculated on the basis of the balance-of-payment methodology was equal to USD 32.1 billion, being 43.4% below the figures of February 2008. Export made USD 18.7 billion, which is a bit more than a half of that of the previous year. As compared with January, export went up by 4%. Import made USD 13.4 billion, which is 36.5% below the figures of the previous year, but 30% above the figures of this January. Due to the accelerated decrease in export figures, trade balance reduced down to USD 5.3 billion, as compared with USD 14.5 billion in February 2008 and USD 9.4 billion in January 2009.

In February world prices for the most kinds of the fuel commodities and raw materials continued to decrease. As compared with the previous month only reinforcing steel, copper and some kinds of fertilizers went up in price.



Source: Central Bank of Russian Federation

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

In February 2009 the average price for oil grade Brent decreased by 52.7% as compared with February 2008, and by 4% as compared with January 2009. Over the period from February 15 to March 14 the average price for oil grade Urals made USD 42.035 per barrel. As a result export customs duty rate for crude oil was lowered from USD 115.2 per ton to USD 110 per ton from April 1, 2009. Duty rates for light oil products were lowered from USD 90 per ton to USD 86.4 per ton, and for dark oil products – from USD 48.5 per ton to USD 46.5 per ton.

At the world market of non-ferrous metals there are no significant changes expected in the forthcoming time. The worsening of the economic situation and the decrease in the demand for metals is observed.

At the beginning of February 2009 some increase in prices was observed at the aluminum market. Over the first part of the month the metal went up in price from USD 1316 per ton to USD 1422 per ton, that is nearly by 8%, but by the middle of the month the prices went down to USD 1340 per ton and by the end – to USD 1290 per ton. However in March the prices recovered and on March 26 they went up to USD 1409 per ton. It is the excessive supply of this metal at the world market with a consequence of the accumulation of the large world stocks of the metal, which, according to the International Aluminum Institute, reached 1.676 million of tons in December 2008 – record-breaking level of the past half of the year,- that has a considerable pressure on the prices for aluminum.

In February 2009 prices for copper fixed around the mark of USD 3350 per ton, that is exceeded the level of January. A sharp drop of prices for copper is also a consequence of the excessive stocks of the metal at exchanges, which was made possible by the excessive supply of the metal at the world market, which was mainly accounted for by the inertia expansion of facilities in the mining sector.

The prices for nickel reached USD 11650 per ton in the first days of February. For nearly all the first ten days of the month they remained at the level of USD 11000 per ton, but then they dropped by 12% - down to USD 10135. By the end of February the prices dropped to USD 9650-9675 per ton. The prices for nickel are also under the pressure of the relative overproduction of the metal in the world.

In February 2009 as compared with February 2008 average world prices for non-ferrous metals at the London Metal Exchange (LME) decreased: prices for nickel – by 2.7 times, prices for copper – by 2.4 times, prices for aluminum – by 2.1 times; as compared with January 2009 prices for copper went up by 2.9%, prices for aluminum – decreased by 5.9%, prices for nickel – by 7.9%.

Table 1

## AVERAGE MONTHLY WORLD PRICES IN FEBRUARY OF CORRESPONDING YEAR

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Oil (Brent), USD/barrel	15,0	10,8	26,9	27,2	20,3	32,1	30,9	44,8	59,7	58,26	92,66	43,87
Natural gas, USD/1 mln BTU	1,994	2,036	2,828	5,642	2,260	6,367	5,407	6,242	6,128	7,606	8,58	4,414
Petroleum, USD/gallon	0,508	0,524	0,934	0,882	0,616	1,045	1,045	1,37	1,734	1,662	2,48	1,262
Copper, USD/ton	1673,3	1414,8	1779,1	1811,4	1601,5	1705,9	2759,0	3254	4982	5671,1	7887,7	3314,7
Aluminum, USD/ton	1479	1188,1	1584,2	1602,1	1370,8	1428,04	1685,6	1883	2455	2759,14	2776,9	1330,2
Nickel, USD/ton	5462,2	4629,4	10269,6	6544,6	6042,7	8619,64	15178,3	15350	14979	41154,5	27955,5	10409

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

Unfavorable situation at the world market for the Russian export accounted for the reduction of its volumes. In January-February 2009 export was equal to USD 36.7 billion, or 52.3% of the corresponding figure of 2008.

Decrease in value volume of the Russian export took place as a result of both the decrease in prices for export goods and the decrease in the physical volumes of the export supplies. In February 2009 index of average prices was equal to 57% of the level of February 2008, whereas the index of the physical volume reduced to a less extent and made 91.2%.

In connection with the considerable drop in contract prices for oil and oil products the share of fuel and energy commodities in the total volume of the Russian export decreased down to 66.4% versus 71.2% in January-February 2008. The proportion of oil export in the total volume of Russian export in January-February 2009 made 31.8%, in the export of fuel and energy commodities – 47.9% (36.1% and 50.7%, correspondingly, in January-February 2008).

The value of export of chemistry and rubber industry production reduced by 36.3%, which was accounted for by the decrease in the rubber value export by 3.1 times, ammonia – by 2.3 times, methanol – by 7.6 times.

Export of metals and goods thereof reduced in terms of value by 42.1%. The reduction in the value volume of export of these kinds of goods was influenced by the decrease in purchase of cast iron, half-finished products of iron and plain steel, flat rolled metal – due to the reduction in the physical volumes and prices, as well as by the decrease in purchase of copper, unprocessed aluminum and unprocessed nickel – mainly due to the reduction in average contract prices.

Export of timber and pulp-and-paper goods reduced by 44.7% due to the decrease in the physical volumes of the main goods of this group – processed and unprocessed timber by 1.7 and 2.9 times, correspondingly.

Export of machinery, equipment and transport vehicles (in terms of value) reduced by 40.8%. Export of passenger cars decreased in terms of physical volume by 25 times and of trucks – by 4 times, contract prices growing by 2.5 and 2.9 times, correspondingly.

In January-February import made USD 23.8 billion or 64.5% of January-February 2008. At the beginning of 2009 the reduction of the Russian import was accounted for by both the reduction in average prices of import goods and by the drop of the physical volumes. Average import prices in February 2009 reduced but negligibly as compared with February 2008, their index being 97.5%, whereas the index of import physical volume reduced to 66.7%.

Import reduced nearly for all the trading positions. Machine-building production is among the leaders of the decrease, its import supplies reducing by 46.9%. This was mainly due to the reduction in purchase of the overland transport vehicles by 3.2 times, of electric equipment – by 46.5%, of mechanic equipment – by 38.2%, of optic instruments and devices – by 32.7%.

In January-February 2009 the volume of the import of transport vehicles in Russia reduced down to 80.6 thousands of vehicles versus 294.3 thousand a year ago. The import of used cars decreased dramatically. According to the data of the analytical agency “Avtostat”, in February import of used cars reduced by 64.3% versus the indices of the corresponding period of the previous year. In February 2008 there were 54 800 passenger cars imported in Russia, which is nearly twice as much as the figures of January 2009. Due to the increase in customs duty rates for import of the used cars, their import has nearly ceased: the proportion of the used cars in the total import of January made 10%, and in February it did not exceed 0.6%.

Russian import of foodstuffs reduced by 21.8% in February 2009 as compared with February 2008.

In January-February 2009 import of beef in the Russian Federation reduced by 40% versus the corresponding figure of 2008 – down to 39 thousand of tons. Over the same period pork import reduced by 31% - down to 53 thousand of tons, and import of poultry 0 by 18% , down to 92 thousand of tons.

Besides the influence of the seasonal factor such dynamics is connected with large stocks of goods transferred to the beginning of the year, shortage of liquid funds at the majority of the participants of the foreign economic activity, unavailability and high interests rates of the commercial credits and the expected decrease in the demand for finished goods and fresh meat. In addition, the volume of the import was influence by the worsening of the financial situation of a number of the meat-processing enterprises, which are the main consumers of the import beef and pork, and that have a considerable unsettled debt to the suppliers of the raw materials.

At the same time import of pork and beef by-products indicates that the demand for the cheap kinds of the animal protein has increase and the consumer preferences have changed. Thus, pork by-products import increased by 23% in February 2009 as compared with the same period of 2008. In January-February 2009 supplies of beef by-products increased by nearly 20%.

In terms of value import of fish reduced by 31.2% - down to USD 115.6 million. Supplies of sugar in Russia reduced by 27% (to USD 28.3 million), of dairy products – by 36.9%. Import of alcoholic and alcohol-free drinks went down by 55.4% down to USD 61.2 million, of tobacco – by 28.7% down to USD 69.5 million. The supplies of vegetables reduced to the smallest extent – only by 8%. Supplies of fruit (in monetary terms) remained at nearly the same level as in the previous year.

In accordance with the decree of the Government of the Russian Federation from March 31, 2009 No 273 “On temporary customs duty rates for some kinds of collective aperture for televisions communications”, stating with May import duty rates for LCD television sets are increased by one and a half times – from 10 to 15%.

The increase of duty rates was on the request of the enterprises assembling well-known world brands Panasonic, Philips, Hitachi, Sony, Samsung, Hyundai, JVC in the special economic zone of Kaliningrad district. A sharp drop in the orders caused by the aftermaths of the world crisis had already led to the stop of production at a number of enterprises in the special economic zone of Kaliningrad, which made the directors of the enterprises ask the Government for 25% import duty rates. Import duty of 10% that is still in operation cannot protect the assembling of the LCD television sets in Russia from import competition.

The Government however did not go beyond the increase of import duty to 15%. As a matter of fact, the enterprises located in Kaliningrad district enjoy the preferences that are the result of their status of the residents of the special economic zone. For instance, the rules of the customs registration let them import components for assemblage enterprises duty-free.

Duty rate of 25% would be apparently barring since import LCD television sets would become 10-20% more expensive, whereas now the growth of prices for import analogues will make 5-7% of the current price in the foreign exchange. The prices for the television sets assembled in Russia will grow less, and this will stimulate the purchase of goods assembled domestically. ●

## BUDGETARY AND TAX POLICY

O.Kirillov

*The estimated level of the RF federal budget revenues in 2009 is clearly beyond the capacity of financing in a balanced way, while in future, annual budgets deficits are also expected to be deficit ones. It is estimated, in the situation like that, the reserve fund assets can be insufficient for the complete term of overcoming the effects of the global financial crisis.*

The RF Ministry of Finance has prepared a draft of the major trends of the RF tax policy, which proposes a number of innovations, aimed at creating more favorable tax environment for the growth of national economy.

Table 1

BASIC INDICATORS OF THE RF FEDERAL BUDGET EXECUTION IN 2007 – 2009 (% OF GDP)

	2007	February 2008	2008	February 2009	February 2009 <sup>1</sup>
Revenues	23,9	25,9	21,8	23,65	18,40
Expenditures	18,4	16,8	17,8	21,09	21,09
Deficit (-)/ Surplus (+)	5,5	9,1	4,0	2,6	-2,69

Source: RF Ministry of Finance

*Table 1* presents the basic parameters of the federal budget execution in 2007-2009, and, as can be seen, with a relatively stable level of budget revenues in January-February 2009, the budget expenditures have increased, the budget expenditure scope was just over 21 per cent of GDP. Maintaining this level of expenditure during the year will lead to the federal budget deficit, because due to the financial crisis, one cannot expect the sustained high level of the budget revenue, like in the first quarter of 2009, and as of the end of the year result.

It is important to note, that if the RF budget revenues from the management of the Reserve Fund and National Welfare of 2008 are not taken into the account, the Russian federal budget should be disregarded, the RF budget is in deficit already from January of the current year. Revenues from those funds management, accounted in budget revenues for January-February 2009, have amounted to 4 per cent of GDP and 1.3 per cent of GDP, accordingly. Moreover, it should be noted, that in the first quarter of the current year, the GDP should get reduced, and according to some estimates, it has already decreased by 9 per cent.

As of the results of January-February 2009, revenues from export customs duties decreased by nearly 4 per cent of GDP, as compared with a similar indicator of preceding year, while this is the most profitable source among other federal budget lines, which ensures about 20 per cent of the total tax revenues. Within the same period, mineral extraction tax, which makes about 10 per cent of budget revenues, has declined by 2.7 per cent of GDP. The tax on corporate profit tax, taxes on goods, imported to the territory of the RF and import duties have been decreased by less than 1 percentage point in the period under review. The value-added tax on goods sold in Russia made the exception. Revenue from that tax have grown by 2.2 per cent of GDP and nearly 2-fold in nominal terms. However, this is not related with improvements in VAT collection, but is due to the

amended procedure of this tax, payment, as since early 2008, VAT payments have to be made quarterly.

Table 2

## MAJOR REVENUE LINES OF THE RF FEDERAL BUDGET WITHIN 2006 – 2009 (% IN GDP)

	2007	February 2008	2008	February 2009
<b>TOTAL BUDGET REVENUES</b>	23.91	25.89	21.84	23.65
1. Corporate income tax	1.97	1.40	1.79	0.54
2. Unified social tax	1.24	1.26	1.19	1.29
3. Tax on goods and services, sold in the Russian Federation territory	4.61	3.07	2.65	5.09
3.1. Value-added tax	4.27	2.66	2.35	4.88
3.2. Excises on excise goods	0.33	0.41	0.29	0.21
4. Taxes on goods imported into the territory of the Russian Federation	2.76	2.70	2.75	2.22
4.1. Value-added tax	2.68	2.62	2.67	2.17
4.2. Excises on excise goods	0.08	0.08	0.08	0.05
5. Tax on mineral extraction	3.45	4.85	3.78	2.20
6. Import duties	1.50	1.45	1.47	1.22
7. Export duties	5.64	8.52	6.73	4.56

Source: RF Treasury, IET estimates

As to the expenditures of the federal budget, relatively high level of them was demonstrated by actually all revenue lines in GDP shares, which have exceeded the indicators of the relevant period of 2008. The items of Social Issues and Social Politics were exceptional: there were changes by - 0.6 per cent of GDP and -0.4 per cent of GDP, accordingly. The utmost growth in financing occurred on the National Economy (+ 1.9 per cent of GDP) and Intergovernmental Transfers (+ 1.8 per cent of GDP). Let us note, that such a change in the intergovernmental transfers took place mainly due to the growth of transfers to the RF Pension Fund by 1.5 per cent of GDP, as to compared with January-February of the preceding year. Moreover, the increased amount of intergovernmental transfers is due to advanced transfer of financial resources to the regions.

Table 3

## BASIC RF BUDGET REVENUES IN 2006 – 2009 (% VERSUS GDP)

	2007	February 2008	2008	February 2009
<b>TOTAL BUDGET EXPENDITURES</b>	18.39	16.80	17.82	21.09
Federal issues	2.50	2.64	1.97	2.01
Including expenditures associated with the servicing of federal and municipal debt	0.44	0.44	0.36	0.58
National defense	2.56	1.94	2.45	2.40
National defense and law enforcement	2.05	1.96	1.97	2.58
National Economy	2.13	1.06	2.41	2.96
Housing and public utilities	0.91	0.004	0.30	0.05
Environmental protection	0.03	0.01	0.02	0.02
Education	0.91	0.52	0.84	0.67
Culture, cinematography and mass media	0.22	0.16	0.21	0.23
Health care and sports	0.60	0.37	0.66	0.57
Social policy	0.66	0.90	0.69	0.54
Interbudgetary transfers	5.84	7.24	6.30	9.07

Source: RF Ministry of Finance, IET estimates.

According to Alexey Kudrin, the RF Minister of Finance, the period of growth in budget revenues is completed, and in 2010 and in 2011 the budget revenues should be reduced in nominal terms on a number of functional directions. In the forthcoming years the revenues have to be supported in real terms at a sustained level in many economic branches, but however, public financing programs will have to be reduced by a number of industries. Nevertheless, it is expected that in 2010 and in 2011, the RF budget will be kept up roughly at the same level as in 2009 in nominal terms, and the federal budget deficit would have to be reduced from about 7.4 per cent of GDP to 5 per cent of GDP in 2010.

A significant reduction is expected in the regional budgets revenues. The imbalance of their budgets will account to RUR 800-830 bln. Estimated revenues of the RF regions within the current year are going to decrease by USD 1 trln 100 bln, as compared with the previous year.

The deficit of the regional budgets, amounting to RUR 416 bln by early 2009 will be funded from balances in the accounts of the RF Subjects (in the amount of RUR 112 bln), and the balance of deficit will be funded from the federal budget assets (RUR 300 bln). In particular, the federal budget will provide to the regions budgetary credits, amounting to RUR 150 bln at the rate of 1/3 of the Central Bank refinancing rate<sup>1</sup>.

It should be particularly noted, that the possibility of using the Reserve Fund assets to cover the budget deficit and the level of revenues retention will be declined in 2010 and 2011. It is expected, that the Reserve Fund will be almost completely depleted in 2010, after it fulfills its mission to support the budget system during the crisis. The information on the cash flow in the Federal Treasury in the Bank of Russia, relating to the amounts of the Reserve Fund in USD for 2009 is presented in Tables 4 and 5.

As to the National Welfare Fund, there are still no plans to use it to finance the current budgets. The Ministry of Finance has made estimates to use it for various scenarios for the pension reform. According to various estimates, the Federal Reserve Fund assets could be entirely spent on maintaining the pension reform of 2010. In this regard, the Ministry of Finance is developing updated estimates, based on the scenario of the reform, approved by the RF Government.

Table 4

THE AGGREGATE AMOUNT OF THE RF FUND OF NATIONAL WELFARE<sup>2</sup> AND OF THE RF RESERVE FUND IN 2009 (IN RUR BLN)

Date	Federal Welfare Fund	Reserve Fund
01.01.2009	2 584.49	4 027.64
01.02.2009	2 991.50	4 869.74
01.03.2009	2 995.51	4 863.80
01.04.2009	2 915.21	4 117.67

Source: RF Ministry of Finance

Table 5

RF PURCHASES OF FOREIGN CURRENCY FOR THE FEDERAL BUDGET BALANCE IN 2009 (IN USD)

Date	Debited from Reserve Fund Account
1	2
16.03.2009	775 158 189.69
17.03.2009	774 997 990.75

1 According to the Head of the Central Bank Sergey Ignatiev, the Central Bank of Russia can reduce the refinancing rate in case of inflation deceleration. Currently, the refinancing rate is significantly higher than in the majority of European countries due to the high inflation rate.

2 The total Reserve Fund and National Welfare Funds' assets, denominated in Russian rubles, corresponds to the sum of balances in the Federal Treasury at the RF Central Bank to address the Reserve Fund and Reserve Fund, allocated as the reserve of RF the International Monetary Fund, converted at the official exchange rate of foreign currencies, established by the Central Bank.



Table 5, cont'd

1	2
18.03.2009	781 887 998.89
19.03.2009	784 420 821.43
23.03.2009	807 826 945.52
24.03.2009	810 728 033.77
25.03.2009	811 478 513.85
26.03.2009	800 550 304.21
27.03.2009	806 769 694.14
31.03.2009	793 804 794.58

Source: RF Ministry of Finance.

The RF Ministry of Finance has prepared a draft of the main directions of the Russian Federation tax policy plan for 2010 and the planned period of 2011 and 2012. This project does not involve any significant changes in the tax system, but will create conditions for restoring the economic growth in Russia. Currently, the document is provided for coordination to the Ministry of Economic Development and to the Federal Tax Service. After coordination, it will be submitted for consideration to the Government Commission.

The main directions of tax policy provide a number of measures to improve taxation. Basic trends of the tax policy imply a number of measures for taxation instruments improvement. It is scheduled to complete depreciation taxation reform in regard to corporate income tax in the nearest years, which means the amendments of the depreciated groups as per functional purpose, rather than according to the period of service. Since the beginning of the current year, the amount of depreciation has already been raised by 10 per cent, up to 30 per cent. Moreover, the Ministry of Finance has proposed to amend the taxation method of income from transactions with securities and with financial instruments on direct REPO transactions and relevant dividends. For the corporate income, in the situation of instability in the financial markets, it is necessary to cut down the period the term, when the price of the securities is valid at the market (from 12 months up to 90 days).

The Ministry of Finance is also in favor of withdrawal from the 2010 the limits of RUR 500 mln for the application of the zero tax rate on income for the taxation of dividends, received by the Russian shareholders, owning over 50 per cent of the company shares, which is paying dividends. The Ministry of Finance intends to support companies, engaged in exploration work, in terms of profit tax. The Ministry is planning to specify a special procedure for the recognition of the cost of natural resource exploration in the Tax Code, which will include the costs of search and evaluation of mineral deposits. That includes, in particular, the construction and elimination costs of the well, if it turned out to be unproductive.

The RF Ministry of Finance intends to continue work on improving the administration of value added tax. The most important innovation will be acceleration of the VAT refund. It is proposed to accelerate the VAT refund in period from 20 to 30 days under the bank guarantees in order not to create unnecessary barriers to the taxpayers. Moreover, it is necessary to consider the possibility of processing invoices with negative balance for the settlement of applications for tax deductions.

It should be noted, that by the end of the preceding year it was decided to accept a possibility to refund the amount of VAT, paid as an advance payment, which was regarded as an anti-crisis measure. Within the current year, the Ministry of Finance plans to clarify these rules, especially to make execution thereof less burden for the taxpayers.

Herewith, there are no plans to abandon the annual indexation of excise rates in the current situation. Excises on tobacco products will be indexed in quick rates - ad valorem

rate (n percentage of value) will grow by 0.5 percentage points per annum. Excises on petroleum products in 2009-2010 will not be indexed, and in 2011 they are going to be differentiated according to the environmental grade of motor fuel. Excises for the rest of excisable goods, including alcohol, will be indexed according the inflation estimates.

Much attention in the main trends of tax policy is given to the revitalization of the work with citizens. In particular, the Ministry of Finance wants to exempt individuals from the mandatory filing of income tax returns (NDFL), if the taxpayer's income is tax exempt. There is no such a rule in the Tax Code at present time, so people still have to file a tax return. Moreover, the simplified procedure of filling returns on NDFL will be supported not only due to the changes in legislation, but also through the simplified and clear instructions for its completion. In addition, the document suggests optimizing the order of individuals' taxation in securities transactions. That means the imposition of a tax deduction of up to RUR 1 mln in the sale of securities of Russian emitters, traded on Russian exchange markets, if the securities were owned by the holder for more than a year. In case of an individual's losses from the securities transactions, transfer for the future period is also possible. However, losses and revenues from various types of securities will be varied.

Among the innovations in taxation of mineral resources, there is providing of "tax holidays" for oil exploration of the new fields in the Sea of Okhotsk and of the Black Sea. Tax benefits will be granted for a period from ten to 15 years, depending on the type of a license, until the accumulated volume of production at the site reaches 20 mln tons for the Black Sea and 30 mln tons for the Sea of Okhotsk. Besides, the Ministry of Finance favors a tax on additional income from the extraction of hydrocarbons in the new fields. The amount of tax will vary, ranging from 15 per cent to 60 per cent, depending on the cost-effectiveness of exploitation of the deposit. However, the administration of this tax would be significantly more complex, than NDPI, as the Ministry of Finance admits. ●

## THE RF MARKET FOR RESTRUCTURING OF MORTGAGE CREDITS

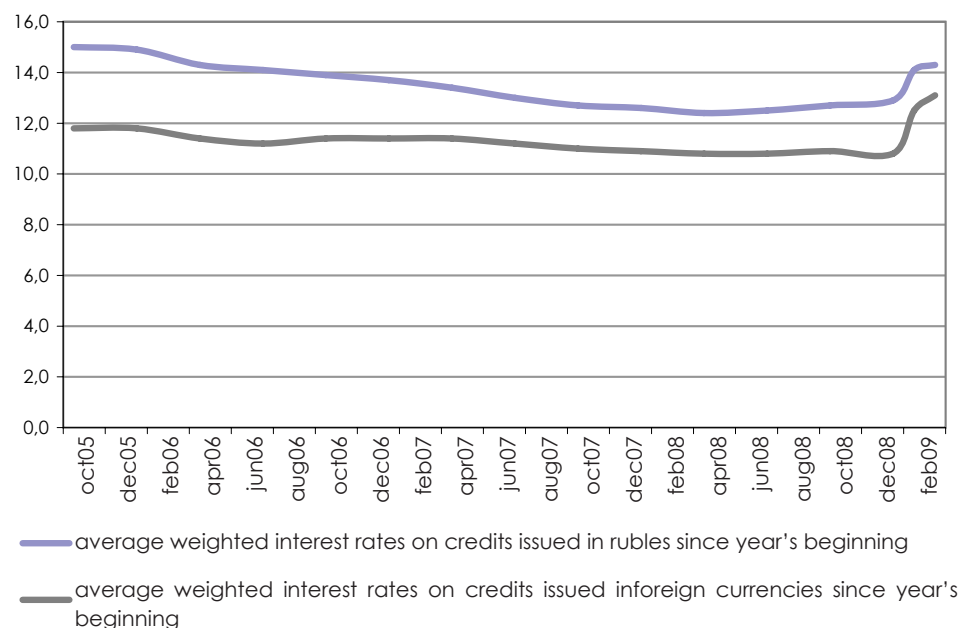
G.Zadonsky

*The volumes of granted and refinanced mortgage credits are decreasing, the interests rates are on the rise. The Agency for Restructuring Mortgage Credits (ARMC) is planning this year to provide support to approximately 100 thousand borrowers. Permits were issued to 23.4 thousand citizens for using “mother’s capital” to redeem the loans granted to them in the amount of approximately 6,3 billion rubles.*

As of 1 March 2009, according to the data of the RF Central Bank, a total of 11.18 thousand housing mortgage credits in the amount of 15.138 billion rubles was issued, whereas in Q 1 2008 the total amount of issued housing mortgage credits was ten times higher – 150.759 billion rubles (no information on housing mortgage credits for the first two months 2008 is available to us). The data for March 2009 will diminish this gap, but the drop in the volumes of mortgage credits in Q 1 can hardly be expected to be less than fivefold. In St. Petersburg the volume of mortgage credits in Q 1 2009 dropped eightfold on the same period of last year by the number of credits issued, and nearly tenfold by their volume.

The outstanding debt against housing mortgage credits as of 1 March 2009 was 1,071 trillion rubles, and the amount of that against all housing credits was 1.28 trillion rubles. The share of mortgages denominated in foreign currencies in the first two months 2009 was only 6.7 % of the total volume of issued mortgages, whereas in Q 1 2008 their share was 24.8 %. Consequently, the share of housing credits denominated in foreign currencies was 7.5 % in the first two months 2009 and 13.2% in Q 1 2008.

According to the RF Central Bank, the average weighted interest rate on ruble-denominated housing mortgage credits as of 1 March was 14.3%, and that on the credits issued since that month’s beginning was 14.5%. The same index for housing mortgage credits denominated in foreign currencies as of 1 March was 13.1 % and 14.5 % respectively. The average weighted interest rate on ruble-denominated housing credits issued since the year’s beginning was, as of 1 March, 14,5%, and that for the credits issued since that month’s beginning



Source: RF Central Bank

Fig. 1 Average weighted interest rates in issued housing mortgage credits

– 14.7 %. The same index for housing credits denominated in foreign currencies as of 1 March was 13.7 % and 14.6 % respectively.

According to *Kreditmart*, the fixed average weighted interest rates on mortgage credits on offer calculated by the programs of 25 banks are higher than the average weighted rates for mortgage credits issued since the month's beginning (the RF CB's data as of 1 March) and are indicative of growth by 19.38 % of the offered rates on ruble-denominated credits with fixed rates, while growth of the average weighted fixed offered rates on USD-denominated mortgage credits has been by 15.45 %. The average weighted floating offered rate on ruble-denominated mortgage credits, after having reached its historic high of 36.09 % in late January 2009, went down to 25 %, while the floating USD-denominated rate is fluctuating around 11 %.

Only the passage of time will make it clear as to what extent the credit rates will be influenced by the lowering, from 24 April 2009, of the RF Central Bank's rate of refinancing (from 13 to 12.5 % per annum), as well as of the interest rates on the operations carried on by the Bank. Nevertheless, President Medvedev supported the measures undertaken by regional authorities in order to subsidize the rates established for certain categories of citizens, and he also believes it necessary to lower the rates on housing mortgage credits.

Sberbank, in Q 1 this year, issued mortgage credits in the amount of 16.5 billion rubles and launched a program envisaging the signing of agreements with the regions for subsidizing the interest rates established for young families.

The growth of average weighted crediting periods for loans granted since a year's beginning observed throughout 2008 in 2009 gave way to decline.

Table 1

AVERAGE WEIGHTED CREDITING PERIOD FOR LOANS GRANTED SINCE THIS YEAR'S BEGINNING (MONTHS)

	01.01.2009	01.02.2009	01.03.2009
Housing mortgage credits in rubles	219.8	211.2	202.0
Housing mortgage credits in foreign currencies	210.5	178.1	173.3
Housing credits in rubles	209.6	197.5	193.0
Housing credits in foreign currencies	203.6	146.7	137.3

Source: RF Central Bank.

Mortgage debt outstanding, according to the data of RF Central Bank, as of 1 March 2009 increased by 7,014 billion rubles, or 0.87 % of outstanding debt for ruble-denominated credits and 7,615 billion rubles, or 2.89 % of credits denominated in foreign currencies. As of 1 January, outstanding debt for granted ruble-denominated mortgage credits was 0.75 %, and 2.86% for credits denominated in foreign currencies. If IAC are applied, the figures become different: mortgage debt outstanding in Promsviazbank in 2008 increased tenfold: from 1.1 % to 11.5 %, and so now it is close to the level of the Agency for Housing Mortgage Lending (AHML)'s mortgage debt outstanding; the situation demonstrated by MDM-Bank with regard to mortgage credits is somewhat better, growth in 2008 having been from 4.8 % to 7.4 %.

According to the Association of Regional Banks, the number of bad loans is 110 thousand; the number of court proceedings for non-payment of mortgage credits is 10 thousand; the number of court decisions concerning claims on mortgaged homes is 3 thousand.

Debt outstanding against the rights of claim acquired by credit institutions under housing mortgage credits was, as of 1 March 2009, 102.67 billion rubles. In accordance with the AHML standards, as of 17 April 144 052 mortgage credits in the total amount of 113.19 billion rubles were refinanced. In Q 1 2009, the AHML refinanced credits in

the amount of 7.73 billion rubles. From 1 April, the AHML discontinued the buying-out of pledges against the credits issued prior to 1 December 2008. At the same time, the volume of refinanced credits decreased by comparison with buying-out by 8 % during the same period - to 343.2 million rubles. According to the Agency's expert's estimations, at present the amount of mortgage credits remaining on the balances of banks and issued in accordance with the AHML's standards can be up to 250 billion rubles.

In the 2009 budget it is planned that the AHML should be granted government guarantees in the amount of 36 billion rubles for the issue of its corporate bonds, for which, as it is intended, banks' mortgage assets can also be traded. Banks can also attract refinancing from the RF Central Bank under the mortgage of these securities. However, none of these refinancing schemes have started to work so far. In April, in addition to the AHML's 10 bond loans in the total amount of 38,675 billion rubles, the Federal Financial Markets Service registered issues of four series of the AHML's non-convertible documented bearer coupon bonds, in a total amount of 28 billion rubles, secured by government guarantees of the Russian Federation.

The housing availability coefficient (HAC) for families (the ratio of housing value to annual income), estimated by year and determined on the basis of the terms of mortgage credits refinanced by the AHML, varies for the Russian Federation on the whole between 2.93 years and 3.7 years, and for federal okrugs – between 2.12 years and 3.99 years. The last figure indicates that the HAS value of 4 years represents an availability threshold. Those families whose incomes when set against the current housing prices yield HAS values of 4 years and more have no practical opportunities to purchase a dwelling on the Russian market.

Table 2

 THE HOUSING AVAILABILITY COEFFICIENT BASED ON MORTGAGE CREDITS  
 REFINANCED BY THE AHML

Federal Okrug	2006			2007				2008				2009
	June	Sept.	Dec.	March	June	Sept.	Dec.	March	June	Sept.	Dec.	March
Central	2.12	2.73	2.98	2.85	3.72	2.68	3.34	3.85	3.69	3.77	3.61	3.68
North Western	3.21	3.40	3.61	3.69	3.39	3.44	3.60	3.49	3.39	3.99	3.60	3.31
Southern	2.81	3.11	3.17	3.78	2.54	2.95	3.13	3.35	3.85	3.71	3.50	3.62
Volga	2.82	2.96	3.23	3.48	3.63	3.56	3.63	4.17	3.67	3.69	3.38	3.30
Urals	2.89	3.15	2.91	3.53	3.48	3.56	3.16	3.60	3.62	3.15	3.24	3.32
Siberian	2.82	3.38	3.54	3.65	3.15	3.24	3.18	3.50	3.83	3.43	3.37	3.18
Far - Eastern	3.05	3.01	2.81	2.75	3.09	2.62	2.73	2.73	3.01	3.51	2.83	3.35
RF, total	2.93	3.16	3.31	3.53	3.37	3.32	3.35	3.70	3.64	3.62	3.40	3.34

Source: AHML.

On 31 March, the Federal Antimonopoly Service initiated a case against the Moscow Oblast Hypothecary Corporation (MOHC) and the Moscow Oblast Duma. Oblast parliament and the Corporation, which is a large-scale builder, are suspected of conspiracy within the framework of the program of resettling the dwellers from decayed buildings and buildings which are under the threat of collapse. Besides, the Federal Antimonopoly Service has notices certain indicia of conspiracy between the MOHC and the administrations of some towns in Moscow Oblast.

This year, the Agency for Restructuring of Mortgage Credits (ARMC) intends to restructure the mortgages of no more than 100 thousand Russian citizens. Out of the total number of borrowers who have applied to the ARMC for help in restructuring their credits,

refusals were issued to 52 % citizens whose documents did not comply with the standards established by the Agency. The ARMC's decision to soften the restructuring standards for the borrowers who are failing to make their interest payments in due time as a result of the crisis will have to be approved by the AHML.

The AHML's Supervisory Council made the decision in April that the list of documents to be collected by a borrower on his own should be shortened, and abolished the requirement of compulsory sale of a car rated in the low-price class in order to redeem an outstanding debt under a mortgage; it supported the suggestion that the older tranches of mortgage securities should be entered into the investment declarations of the RF Pension Fund and the RF National Welfare Fund; besides, the Council assigned to the AHML the task of implementing pilot projects aimed at target financing of Russian credit institutions designed to enable them to issue credits to citizens and juridical persons for developing housing construction, including on the primary credit market, as well as share partnership construction.

The analytical materials released by the Builders' Association of Russia (BAR) and the Union of Surveyor Engineers demonstrated that the prices in rubles for secondary housing products across Russian regions since the autumn 2008 had decreased by 13.1 %, while the average cost of new construction products had gone down 7.31 %.

This year, the RF Ministry of Defense is going to spend 109.5 billion rubles on providing military personnel with housing.

The Ministry for Regional Development raised, practically in every Russian region, the average market price of housing, at which in Q II 2009 the authorities are going to purchase finished apartments from builder companies in order to satisfy the existing social needs. The purchasing price of apartments (established for builder companies) in Moscow increased by 13.48 % to 83.74 thousand rubles per square meter, and in St. Petersburg - by 18.51 % to 52.5 thousand rubles. In Moscow Oblast this index rose by 12.11 % – to 48.15 thousand rubles per square meter; in Leningrad Oblast – by 12.42 % (to 35.75 thousand rubles); in Krasnodar Krai – by 18.39 % (to 36.05 thousand rubles); in Sverdlovsk Oblast – by 6.7 % (to 35.85 thousand rubles).

In April, the Administration of Tver Oblast and the State Company "SU-155" signed an agreement on a program for preferential mortgage crediting, under which the buyer of an apartment is granted not only a 10 % exemption on its price if he chooses to take a preferential mortgage credit, but also the right to receive a subsidy from the oblast budget for partial redemption of his initial contribution towards the buyout of the apartment. **The new mortgage crediting program is designed to help "SU-155" in increasing the availability of its housing construction products to an average buyer.**

As of 3 April, 35.2 thousand persons had already submitted their applications to the territorial branches of the RF Pension Fund concerning the disposal of their core capital funds for the purpose of repaying their loans. The total amount covered by these applications is 9.4 billion rubles. With regard to these applications, 23.4 thousand positive decisions were made, the total amount to be disposed of being 6.3 billion rubles.

At St. Petersburg, the Center for Restructuring of Mortgage Credits was opened. Loans are to be granted to those residents of St. Petersburg who had concluded a credit agreement prior to 1 December 2008. Under this agreement, the mortgaged dwelling must be the only one available to a given family, while that family's monthly income should not exceed the doubled subsistence minimum per member. ●

## MILITARY EXPENDITURE IN THE 2009 FEDERAL BUDGET

V.Zatsepin

*In accordance with the latest changes introduced in April into the current federal budget, its allocations under the National Defense section are cut 10.5 % by comparison with the initially adopted version of the budget. At the same time, despite federal budget expenditure having been increased on the whole by 668 billion rubles by comparison with the initial version, secret expenditure was unexpectedly reduced by 99 billion rubles which may indicate important changes in Russia's budgetary policy.*

The changes introduced into the 2009 federal budget, which was adopted by the Federal Assembly and signed<sup>1</sup> by President Medvedev on 29 April, represented the third consecutive alteration of the initial law<sup>2</sup> signed on 24 November 2008. Last year, its introduction into the State Duma by the RF Government practically coincided with the onset of financial crisis in Russia and with the collapse of oil prices on the world market – the two developments which immediately made it clear that both the estimations forming the basis of the Government's project and, accordingly, the draft budget itself were irrelevant.

As has already been noted<sup>3</sup>, the changes introduced into the Budget Code and entered into force from 2008 considerably reduced the non-classified part of the law on the federal budget. In particular, the current list of its annexes does not include the itemization of federal budget expenditure by sections and sub-sections pertaining to the functional classification<sup>4</sup>, which makes it impossible to analyze the budget with the help of the published law alone<sup>5</sup>. Therefore, when analyzing the April changes of the budget, we also had to use the Federal Treasury's report on the implementation of the RF consolidated budget in February 2009<sup>6</sup>, the explanatory note of the RF Ministry of Finance concerning the draft alterations, and the conclusions of the relevant committees of the RF Federal Assembly and the RF Audit Chamber<sup>7</sup>. That was the only way to determine, with a delay of just 5 months, the whole structure of the expenditure side of the initial version of the law on the 2009 federal budget as well as the major indices of military expenditure in the April version of the federal budget<sup>8</sup>.

Thus, in accordance with the Conclusion of the Council of the Federation Committee on Defense and Security<sup>9</sup>, the initial allocations under Section 02, "National Defense", were

1 For the introduction of alterations in the Federal Law "On the Federal Budget for the Year 2009 and for the Planning Period of 2010-2011", see Federal Law No 76-FZ adopted by the RF State Duma on 15 April 2009.

2 For the federal budget for the year 2009 and for the planning period of 2010 – 2011, see Federal Law No 204-FZ adopted by the RF State Duma on 31 October 2008.

3 The economic and political situation in Russia. November 2008. Pp. 63-64.

4 For more details, see, for example, Annex 8 to the Federal Law "On the 2007 Federal Budget" (Federal Law No 238-FZ, adopted by the RF State Duma on 24 November 2006).

5 See the information on the website of the President of Russia <http://document.kremlin.ru/?DTL=7>.

6 See the information on the website of the RF Federal Treasury: [http://www.roskazna.ru/store/reports\\_file410.xls](http://www.roskazna.ru/store/reports_file410.xls).

7 See all these documents on the website of the RF State Duma among the materials concerning Draft Law No 181653-5: <http://www.duma.gov.ru/faces/lawsearch/search.jsp>.

8 Despite the mistakes contained in the Conclusions of the RF State Duma Committee on Defense (Decision No 47 / 1, of 02.04.2009) and the RF Council of the Federation Committee on Budget (Decision No 3.6-06 / 379, of 20.04.2009).

9 No 3 5-07 / 587, of 21.04.2009.

reduced by 139 billion and 650.5 million rubles (or by 10.5 %) to 1,196 billion and 704.5 million rubles respectively, which will amount to 3.0 % of GDP.

By comparison with 2008, expenditure as a percentage of GDP grows by 0.5 %, which can be attributed, in the main, to the fall in GDP envisaged in the law on the budget. So far as the year-on growth in expenditure under this section is concerned, it is still impossible to determine its scope in real terms because of the rapid rise in prices observed in this country. However, judging from the trend observed over recent years, it is most likely that by comparison with last year (the nominal increase of 15 %) the growth of expenditure in real terms will be negligible.

As is noted in the Conclusion of the RF Audit Chamber, the more than 86 % of the almost 140 billion rubles cut from the budget allocations under Section 02, “National Defense”, accounts for the expenditure of the RF Ministry of Defense (125 billion rubles).

Allocations under Sub-Section 0201, “The Armed Forces of the Russian Federation”, are reduced by 77 billion and 449 million rubles. Allocations to the material support of the Armed Forces are reduced, on the whole, by 22 billion and 300 million rubles; it should be noted that the cuts in expenditures on petrol, oil and lubricants by 18 billion and 953 million rubles will result, according to the RF Ministry of Defense, in the Armed Forces being able to purchase only 2.2 million tons of petrochemical products, including 1.0 million tons under the already placed contracts. With their estimated<sup>1</sup> demand for petroleum products standing at 4.7 - 5.4 million tons, the RF Armed Forces will have to use part of their emergency reserves in order to cover the resulting deficit of approximately 50 %. The further cutting of expenditures on the food supply of servicemen by 1 billion and 800 million rubles will increase the deficit built into the budget from 20 % to 25 %.

With allocations to the supply of military clothing to servicemen being cut by 1 billion and 273 million rubles, the deficit existing in this sphere of the material support for servicemen will rise from 66 % to 71 % of the annual demand. As a result, the already dire situation with providing servicemen with customer-fit uniforms will further deteriorate, as well as that with the provision of bed accessories to them and with the purchasing of field uniforms for contractees. The altered budget still fails to satisfy the RF Ministry of Defense’s request for 2 billion and 270 million rubles to be spent on preparing the transition to a new uniform.

The situation with all the other expenditures on the upkeep of the RF Armed Forces will not improve, either: the allocations earmarked for the RF Ministry of Defense and designed to be spent on capital repairs of buildings and structures are cut almost by one-third (by 1 billion and 956 million rubles) of the initial volume, which covered just 20 % of the demand; the RF Military of Defense’s housing operating expenses and transport costs will be covered by 45 % and 86 % of the demand respectively.

According to the Audit Chamber, the state defense order of the RF Ministry of Defense is reduced by 36 billion and 500 million rubles. Only under Sub-section 0208, “Applied Research in the Sphere of National Defense”, budget allocations are cut by 11 billion and 256 million rubles, among other things by scrapping two hundred research and development projects in the amount of 7 billion and 700 million rubles, and by broadening and optimizing the rest of them. The other cuts in the state defense order were carried out in the following ways<sup>2</sup>:

1 The Conclusion concerning Draft Federal Law No 94777-5 “On the Federal Budget for the Year 2009 and for the Planning Period of 2010-2011”. Approved by the Committee on Defense’s Decision No 22 / 1 of 08.09. 2008. P. 7.

2 The Conclusion concerning Draft Federal Law No 181653-5 “On the Introduction of Changes in the Federal Law “On the Federal Budget for the Year 2009 and for the Planning Period of 2010-2011”. Approved by the Committee on Defense’s Decision No 47 / 1 of 02.04.2009. P. 7.



- by reducing the volumes of allocations to the delivery of spare parts, accessories and products for technical and production purposes, and other property, as well as the volumes of work aimed at maintaining the operability of the existing stock of arms and military equipment;
- by canceling the orders for the supply of arms and military equipment, which cannot be placed because the enterprises of the military defense complex are unable to begin production;
- by postponing the timelines for R & D and repair of less important arms and military equipment.

However, changes in the state defense order were not limited to cuts – on the whole, the power structures were allocated 12.5 billion rubles, to be spent on additional procurement of transport vehicles (the RF Ministry of Defense got 4 billion rubles). According to RF Prime Minister Putin, the main purpose of those allocations was “to support our national manufacturers”<sup>1</sup>.

The RF Ministry of Defense’s allocations for the implementation of federal target programs (FTPs) are cut by 33 billion rubles, including 15 billion and 986 million rubles being cut from the FTP “*The improvement of the system of filling the positions of sergeants and privates with military servicemen switched over to military service under contract, and the implementation of switchover to filling the positions of sergeants (petty officers) of the Armed Forces of the Russian Federation and other troops, military formations and bodies, and also of sailors on the crews of the Navy by military servicemen conducting military service under contract (the years 2009 – 2015)*”, which amounted to a 61.5-percent reduction in its initially approved financing. The Presidential Program “*The Elimination of Chemical Weapons Stocks in the Russian Federation*” thus loses 7 billion and 573 million rubles in allocations, while the FTP “*The Industrial Utilization of Arms and Military Equipment (the years 2005 - 2010)*” is cut down by 2 billion and 404 million rubles; while allocations to the FTP “*The Creation of a System of Bases for the Black Sea Fleet in the Territory of the Russian Federation in the years 2005 - 2020*” are reduced by 1 billion and 600 million rubles.

At the same time, there were no cuts in the allocations earmarked for settlements with the personnel of the RF Ministry of Defense and for pension provision. Thus, the growth in allocations by comparison with last year, which is observed with regard to the targeted items of expenditure on the Ministry of Defense, entitled “Military Personnel” (by 35 %) and the Ministry “Pension Provision” (by 17 %), will ensure not only the covering of the one-time 7.5-percent increase of money allowances and pensions planned for August 2009, but also to fully compensate servicemen and military pensioners for the current year’s rise in consumer prices, provided there is a corresponding political will on the part of the authorities. A more significant growth in allocations under the “Military Personnel” item of expenditure is explained by the introduction, from the year 2009 onwards, of a system of cash bonuses to be paid to approximately 10 % of the officers of the Armed Forces. It should be noted that RF Prime Minister Putin has voiced the Government’s intention to extend such payments, representing a new system of money allowance, to all the servicemen of the Armed Forces as early as by the year 2012<sup>2</sup>.

On the other hand, the repeated affirmations of the officials from every branch of state authority, including the RF Audit Chamber, that the RF Ministry of Defense’s social expenditures will not be subject to cuts should be seen as wishful thinking rather than as

1 Stenogrammy zasedanii Gosudarstvennoi Dumy. Stenogramma zasedaniia 6 apreliia 2009 g., No 84 (1057). (Minutes of State Duma sessions. Minutes of the session on 6 April 2009, No 84 (1057)). See <http://wbase.duma.gov.ru/steno/nph-sdb.exe>.

2 See *ibid.*

anything else. It is not very clear how the military social sphere could be immune to the ongoing economizing on catering and clothing the servicemen, as well as on the lighting, heating and repairing of military camps. Maybe it would be better for the RF Ministry of Defense to economize on the development and the subsequent advertising of its own strategy of social development until the year 2020, if its officials are so accustomed to their own social sphere being permanently underfinanced.

In this connection, much hope is being pinned on V. Chistova's transfer, in April, from the Ministry of Finance to RF Ministry of Defense, after having been appointed Deputy Minister of Defense for financial and economic issues. In recent years V. Chistova always bested all the financial bigwigs of Russia's military department, which is proved by the very size of the aforesaid deficits in the military economy of this country. We hope that things will start moving immediately, that the State Duma Committee on Defense' Conclusion (expected in September) concerning the 2010 draft federal budget will no longer contain the habitual complaints about the most urgent needs of military men being underfinanced, and that the general public's deeply rooted *perception* of the Russian soldier as a hungry ragamuffin will begin to disappear.

Our analysis of the structure of the 2009 federal budget's allocations at the level of sections and subsections of its expenditure classification indicates that, despite the 667.564 billion ruble rise in overall budget expenditure, the classified expenditures in the April version of the budget have been unexpectedly cut by 99 billion and 210 million rubles, of which only 36 billion and 500 million rubles could be associated with the cuts in the RF Ministry of Defense's state defense order. The question of where the Government managed to find the remaining 62 billion and 710 million "classified" rubles cannot be answered at the present moment. Nevertheless, by comparing the shares of classified allocations in the initial version of the federal budget (Table 1) with the available data from the April version (on the whole, the share of classified allocations in the federal budget's expenditure has declined from 11.99 % to 10.14 %), one can make an assumption that in conditions of the current economic crisis the urgency of classified allocations has significantly dwindled.

Table 1

## THE SHARE OF CLASSIFIED ALLOCATIONS IN THE 2003 – 2009 FEDERAL BUDGETS, %

Code and Title of Section (Subsection) Containing Classified Expenditures	2003	2004	2005	2006	2007	2008	2009
1	2	3	4	5	6	7	8
Total expenditure of federal budget	9.73	9.83	11.33	11.80	10.33	11.92	11.99
0100 GENERAL ISSUES OF STATE IMPORTANCE	n/a <sup>1</sup>	n/a	3.67	6.28	5.52	8.66	5.41
0108 International relations and international cooperation	31.88	18.04	–	0.01	< 0.01	3.66	–
0109 State material reserve	97.73	93.33	82.86	89.23	92.18	90.17	88.34
0110 Fundamental research	–	–	2.13	1.22	1.12	0.97	0.92
0114 Other issues of national importance	n/a	n/a	0.05	0.72	0.28	4.42	0.48
0200 NATIONAL DEFENSE	37.22	38.40	42.06	42.77	45.33	46.14	46.68
0201 Armed Forces of Russian Federation	35.39	36.11	33.07	35.59	37.11	39.04	40.85
0204 Mobilization preparedness of economy	100.0	100.0	100.0	100.0	100.0	100.0	100.0
0205 Preparation and participation in safeguarding collective security and peace-keeping activity	–	–	100.0	100.0	100.0	–	–
0206 Nuclear Weapons Complex	100.0	100.0	100.0	100.0	100.0	100.0	100.0
0207 Realization of international obligations in sphere of military-technological cooperation	100.0	41.05	45.22	46.90	50.65	100.0	100.0
0208 Applied research in national defense sphere	n/a	n/a	98.37	93.94	93.69	93.20	92.19
0209 Other issues in national defense sphere	n/a	n/a	2.49	8.79	24.38	29.21	25.15

Table 1, cont'd

1	2	3	4	5	6	7	8
0300 NATIONAL SECURITY AND LAW ENFORCEMENT ACTIVITY	23.33	20.79	28.52	31.64	31.07	31.84	30.77
0302 Internal security agencies	3.40	3.01	4.76	6.31	5.16	4.97	4.52
0303 Internal service troops	13.21	11.10	11.76	10.31	9.80	10.25	8.99
0306 Security agencies	100.00	98.91	97.80	95.49	97.31	99.05	99.49
0307 Frontier defense bodies	19.73	22.88	100.00	98.97	97.62	100.00	99.54
0309 Protection of population and territory from natural and man-made emergency situations, civil defense	43.69	41.74	59.02	62.39	50.65	51.39	51.04
0313 Applied scientific research in sphere of national security and law – enforcement activity	n/a	n/a	73.95	66.41	64.43	75.49	78.99
0314 Other issues in sphere of national security and law – enforcement activity	n/a	n/a	8.26	50.71	39.95	56.32	58.05
0400 NATIONAL ECONOMY	n/a	n/a	0.05	0.02	0.44	0.64	1.06
0411 Applied research in sphere of national economy	n/a	n/a	–	–	5.23	5.84	4.09
0412 Other issues in sphere of national economy	n/a	n/a	0.12	0.06	< 0.01	0.31	1.95
0500 HOUSING AND COMMUNAL UTILITIES COMPLEX	n/a	n/a	–	3.42	0.85	6.96	18.92
0501 Housing complex	n/a	n/a	–	4.22	5.69	15.97	20.96
0700 EDUCATION	–	–	2.76	2.69	2.39	2.55	3.21
0701 Pre – school education	–	–	2.03	2.17	2.44	2.48	2.39
0702 General education	–	–	1.51	1.91	2.14	2.00	2.88
0704 Secondary vocational education	–	–	1.06	1.03	1.02	0.86	0.97
0705 Professional training, retraining and advanced training	–	–	16.85	15.78	17.22	1.80	7.63
0706 Higher and postgraduate professional education	–	–	3.15	2.93	2.53	3.08	3.77
0709 Other issues in sphere of education	–	–	0.30	0.33	0.28	0.29	0.38
0800 CULTURE, CINEMATOGRAPHY AND MASS MEDIA	–	–	0.17	0.17	0.21	0.17	0.18
0801 Culture	–	–	0.14	0.10	0.16	0.10	0.11
0804 Periodical press and publishing houses	–	–	13.46	7.45	2.57	2.62	2.76
0806 Other issues in sphere of culture, cinematography and means of mass communication	–	–	0.02	0.15	–	–	–
0900 PUBLIC HEALTH CARE, PHYSICAL CULTURE AND SPORT	–	–	4.30	3.99	2.57	4.14	3.30
0901 In-patient medical care	–	–	5.61	4.66	2.94	3.24	2.68
0902 Out-patient medical care	n/a	n/a	n/a	n/a	n/a	13.94	4.74
0905 Spa and rehabilitative care	n/a	n/a	n/a	n/a	n/a	14.07	16.80
0907 Sanitary and epidemiological well-being	n/a	n/a	n/a	n/a	n/a	2.09	1.75
0908 Physical culture and sport	–	–	0.28	0.26	0.24	0.42	0.26
0910 Other issues in sphere of public health care, physical culture and sport	–	–	–	–	–	1.74	0.91
1000 SOCIAL POLICY	–	–	–	–	–	0.01	0.01
1003 Social security of population	–	–	–	–	–	0.02	0.02
1100 INTERBUDGETARY TRANSFERS	–	–	–	–	0.16	–	–
1101 Dotations to budgets of subjects of Russian Federation and municipal formations	–	–	–	–	0.50	–	–

*Source:* The IET's estimations based on the data from approved federal budgets for 2003 – 2009 (the data for 2003 – 2007 are brought in conformity with the relevant sections and subsections of the budget classification introduced from January 2008). For 2009, the data taken from Federal Law No 204-FZ of 21 November 2008 and the Federal Treasury's report on the execution of the RF consolidated budget, issued in February 2009, are applied.

Also, it seems plausible that the economic crisis will help Russia to overcome the RF Ministry of Finances' apparent tendency to artificially enlarge and merge together the purpose-oriented military expenditure items of the federal budget, which is aimed at removing these budget items from under any control on the part of the legislative authority and society. Thus, to make the federal budget more transparent is one of the major preconditions for Russia's exit from the economic crisis. ●

## ON THE PRINCIPLES OF RESPONSIBLE BUDGETING POLICY FOR THE YEAR 2010 AND THE PLANNING PERIOD OF 2011–2012

V.Nazarov

*At the extended meeting of the Collegium of the RF Ministry of Finance Russia on 14 April 2009, Minister of Finance Alexey Kudrin spoke of the necessity to cut budget expenditure in the year 2010. In the nearest future, the RF Ministry of Finance is going to prepare a draft of the main directions of Russia's budgeting policy for the year 2010 and the planning period extending over the years 2011 and 2012. In this connection, it appears feasible to consider the main principles of the budgeting policy of the Russian Federation for the next three years.*

As the key principles of responsible budgeting policy during the period of economic crisis, it appears feasible to suggest the following ones.

1. A scenario-based approach for forming the revenue and expenditure sides of the federal budget

The approach that has been applied until recently to the mapping of three-year budget could ensure stability of the budgetary system only in conditions of an unchanging foreign economic situation, and it has turned out to be practically useless during an economic crisis. So, it appears reasonable to switch over to a scenario-based approach to forming federal budget revenue and expenditure. For this approach to be implemented, it is necessary to forecast federal budget revenue under various macroeconomic conditions:

- the conservative scenario, which will reflect a near-zero growth rate of the national economy in 2010 – 2012 and a low level of prices of energy carriers (oil prices of approximately 20 USD per barrel) in conditions of the global economy's stagnation;
- the basic scenario, based on the assumption of stabilization of the global economy in 2010 – 2012, with the preservation of the current level of prices of energy carriers;
- the optimistic scenario, based on dynamic growth of the Russian economy in conditions of renewal of economic growth in developed countries and growing prices of energy carriers.

All the spending obligations of the federal budget must be subdivided into 3 groups, depending on the priority of each expenditure item and the period of implementing a given spending obligation: "A", "B1", and "B2":

- Group "A" expenditure items represent those spending obligations that cannot be subject to any cuts no matter which scenario of the Russian economy's development is actually realized;
- Group "B1" expenditure items are those spending obligations that can be cut beginning from the year following a current financial year;
- Group "B2" expenditure items are those spending obligations that can be cut during a current financial year.

The distribution of spending obligations between groups "A", "B1" and "B2" must be regulated by a special normative legal act of the Government of the Russian Federation. When the State Duma will be considering the draft federal law for the federal budget for the next financial year and the planning period, the RF Government must submit to the deputies information on the distribution of spending obligations between the aforesaid categories (as a possible variant – in the form of a separate annex to the law on budget).

A criterion of the stability of the federal budget should be the possibility to ensure the backing of the Group “A” expenditure items by appropriate revenue in accordance with the pessimistic forecast of the development of Russia’s economy, and the backing of the implementation of Group “A” and “B1” expenditure items by appropriate revenue in accordance with the basic scenario of the of Russian economy’s development. Thus, Group “B1” expenditure items represent, in fact, the directions for the use of supplementary budget revenues. In order to ensure transparency of the budgeting process, it appears feasible to determine in advance the directions for the use of possible supplementary revenues.

## 2. A balanced budget

Budget expenditure in 2010 – 2012 must be of an appropriate size, capable of ensuring a well-balanced budget (those expenditure items that cannot be cut in the next financial year must be covered by revenue in accordance with the conservative scenario of the national economy’s development, while those expenditure items that can indeed be cut over a planning period must be covered by federal budget revenue in accordance with the basic scenario). In this connection, the emergence of “technical” deficit in the federal budget would be acceptable (for example, if the economy develops under the conservative scenario, but Group “B1” expenditure items will anyway have to be financed during a current year) in an amount of no more than 3 % of GDP. A more substantial budget deficit would create depreciation expectations (thus, for example, individuals and companies alike, in expectation of a nearly three-trillion deficit in the 2009 federal budget (7 – 8 % of GDP) are very reluctant to part with their currency reserves even in conditions of a local depreciation of the ruble as a result of a stabilizing foreign economic situation) and would have a certain impact on the inflation rate’s acceleration.

At present, Russia is in need of modernization – both of general economic and social institutions, and the national economy’s branch structure. Additional government expenditures cannot ensure a country’s modernization. For the improvement of institutions, what is needed is reforms, and not simply more investments in the already existing inefficient institutions. As is demonstrated by global experience, modernization of a national economy must be triggered by external demand, while budget spending can provide only for a temporary growth of domestic demand and a conservation of certain components specific of that particular country’s economic backwardness.

## 3. Responsibility for the next generations and unacceptability of populism in the sphere of pension provision

Russia, like most of the other developed countries, represents part of the basic demographic process – the population’s ageing. It is the phenomenon of the population’s ageing that makes difficult the prospective existence of those pension systems where the principle of “generations’ solidarity” is the prevailing one. This negative demographic trend represents a long-term strategic challenge for the pension system of Russia.

Table 1

RATIO OF THE SIZE OF POPULATION BELONGING TO THE ABLE-BODIED AGE GROUPS AND THE SIZE OF POPULATION BELONGING TO SENIOR AGE GROUPS IN 2007 – 2050\*

Year	Population, million persons		Number of persons older than able-bodied age per 1000 able-bodied persons
	Able-bodied	Senior	
1	2	3	4
2007	89.8	29.4	327
2010	87.5	30.8	352
2015	81.3	32.6	401
2020	75.3	33.9	450

Table 1, cont'd

1	2	3	4
2025	71.2	33.9	476
2030	67.7	33.3	492
2035	63.1	32.9	521
2040	57.1	32.9	576
2045	50.7	32.9	649
2050	45.8	31.7	692

\* The table presents an inertia-based demographic forecast, without any changes in the main demographic indices.  
*Source:* Rosstat of Russia; the IET's estimations.

During the next decade, the demographic situation will already be developing in such a way that the pensions expenditures will significantly increase due to the growing number of pensioners coupled with the simultaneously declining number of employed citizens who are the payers of pension contributions. Later on, as the population grows increasingly older, the situation will be deteriorating still further.

Joint responsibility of generations can effectively provide a solution to the problem of pension endowment in a situation characterized by favorable demographic conditions (growth or overall reproduction of the population), stable growth of the remuneration level, and absence of any significant and long-term changes in the actual share of employed persons in the total population. However, if the population is ageing, and economic growth largely depends on the economic situation, then there emerge problems associated with shortage of financial resources needed for ensuring the payment of pensions for next generations (or, at least, the risk of the appearance of such problem becomes higher). In this connection, the switchover to a funded pension system cannot provide any short- and medium-term solutions to the existing problems, either, because then there will arise a need not only in additional resources for funding the “double payment” of employed citizens during the transition period (when the working generation will have to accumulate the means to cover their own pensions, while at the same time to pay for the pensions of the previous generation), but also the necessity to create efficient instruments for investing pension savings. So, it thus becomes necessary to attract additional financial resources into the pension system, that is, incomes from investments of the National Welfare Fund's resources (following the example of Norway) and incomes from privatization of government property (following the examples of Poland and some other countries where a switchover to a funded system has been implemented).

Given all the aforesaid considerations, it does not seem feasible to spend the resources accumulated in the National Welfare Fund on “patching the holes” in the Pension Fund's budget at a time when the demographic situation still remains at a relatively comfortable level in terms of sustaining the existing pension system. Pursuing such a policy would mean “eating up” the resources of next generations.

The main problem of budgeting policy in 2010 – 2012 will be the adoption by the government of certain obligations which it will be then unable to cancel. Here we mean, first of all, changes in the revenues and expenditures of off-budget funds in 2010:

- the revenues of off-budget funds in 2010 will be reduced approximately by 10 % (about 0.5 % of GDP) due to the threshold established in 2010 for the charging to wages and salaries of the contributions to compulsory pension, medical and social insurance at the level of 415 thousand rubles, while the basic rate of the contributions remains at the level of 26 % (its increase to 34 % is planned for the year 2011);

- valorization of pension rights in 2010 and a raise of the basic pension level up to the subsistence level at the end of 2009. Taken together, these measures are going to increase the federal budget expenditures earmarked for the payment of pensions by nearly 1.5 % of

GDP (more than 1 % of GDP will be required to finance the valorization, and more than 0.4% of GDP – to raise the basic pension up to the subsistence level).

Thus, the obligations assumed by the government only in the sphere of pension provision will mean growth of federal budget deficit in 2010 by nearly 2 % of GDP.

As the possibilities available to the State in terms of financing its pension system in the years to come are going to be significantly limited, it appears feasible that the spending of its resources should be focused on the most important goal. The main priority in the sphere of pension provision in the next few years will be to eliminate poverty among pensioners – that is, to bring the level of the basic part of pension up to a pensioner's subsistence level. Due to the accelerated indexation of the basic part of pension as a result of increasing the size of social pension to a pensioner's subsistence level and slowdown of the growth rate of wages and salaries in 2009, the ratio of average labor pension to average salary in this country will increase significantly - from 22.8 % in 2007 to 27 % in 2009 – 2010.

The bringing of the basic part of pension up to the subsistence level and subsequent indexation of the basic pension in relation to the growth rate of consumer prices will make it possible to ensure stability of pensioners' real incomes and to lower the risks of poverty among the senior age groups of the population.

In this connection, the equalization of the basic part of pension with the subsistence level and the subsequent maintaining it on this level will require substantial spending of financial resources, and thus it appears feasible to abstain, in the nearest future, from implementing any other measures designed to increase the level of pension provision. We mean, first of all, the reevaluation of the rights acquired by the moment of onset of pension reform. The one-time overall increase by 30 % of the insurance part of labor pension early in 2010 may be fraught with an upsurge of inflation.

#### 4. The priority of supporting the population over giving support to businesses

It appears that federal budget expenditure should be strictly oriented to supporting the population, in order to prevent any dramatic decline of living standards and the quality and availability of budget-funded services. So, it would be feasible to minimize the volumes and areas of support provided to businesses. This is conditioned by a number of reasons, the core ones among which are as follows:

- uncertainty of the economic of some or other enterprises in this particular phase of the crisis;

- lack of any reason in a policy aimed at actual support of inefficient owners and managers who failed, during the period of rapid economic growth, to make sufficient reserves that could be used for surviving in a more difficult economic situation;

- the impossibility to ensure transparency of the criteria and procedures for actually rendering this support.

It appears that direct support to enterprises can be feasible only in exceptional cases, and primarily in infrastructure-related sectors and mono-towns.

At the same time, it would be feasible to provide sufficiently significant support to businesses in indirect ways - because in conditions of crisis they can be relieved of the administrative burden of sustaining excessive employment. The State must take it upon itself to ensure employment. Thus, one of the most important barriers in the way of restructuring enterprises and their adaptation to the new economic situation will be removed.

5. More significant cuts in the financing of non-priority budget expenditure items (or those expenditure items the financing of which in previous years has been artificially inflated) instead of proportional reduction of all spending obligations. If some expenditure items of the Russian budget are compared with the similar items in the 2008 budgets of the OECD



countries, it become possible to notice certain reserves for cutting the spending under such items as national security, law enforcement activity, and the national economy. The consolidated budget expenditure of the Russian Federation earmarked for law enforcement activity in 2008 amounted to 2.63 % of GDP, whereas the OECD countries in 2003 – 2007 were spending on these purposes, on the average, 1.8 % of their GDP. The consolidated RF budget expenditure earmarked for national economy in 2008 was 5.42 % of GDP, while the OECD countries in 2003 – 2007 were spending on the same item 3.,9 % of their GDP. When the financing of these items of the federal budget is cut, it will become possible to increase the financing of national defense expenditure items, in order to ensure the 100% switchover to the manning of the Armed Forces of the Russian Federation on a contractual basis. Military reform will be of an anti-crisis nature, because it will have a positive influence on the structure of employment: unemployed citizens will be able to find jobs in the Armed Forces, while those specialists for whom there is a demand in the national economy will be able to continue their training or work in civil sectors.

#### 6. Organization of performance-based budgeting process

The organization of the budgeting process has significant reserves for improving the quality of managing budget resources. However, for these resources to be implemented in actual practice, it will be necessary to improve the budgeting process in a comprehensive manner, so as to cover a variety of directions, the main ones among which are as follows:

- separate planning of the existing and newly assumed obligations;
- the use of adequate instruments for estimating the effect of budget expenditures in terms of performance, and incorporation of this estimation principle in budget planning.

Separate planning of the existing and newly assumed obligations means that priority should be given in the budget to the financing of the already existing spending obligations. New spending obligations can be assumed only to the extent of the difference between the volume of the existing obligations and budget revenues, and the sources of financing to cover the budget deficit in a planning period. Separate planning of the existing and newly assumed obligations will have the following positive results:

- improved financial discipline, that is, avoidance of situations when, alongside a failure to fulfill the already assumed spending obligations, new obligations are assumed, as a result of which the burden on the budget increases significantly;
- certain competition will arise between the subjects of budget planning in the course of budget resources being distributed among the assumed obligations, which will increase their incentives both for efficient spending on the existing obligations and for improving the quality of applications for budget allocations to newly assumed obligations;
- a mandatory estimation will be envisaged for the effect that the spending obligations assumed during a given budgetary cycle can produce on the important existing obligations, thus making it possible to understand to what degree these obligations can be financed at the expense of forecasted budget revenues.

The budgeting process must be organized in such a way so as to ensure the orientation of budget expenditure not to the support of the existing budgetary network, but to the rendering of budget-funded services and the achievement of socially important results. Such an orientation of budget expenditures can be achieved by various methods: through the preparation, by subjects of budget planning, of their reports on the results and main directions of their activity; by increasing the quality of target programs, etc. However, no matter which method is selected, it will be necessary, within the framework of the budgeting process, to perform the following tasks.

1. Performance-based qualitative estimation of budget expenditures implemented by subjects of budget planning, which should reflect both the volume and quality of the services

rendered (direct results) and their effect on the overall socioeconomic situation (end-results). The selected quantitative indices should comply with the following requirements:

- to remain strictly within the powers of the relevant level of authority;
- to maximally reflect the independent efforts of a subject of budget planning, and not to depend on external circumstances;
- to be determined by the activity of a subject of budget planning within the framework of a planning period.

2. Analysis of the performance level of subjects of budget planning during a reporting period, identification of the reasons for their failure to achieve certain performance indices. In this case it is important to estimate both the fact of achieving the indices demonstrating direct results and their influence on the forecasted dynamics of end-results. At the same time, a failure to achieve certain performance indices should by no means result in an automatic change of the volumes of financing allocated to a subject of budget planning (either upward or downward), but be treated as an evidence of performance-related problems with expenditures in a given sphere, to which adequate solutions must be provided.

3. The dependence of the distribution of the budget resources allocated to assumed obligations on the level of performance and the forecasted contribution in the achievements of the established priorities of the socioeconomic policy pursued by the bodies of authority of the Russian Federation. In this connection, it will be necessary to introduce some elements of competition between the subjects of budget planning for budget allocations to finance their assumed obligations, in order to eliminate any incentives for them to underestimate their performance indices, while simultaneously establishing responsibility for resorting to “dishonest competition” though unjustified overestimating these indices.

4. Mandatory participation in the estimation of the performance level of subjects of budget planning of a broad spectrum of related participants, as well as mandatory publicity of that process. This can be achieved on condition that the key role in the performance estimation is to be played by the Commission for Improving the Efficiency of Budget Expenditures, or another similar body incorporating representatives of the legislative and executive authority, the public, experts, etc.

If the mechanisms for estimating performance are applied in the budgeting process, then the following goals can be achieved:

- elimination of those expenditures that fail to provide adequate solutions to the issues the Russian Federation is actually faced with;
- the concentration of resources on socially important priorities, instead of their dispersion in small amounts between a multitude of existing problems, without actually solving any of them;
- the organization of a comprehensive dialogue between all the related parties, thus placing a barrier in the way of purely populist projects.

The implementation of all the aforesaid principles will make it possible to turn the RF budget into a mechanism for institutional modernization of this country, instead of an object for trade between branch-related lobbyists. ●

## MUNICIPAL REFORM AND VERTICAL OF POWER: THE FINAL DIAGNOSIS

I.Starodubrovskaya, N.Mironova

*The State Duma has approved the President's amendments to legislation on local self-government which envisage the dismissal of heads of municipal formations without considering the population's opinion on this matter. The discussion around these amendments has revealed the presence of conceptual disagreements between the proponents and opponents of these innovations not only with regard to issues of local self-government, but also to the principles of building the whole system of authority.*

The most important event of the first months of 2009 in the sphere of local self-government has become the discussion on the amendments to the Federal Law "On the general principles of the organization of local self-government in the Russian Federation" put forth by the RF President in late January 2009. These amendments envisaged the emergence of a new institution of "removing from office" the heads of municipal formations, in addition to the previously existing mechanism of their dismissal. In contrast to the latter procedure, the new mechanism envisaged an extrajudicial procedure for the dismissal of heads of municipal formations on the initiative of the representative body of a municipal formation or of the supreme administrative officer of the Federation's subject. At the same time, the grounds for dismissal were formulated with insufficient precision, and their list was an open one. In an event of the head of a municipal formation disagreeing with the decision concerning his or her dismissal, the latter was granted the right to express this special opinion in writing. In an event of the relevant initiative being declined by the representative body of a municipal formation, this issue could be once again submitted to it one month later.

Despite the "presidential" character of these amendments, they produced a far from unanimous response in society. This issue became the focus of animated debate at the meeting of the State Duma, in the experts community, and in the press. The draft law encountered stiff opposition from some political parties – the Communist Party of the Russian Federation (CPRF) and "Yabloko"; the deputies from the CPRF did not vote for the draft law in the first reading<sup>1</sup>. The All-Russian Council of Local Self-Government received more than 300 comments from municipal formations suggesting significant alterations. The issue attracted the attention of the Congress of Local and Regional Authorities of the Council of Europe, which requested all the documents relating the draft law, as well as an independent experts' estimation. Nevertheless, on 20 March 2009, the draft law was adopted in the first reading by a vast majority of 87 % of votes.

The content and the possible consequences of the adoption of this draft law have already been analyzed in detail in our previous publications. Here we should like to offer a general

1 It is necessary to note that this draft law was by no means supported by all the deputies from *United Russia*, either. Thus, one deputy from this party, Yelena Panina, declared that the mechanism of subordination of heads of local self-government to representative bodies suggested in this document is not going to work effectively. "The endowment of local assemblies with additional powers, on the one hand, will result in strengthening the positions of local officials: during an electoral campaign for the representative bodies, the municipality's head will do his best to pass to parliament a maximum number of his supporters. On the other, this creates the foundation for a takeover of local assemblies and councils by criminal structures, which will actually manipulate the mayor who is going to be dependent on them". (Based on materials published by *Vzgliad*, *Pravo.ru*, *BIA*, *REGNUM*, *Newsinfo*, 20.03.2009).

overview of the arguments “for” and “against” the adoption of these amendments, because they are sufficiently comprehensive in depicting the conceptually differing views of the prospects of local self-government in Russia.

The standpoint of the proponents of these amendments has found its most full expression in the discussions of this issue at the State Duma during the passage of the amendments in the first reading. It is noteworthy that their arguments were by no means based on appeals to legal norms. The in-depth analysis of the fact that a certain amendment was contrary to the RF Constitution, the previously adopted resolutions of the Constitutional Court, and the European Charter of Local Self-Government, attracted no attention at all, while the responses to such comments were of a purely declarative character (“no controversies”). The positive substantiation of the amendments was based exclusively on the feasibility of adopting such measures, irrespective of whether they were indeed compatible with the legal framework of the Russian institutional system.

Firstly, it was stated that this legislative act was designed to protect the population from incompetent officials. In this connection, it was assumed that this protection can most quickly and efficiently be achieved by the superior bodies of authority, and not the population of a municipal formation by itself.

Secondly, it was stressed that the abuses resulting from the application of this legislative act can negatively reflect on only a very small range of persons, whereas for the majority of municipal formations the effect of these amendments will be positive. Thus it was recognized that the protection of the rights of some citizens can be sacrificed in order to satisfy the populist demands of all the others.

Thirdly, it was estimated as a positive achievement that the ideology pursued in the amendments was a successor of the practices of the Soviet time. Thus, in the speech delivered by one representative of Fair Russia’s fraction it was stated that in the early 1990s we destroyed the Soviet system of local authority where lower tiers were rigidly subordinated to the upper ones, and so the President’s initiative was aimed at restoring that type of responsibility.

And fourthly and finally, there was expressed the conviction that, even if the draft law could indeed open up some opportunities for abuse, these opportunities would not be taken advantage of in actual practice. From this point of view, the following remark made by the Chairperson of the Committee for Local Self-Government of the State Duma, V. S. Timchenko, is very characteristic: “I am not sure than any political forces would, due to their political sympathies alone, prosecute any top officials, or heads of municipal formations”.

At the same time, the opponents of this amendment noted that its adoption will result in the creation of an institution for dismissing inconvenient heads of local self-government who might be for some reason disliked by a corresponding governor; besides, this amendment increases the dependence of municipalities on the party of power. Thereby the independence of local self-government and its status outside of the system of bodies of state authority, which is guaranteed by the RF Constitution, is grossly violated. These arguments are, to a varying degree, made use of by all the opponents of these innovations. Thus, in the Statement made by the European Club of Experts in Local Self-Government and the Municipal Workers Club it is noted that, according to the experts’ community, the mechanisms suggested in the draft law cannot help in achieving the desired goal; on the contrary, they can only aggravate the situation still further, because 1) they destroy the well-balanced structure of the existing branches of local public authority, which is part of the constitutional foundation of the State, 2) they violate the constitutional principle of independence of local self-government, 3) they introduce an extra-judicial procedure for depriving authority of its powers, which opens up unlimited opportunities for corruption. The same points are stipulated in the appeal to the RF President of the Russian Democratic Party YABLOKO: “The vagueness of the procedure

for enforced dismissal, lack of guarantees of judicial protection, the absence of an arbiter in the estimation of the grounds for putting forth the initiative of an enforced dismissal will inevitably give rise to intrigues, punishments based on motives of personal dislike, political ideology or economic interests”.

In brief and more specifically, the arguments against the the draft law were as follows:

- The removal of the head of a municipal formation is to take place without taking into account the population’s opinion, which is especially unacceptable in cases when the head has been elected at a universal election, and not from among the members of a representative body;
- the draft law does not envisage, in an event of making the decision concerning the dismissal from his post of the head of a municipal formation, the right for judicial protection (to which even representatives of some subjects of the Federation voiced their protest);
- the removal of the head of a municipal formation on a governor’s initiative represents interference of bodies of state authority with the independence of local self-government guaranteed by the RF Constitution<sup>1</sup>;
- the insufficiently specific and open list of grounds for dismissing the head of a municipal formation is unacceptable;
- the possibility of regular (with one-month interval) introduction of the initiative of dismissing the head of a municipal formation, in whom de facto the deputies’ corps have expressed their trust, is fraught with the possibility of destabilization of the municipal formation’s administration.

In the text of the draft law prepared for the second reading only two important comments were incorporated (though only in compromise form): the list of grounds for dismissing the head of a municipal formation has been made more specific and close-end, and the interval for the reintroduction of the dismissal motion has been extended to two months. The issues relating to the governor’s role in initiating the dismissal process, the absence of judicial protection of the head of a municipal formation, and the passive role of the population in this process have remained unchanged. The draft law was approved in the second reading on 22 April, and in the third reading – on 24 April 2009, virtually without any discussion.

By all indications, the final approval of the President’s amendments can be taken for granted, and the removal of heads of municipal formations will become yet another instrument for building the vertical of power and alienating local self-government from the population. However, the analysis of discussions going on around the draft law has also led to some more general conclusions. It is evident that the proponents and opponents of these amendments disagree not only with regard to the assessment of certain particular questions, but are guided by entirely different basic principles of organizing the system of authority and determining the role of local self-government in that system. While the opponents of this innovation refer to the values of the rule-of-the-law state, the need to comply not only with the letter but also the spirit of law; and the priority of the protection of the rights and freedoms of the person, its proponents rely on the priority of feasibility (as they understand it), populist approaches and hopes for the goodwill of authorities and political structures, who thus are not going to allow any law violations and corruption. Given this difference in their most fundamental views, one can hardly have any hope for a compromise. ●

<sup>1</sup> Thus, in its Ruling of 11.06.1999, No 105-O, the RF Constitutional Court pointed directly to “the responsibility of both the federal legislator and the legislator of a RF subject to ensure the unconditional right of the population and of the representative bodies of local self-government elected by it to independently, without the interference of bodies of state authority and state officials, form the bodies of local self-government” (paragraph 5 of Item 4 of the Declaration).

## ON POSITION OF SMALL-SCALE ENTERPRISES IN 2008

O.Izryadnova

The analysis of the situation in the small business in 2008 is the starting point for the analytical base for 2009 and is based on the following indices: (1) the number of the registered enterprises; (2) Average listed number of employees; (3) turnover of small-scale enterprises and (4) investments in fixed assets.

As on December 1, 2008 the number of the registered small-scale enterprises made 282.7 thousand throughout Russia as a whole or 199 for 100 thousand of the population. As broken by regions the biggest number of the small-scale enterprises registered for 100 thousand of the population was observed in the North-Western (232.6) and Siberian (232.2) federal okrugs, and the smallest – in the Ural federal okrug (91.5)

Table 1

NUMBER OF ENTERPRISES AND NUMBER OF EMPLOYEES AT SMALL-SCALE ENTERPRISES AS ON 01.01.2009, (MICRO-ENTERPRISES NOT INCLUDED)

	Number of enterprises		Number of employees (by-workers excluded)	
	total	as for 100 thousand of the population	thousand of people	as percentage to the total number of the employed in the economy
Russian Federation	282.7	199.1	6217.1	11.4
Central Federal Okrug	82.1	221.0	1678.4	11.7
North-Western Federal Okrug	31.4	232.6	812.7	9.0
Southern Federal Okrug	39.9	174.7	872.5	11.3
Privolzhski Federal Okrug	58.8	194.4	1406.5	10.6
Ural Federal Okrug	11.2	91.5	360.8	17.2
Siberian Federal Okrug	45.4	232.2	842.4	11.1
Far Eastern Federal Okrug	13.9	214.3	243.8	13.5

Source: Federal State Statistics Service

In 2008 6.2 million of people were employed by small-scale enterprises, which made 11.4% of the average annual number of the employed in the Russian economy as a whole. The level of the employment in the small business varied considerably throughout the territory of the Russian Federation and had a profound impact on the situation at the regional labor markets. In 2008 the highest level of employment at small-scale enterprises was registered in Ural and Far Eastern federal okrugs, and the lowest – in Privolzhski and North-Western federal okrugs.

The analysis of the distribution of the registered small-scale enterprises by the kinds of the economic activity demonstrates that in 2008 about 64% of enterprises belonged to the sector of services. In industry there were 46.1 thousand of small-scale enterprises registered, at which 1 253 million of people were employed, which makes 9.0% of the total number of the employed in the industry in Russian on the whole. In the construction, the average number of the employed made 1.0 million or nearly 19% of the average number of the employed in the construction on the whole.

The prevailing part of the enterprises and workplaces in the small business belongs to the trading enterprises, to the services for the operations with the immovable property.

Small-scale trading enterprises provide 14.2% of the employed in the activity “wholesale and retail trade, repair of motor-vehicles and motorcycles, household appliances and the items of private use” on the whole over the country with the workplaces.

On the whole the number of those employed at the small-scale enterprises throughout 2008 increased from 6069.3 thousand of people in the 1<sup>st</sup> quarter to 6262.6 thousand of people in the 3<sup>rd</sup> quarter. However against the background of the changes in the conditions for the development of the Russian economy under the influence of the world financial crisis and its spread to the real sector of the economy the constant increase in the number of the employees at small-scale enterprises that was observed in January-September 2008 was replaced by the reduction in the number of workplaces by 45.5 thousand in the 4<sup>th</sup> quarter. It should be noted that the decrease in the number of the employed was observed in nearly all federal okrugs and by all kinds of economic activities and was accompanied by the reduction in the goods and services output.

Table 2

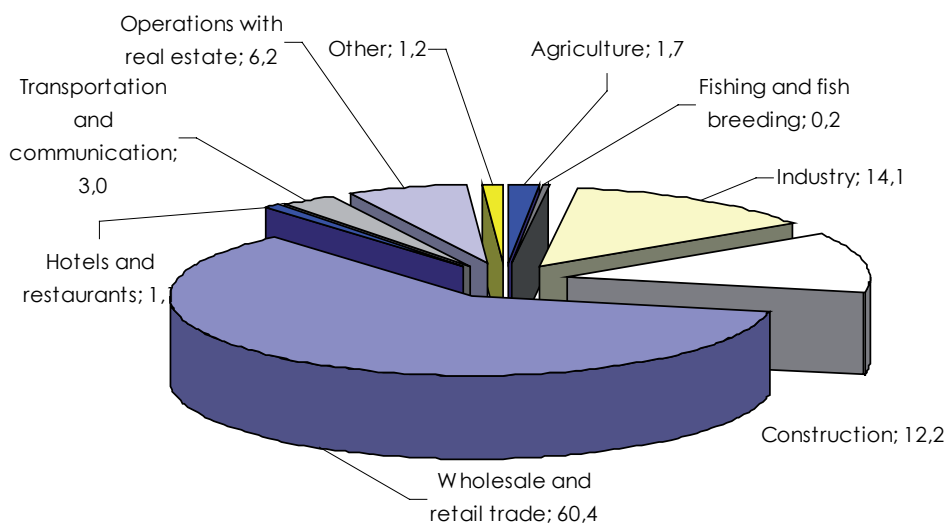
NUMBER OF ENTERPRISES AND NUMBER OF EMPLOYEES OF THE SMALL-SCALE ENTERPRISES BY KINDS OF ECONOMIC ACTIVITIES AS ON 01.01.2009, (MICRO-ENTERPRISES EXCLUDED)

	Number of enterprises		Number of employees (by-workers excluded)	
	thousand	as percentage to the total	thousand of people	as percentage to the total
Total	282.7	100	6217.1	100
Sector of goods	101.3	35.8	2750.4	44.2
agriculture, hunting, forestry	16.4	5.8	472.6	7.6
industry	46.1	16.3	1253.6	20.2
construction	37.9	13.4	1000	16.1
Sector of services	181.4	64.2	3566.7	57.4
wholesale and retail trade, repair of motor-vehicles and motorcycles, household appliances, items of private use	83.9	29.7	1659.4	26.7
hotels and restaurants	8.7	3.1	206.5	3.3
transportation	15	5.3	314.9	5.1
communication	2	0.7	33.8	0.5
operations with real estate, rent and services rendering	55.1	19.5	1002.7	16.1
health care and rendering of social services	4.1	1.5	66.6	1.1
rendering of other utilities, social and personal services	7.8	2.8	144.5	2.3
other kinds of activities	4.8	1.7	138.3	2.2

Source: Federal State Statistics Service

Structure of the small-scale enterprises' turnover on the whole throughout Russia was formed by the enterprises of wholesale and retail trade by 3/5 and the changes in the situation at the internal consumer and wholesale markets had a prevailing impact on the positions of the small business in the Russian economy.

In 2008 on the whole the turnover of the small-scale enterprises made RUR 10093.5 billion or 13.6% of the turnover by kinds of activities in the Russian economy, the share of turnover of small-scale enterprises in the kind of activity “construction” made 30.9%, “fishing and fish-breeding” – 25.4%, “agriculture” – 17.4%, “trade” – 18.8% and in “industry” – 5.5%. It is obvious that the slow-down of the works in the construction down to 12.8% in 2008 versus 18.2% in 2007, of the retail trade turnover – to 13.3% versus



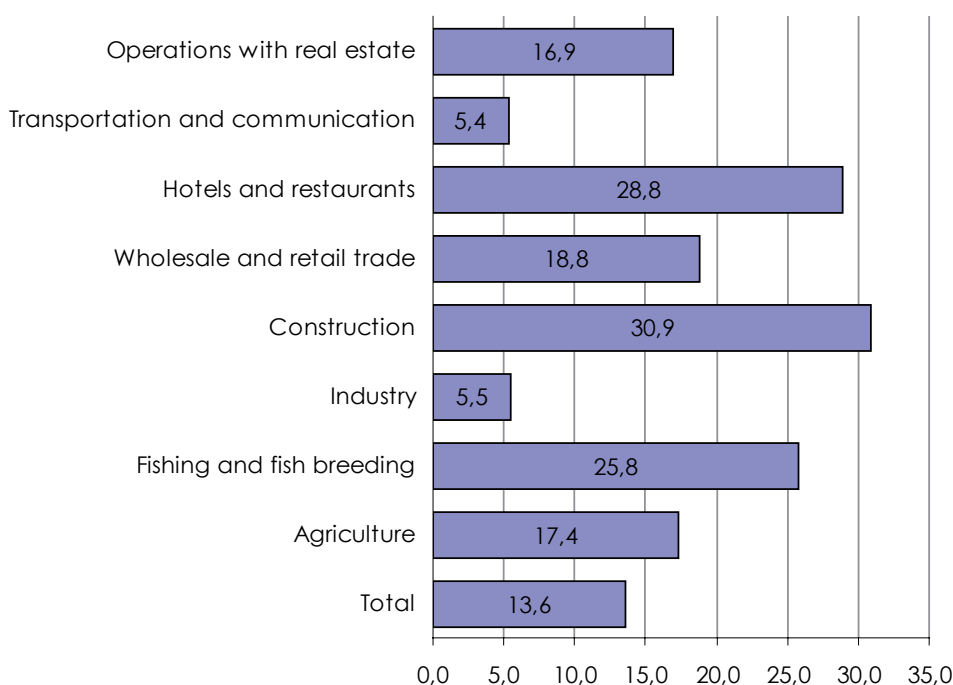
Source: Federal State Statistics Service

Fig. 1 Structure of Turnover of Small-scale Enterprises As Broken by Kinds of Economic Activities in 2008, as percentage to the total

17.7% and of wholesale trade turnover – to 4.7% versus 13.4% on the whole throughout the economy had a negative impact on the functioning of the small-scale enterprises. The comparative analysis of the small-scale enterprises turnover demonstrates that in the 4<sup>th</sup> quarter of 2008 as compared with the 3<sup>rd</sup> quarter the absolute reduction in the volumes or the sharp decrease in the

growth figures are observed versus the previous period.

It should be noted that the rates of the growth of production volumes of the Russian agriculture being exceptionally high in 2008 – 10.8% as compared with the preceding year – the small-scale agriculture enterprises also demonstrated quite high results and even in the 4<sup>th</sup> quarter there was the positive dynamics of the turnover growth observed. In the light of the territorial structure in the 4<sup>th</sup> quarter 2008 there was an absolute decrease in the small-scale enterprises turnover observed as compared with the previous quarter.



Source: calculated on the basis of the data by the Federal State Statistics Service

Fig. 2. Share of Turnover of Small-Scale Enterprises in All-Russian Figures of Organizations' Turnover By Kinds of Economic Activities in 2008, as percentage to the total

Slow-down of growth rates of credits issuing for enterprises from 31.28% in the 1<sup>st</sup> half of 2008 to 2.67 in July-October as on the corresponding period of the previous year had a negative influence on the conditions for small- and medium-scale enterprise functioning. In the 4<sup>th</sup> quarter the situation was aggravated by the influence of the reduction in the credit portfolio of 6 largest banks, crediting small business by more than RUR 50 billion (from RUR 853 billion to RUR 795 billion) or by 6%. It should be noted that it proceeded against the



background of the increasing of the average weighed rates fro credits to small- and medium-scale enterprises up to 20% versus 13% at the beginning of 2008.

Table 3

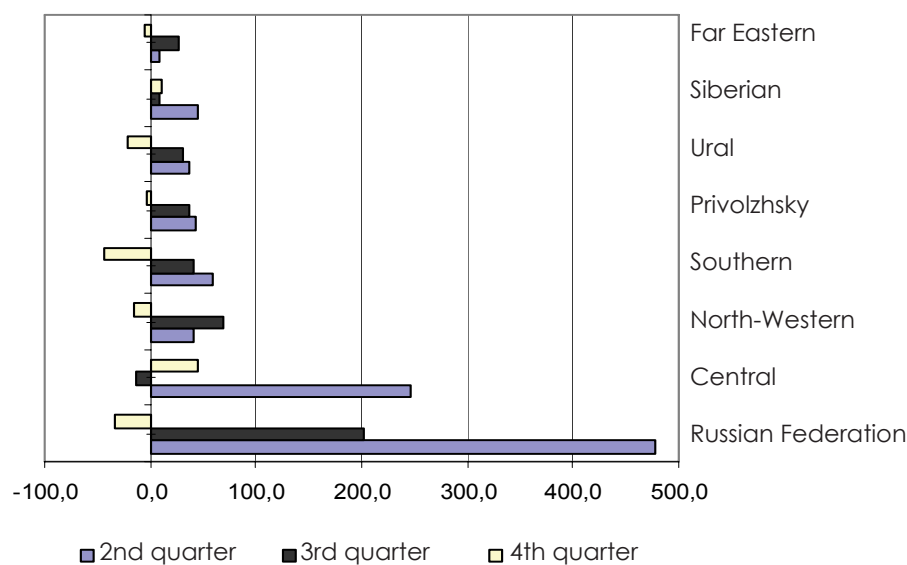
TURNOVER OF SMALL-SCALE ENTERPRISES BY KINDS OF ECONOMIC ACTIVITIES AS RUR BILLION, IN CURRENT PRICES (MICRO-ENTERPRISES EXCLUDED)

	2008	Including by quarters			
		I	II	III	IV*
Total, including::	10093.5	2072.9	2550.1	2751.9	2718.6
agriculture, hunting, forestry	170.7	32.8	35.2	50.7	52
fishing, fish breeding	23.1	4.8	6.1	6.5	5.7
industry	1418.7	280.6	365.8	403	369.3
minerals extraction	59.8	10.5	13.9	19.7	15.7
processing industries	1311.3	258.7	340.9	372.1	339.6
electricity, gas and water production	47.6	11.4	11	11.2	14
construction	1228.4	183	300.1	353.6	391.7
wholesale and retail trade, repair of motor-vehicles or motorcycles, household appliances, items of private use	6095.5	1332.5	1551.3	1615.8	1595.9
hotels and restaurants	106.7	23.1	28.4	27.9	27.3
transportation and communication	306.7	61.7	75.1	94.4	75.5
operations with real estate, rent, services rendering	627.4	131	157.9	168.3	170.2

Source: Federal State Statistics Service, author's calculations

The total volume of the investments in the fixed assets of the small-scale enterprises in the Russian Federation made RUR 317.4 billion in 2008. The leaders by the figure of the amount of the investments in the fixed assets are Southern, Siberian, Ural and Privolzhski federal okrugs. The smallest amount of the investments in the fixed assets was registered in far Eastern and North-Western federal okrugs. There is no connection between the level of the investments in the fixed assets and the labor efficiency, measures as the ratio of the turnover of small-scale enterprises to the number of the employed, observed. It is in the South-

ern, Siberian, Ural and Privolzhski federal okrugs where the turnover of the small-scale enterprises per one worker is on average 15% lower than the resumptive coefficient throughout the country as a whole. It is likely that the level of the efficiency depends on the direction and the structure of the capital expenditures and needs to be closely analyzed, especially in connection with the decisions to support the entrepreneurship planned for 2009.



Source: Federal State Statistics Service

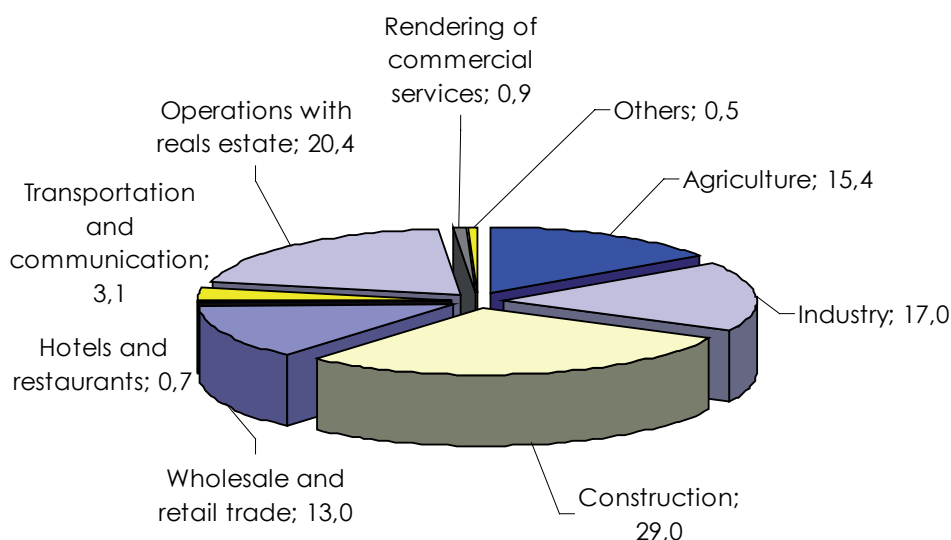
Fig. 3 Changes in Volumes of turnover of Small-Scale Enterprises by Federal Okrug in 2008, as RUR billion on the previous quarter

Table 4

INVESTMENTS IN FIXED ASSETS AT SMALL-SCALE ENTERPRISES BY FEDERAL OKRUGS OF RUSSIAN FEDERATION IN 2008

	Investments in fixed assets		Turnover at small-scale enterprises per one employee, as RUR thousand
	Total – as RUR billion	per one employee, as RUR thousand	
Russian Federation	317.4	51.1	1623.5
Central Federal Okrug	55.2	32.9	1831.0
North-Western Federal Okrug	20.9	25.8	1951.0
Southern Federal Okrug	67.2	77.0	1354.6
Privolzhski Federal Okrug	84.9	60.3	1349.5
Ural Federal Okrug	23.3	64.6	2319.3
Siberian Federal Okrug	60.1	71.4	1406.6
Far Eastern Federal Okrug	5.8	23.7	1365.7

Source: Federal State Statistics Service



Source: Federal State Statistics Service

Fig. 4 Structure of Investments in Fixed Assets Made by Small-Scale Enterprises As Broken by Kinds of Economic Activities in 2008, as Percentage to the total

As broken by kinds of economic activities, in 2008 more than 3/5 is accounted for by construction, operations with real estate, wholesale and retail trade. Investments in fixed assets of the small-scale enterprises in industry made 17%, in agriculture – 15.4%.

Among the obstacles for the development of the small-scale enterprises one can single out general and specific, which are characteristic for

different kinds of activities. The state of the infrastructure, availability of credit resources, availability of qualified staff, administrative barriers can be named among the general. For agriculture the main obstacles include in addition to the general, slow turnover of the capital, seasonal nature of the agriculture production, long-term realization of the investment funds, low provision with elite seed material and pedigree cattle, forage, fertilizers; disparity of prices for goods that are sold and purchased by the agriculture producers.

In the processing industry the subjects of the small-scale production faced high interest rates for commercial credits, high prices for production equipment, difficulties in accessing the trading networks, low prices for energy carriers, shortage of qualified workers, complicated system for obtaining certificates and licenses. ●

**MEETINGS OF THE GOVERNMENT OF  
THE RUSSIAN FEDERATION IN APRIL 2009**

M. Goldin

*In April at the meeting of the Government of the Russian Federation the following issues were considered: the progress of measures aimed at the recovery of the situation in the financial sectors and in some branches of the economy, the project of the Decree of the Government of the Russian Federation on measures to improve its activity connected with drafts of the laws.*

On April 9, 2009 at the meeting of the Government of the Russian Federation the report by the Minister of the Economic Development of the Russian Federation, Nabiullina E. S., “On the progress of measures aimed at the recovery of the situation in the financial sectors and in some branches of the economy” was heard.

It is mentioned in the report that the anti-crisis program, prepared by the Government of the Russian Federation, defines the main priorities of its actions as well as envisages the measures aimed at strengthening of the social protection of the population, at the perseverance and the development of the industrial and technological potential of the country, at the increase of the steadiness of the national financial system, contains the statements aimed at the fulfillment of the anti-crisis measures in the subjects of the Russian Federation.

When fulfilling anti-crisis program the Government of the Russian Federation acts on the basis of its seven main priorities. One of such priorities in the anti-crisis program is the confirmation by the state the fact that its public responsibilities to the population will be fully executed. It is stated that the citizens and families that were hard hit in the period of the world financial crisis will be supported. This envisages the strengthening of the social protection of the population, increase in volumes and quality of the rendering of social and medical services, improvement of the situation with the provision of medications, and especially with the vitally important medicines. Special attention will be paid to the sustention of the labor potential. The scale of the state actions in the field of employment, unemployment counteraction, and development of retraining programs for employees having a risk of redundancy will be enhanced.

The report cited the measures undertaken by the Government of the Russian Federation in order to overcome the aftermaths of the financial crisis in the country. For instance, in March 2009 the decisions connected with the support of the financial stability of the economic entities and commercial banks were adopted. The measures aimed at assisting the employment in the subjects of the Russian Federation are being fulfilled. At the same time the projects of the regulatory legislative acts concerning the provision of the possibility for conducting of leasing operations for the state purchases, giving the objects of the federal real estate to the subjects of small-scale and medium-scale enterprises were submitted to the Government of the Russian Federation. In order to allow the placement of temporary spare funds of the federal budget at the deposits of the commercial banks the Decree of the Government of the Russian Federation from March 29, 2008 No 227 “On the procedure for placement of the funds of the federal budget at the bank deposits” was adopted. At the same time a number of the regulatory legislative acts aimed at improvement of the customs and tariffs regulation of the economy was adopted. In accordance with the Federal Law from November 24, 2008 No 204-FZ the Government of the Russian Federation issued the

Decree from March 10, 2009 No 205 “On adoption of the rules for granting subsidies from the federal budget to the Russian enterprises of agriculture and tractor machine-building, timber complex, machine-building for oil and gas complex and machine tools industry to compensate a part of the expenses for the payment of interest rates for credits received at the Russian crediting organizations for the purposes of equipment modernization for the period of up to 5 years”.

On April 23, 2009 at the meeting of the Government of the Russian Federation the project of the Decree of the Government of the Russian Federation “On measures to improve the work on draft of laws in the Government of the Russian federation” was considered. The Project envisages a considerable change in the mechanism for the development of the drafts of federal laws, whose subject of law is the Government of the Russian Federation, as well as the development and adoption of the regulatory legislative acts of the President and the Government of the Russian Federation necessary to execute the federal laws.

The project, for instance, envisages:

- making transfer to middle-term planning of the legislative activity of the Government of the Russian Federation;
- regulatory fixation of the mechanism of making executive decisions on development and submission of drafts of the laws;
- development of the drafts of the law within the working groups created by the Government of the Russian Federation with the attracting of the representatives of the chambers of the Federal Assembly, public authorities of the subjects of the Federation, scientific expert and non-government organizations;
- improvement of the procedure for the preparation of the drafts of the laws, the drafts of the regulatory legislative acts of the President and the Government of the Russian Federation necessary to fulfill federal laws by the federal executive bodies.

On April, 27 at the meeting of the Government of the Russian Federation the drafts of the federal laws aimed at the fulfillment of the measures for the development of the pension systems and envisaging the increase of the level of pension provision and financial stability of the pension system in the long-term prospect – “On insurance contributions in the Pension Fund of the Russian Federation, Fund for Social Security of the Russian Federation, funds for compulsory health insurance” and “On making changes to some legislative acts of the Russian Federation and recognition as invalid some legislative acts (statement of legislative acts) of the Russian Federation in connection with the adoption of the Federal Law “On insurance contributions in the Pension Fund of the Russian Federation, Fund for Social Security of the Russian Federation, funds for compulsory health insurance”.

The draft of the law on insurance contributions in connection with the cancellation of the single social tax and the transfer to the insurance principles of the formation of the government off-budget funds the system of payment of insurance contributions to the Pension Fund of the Russian Federation - for compulsory pension insurance, to the Funds of Social Security of the Russian Federation – for compulsory social insurance in case of temporary incapacity for work and maternity leave, to Federal and territorial funds for compulsory health insurance and for the relations evolving during their administration is introduced.

According to the draft of the law it is envisaged that starting with January 1, 2011 the unified tariffs for all the employers are established: at the rate of 26.0% - to the Pension fund, at the rate of 2.9% to the Fund for Social Security, at the rate of 5.1% - to the Compulsory Health Insurance funds. At the same time in 2010 the tariffs of the insurance contributions to the mentioned government off-budget funds are preserved at the rate of the existing rate of the single social tax – correspondingly, - 20.0%, 2.9%, 3.1%.

For the payers of the insurance contributions not making payments for the benefit of natural persons (individual entrepreneurs, barristers and others) it is suggested to establish insurance fees at the fixed rates basing on the cost of the insurance year. The cost of the insurance year is defined by the formula: minimum wages\*12 months\*tariff.

One of the key features of the new system for payment of the insurance contributions from the existing single social tax (the tax rate decreases stepwise depending on the size of the taxation base reaching certain limits) consists in the establishment of the maximum size of the taxation base. Thus, for charging of the insurance fees for a natural person for employers who are payers of the insurance contributions by all kinds of compulsory social insurance the size of the taxation base is defined at the sum not exceeding RUR 415.0 thousand in 2010. In future its indexation is envisaged along with the increase of the average wages. The sums of payments and other rewards (for the benefit of natural persons) exceeding RUR 415.0 thousand there will be no insurance fees charged.

According to the draft of the federal law on making changes to some legislative acts of the Russian Federation and recognizing as invalid some legislative acts (statements of legislative acts) in connection with the draft of the law on the insurance fees the mechanism of the increase of the monetary estimation of the insured's pension rights is introduced.

Starting with January 1, 2010 the retirement pension will be increased to all the pensioners, in case their amount is defined with the application of the monetary estimation of pension rights received before January 1, 2002. It is envisaged that the calculated pension capital of the insured will be increased by 10% and by 1% above that for each year of seniority received before January 1, 1991.

Instead of the basic part of the retirement pension the fixed basic rate is introduced as a component of the insurance part of the retirement pension that is to be indexed according to the roles of indexation of the insurance part. Starting with January 1, 2015 the amount of the fixed basic rate will be increased by 6% for each year of the insured seniority exceeding 30 years. ●

## REVIEW OF ECONOMIC LEGISLATION

I.Tolmacheva

*At the end of March and in April the following changes were made: the procedure for appointing of a supreme official of a subject of the Russian Federation; the list of assets in which the means of the insurance contributions for financing of the saving part of the retirement pension; the new procedure for licensing of the educational activity was established; refinancing rate of the Bank of Russia was lowered.*

### **I. Federal Laws of the Russian Federation**

1. “ON MAKING CHANGES IN THE FEDERAL LAW “ON GENERAL PRINCIPLES FOR THE ORGANIZATION OF LEGISLATIVE (REPRESENTATIVE) AND EXECUTIVE BODIES OF THE PUBLIC AUTHORITIES OF THE SUBJECTS OF THE RUSSIAN FEDERATION” AND IN THE FEDERAL LAW “ON POLITICAL PARTIES” from 05.04.2009 No 41-FZ.

The law comes into effect in 90 days after its official promulgation.

It is established that the suggestions on the candidates for the posts of supreme officials of a subject of the Russian Federation (head of the supreme executive body of a subject of the Russian Federation) can be submitted to the President of the Russian Federation by the political party whose list of candidates received the majority of electorate’s votes according to the officially promulgated results of election to the legislative body of the subject of the Russian Federation latest to the day of submission and was allowed to participate in the distribution of the deputy’s mandates (in accordance with the version of the Federal Law “On political parties” currently in effect the right to initiate the consideration of the suggestion on the candidates for the supreme official of the subject of the Russian Federation belongs to the political party that has received the majority of the deputy’s mandates as a result of their distribution). The procedure for the submission of the suggestions on the candidates, the list of the necessary documents, the procedure for holding of the consultations and the procedure for consideration of the suggestions are established by the President of the Russian Federation.

Besides, the procedure for the dissolution of the legislative body of the Russian Federation in case the candidate for the post of the supreme official of the subject of the Russian Federation suggested by the President of the Russian Federation is dismissed or the decision on the candidate is not made in the established period (for instance, the number of the consultations held is reduced), the procedure for the submission of proposal of the candidate on the supreme official of the subject of the Russian Federation in case the authority of the supreme official of the subject of the Russian Federation ceased before the term was specified, the conditions under which a citizen cannot be a candidate for the supreme official of a subject of the Russian Federation were established, the authorities of the person temporarily acting as a candidate for the supreme official of the subject of the Russian Federation were specified.

### **II. Decrees of the Government of the Russian Federation**

1. “ON MAKING CHANGES TO THE REGULATIONS ON INVESTING THE MEANS OF THE INSURANCE CONTRIBUTIONS TO FINANCE THE SAVING PART OF THE RETIREMENT PENSION ACCRUED BY THE PENSION FUND OF THE RUSSIAN FEDERATION DURING THE YEAR” from 30.03.2009 No 257.

It is established that the funds of the insurance contributions to finance the saving part of the retirement pension accrued during the year by the Pension Fund of the Russian Federation can be also placed as ruble deposits in Russian crediting organizations that meet certain requirements (have general license of the Central Bank of the Russian Federation, have rating of long-term solvency of definite level according to the classification of the international rating agencies, have own funds of no less than RUR 5 billion etc.).

Besides, the Pension Fund of the Russian Federation was granted the right to make operations on transfer of securities and monetary funds between investment portfolios (of different financial years) formed by the means of the insurance contributions. The Pension Fund of the Russian Federation is also to inform the Ministry of Finance of the Russian Federation on the volume and the structure of the investments of the insurance contributions, and the Federal Service on Financial Markets on the operations with assets composing investment portfolios.

2. “ON ADOPTION OF THE DECREE ON LICENSING OF EDUCATIONAL ACTIVITY” from 31.03.2009 No 277.

Comes into effect on July 1, 2009, excluding some statements.

The decree establishes the procedure for the licensing the educational activity of educational institutions and organizations, created in other organizational and legal forms, as well as scientific organizations, fulfilling main and (or) additional educational programs and programs for professional training. New Statement on the whole reproduces the norms of the procedure, earlier in effect, for instance, the educational activity in the form of one-time lectures, seminars and other forms of training that are not accompanied with the certification and issue of the documents on education or qualification, as well as the individual pedagogical activity, including the activity in the field of the professional training.

New statement on the licensing of the educational activity embrace the correspondent education as well, for which purpose the applicant for the license, having the intention to fulfill the educational programs with the partial or full use of the correspondent educational technologies presents the data and copies of the documents giving the evidence for the corresponding methodical and resource supply, substituting partially or fully the traditional educational resources.

It is envisaged that the licensing of the educational activity in concordance with the established competence is carried out by the Federal Service of Supervision in the field of Education and Science and executive bodies of the Russian Federation, supervising the field of education. Earlier local authorities also had a right to issue the license.

The period of the license validity cannot exceed six years.

The Decree of the Government of the Russian Federation from 18.10.2000 No 796 “On adoption of the decree on the licensing of the education activity” is recognized as invalid.

### **III. Instructions, Letters, Orders**

1. Instruction of the Central Bank of the Russian Federation from 23.04.2009 No 2222-U “ON REFINANCING RATE OF THE BANK OF RUSSIA”

From April 24, 2009 the refinancing rate of the Bank of Russia is established to be 12.5% per annum. Earlier the refinancing rate was equal to 13% per annum. ●

## REVIEW OF REGULATORY DOCUMENTS CONCERNING TAXATION OVER MARCH–APRIL 2009

L.Anisimova

1. According to the Letter of the Federal Tax Service of the Russian Federation from April 10, 2009 No ShS-22-3/279@ and the Letter of the Ministry of Finance of the Russian Federation from 24.03.2009 No 03-07-15/47 the question on the procedure for fulfilling the Supplement to the Tax Declaration on VAT approved by the Decree of the Ministry of Finance of the Russian Federation from 07.11.2006 No 136n, in case the modernization (reconstruction) of the building is being carried out is clarified.

The matter of importance is the following. If the object of immovable property is to be used to produce goods (work, services) that not to be levied with VAT, the VAT included (that was earlier deduced or compensated) is to be recovered to the tax-payer and he is to pay it during 10 years (this does not apply to the completely amortized objects and objects in operation for more than 15 years).

The recovered sums are not to be reflected in the tax declaration.

Besides, the letter clarifies the situation when the reconstruction (modernization) of the fixed assets was carried out with the object being removed from service or not being removed from service. In case reconstruction (modernization) of the object of fixed assets is carried out it not being taken out of service a special Supplement to the declaration is filled out for the sum of tax, declared for the reduction by building and assembly works, as well as by goods (works, services) purchased to fulfill the building and assembly works, and the account of VAT related to the increment value as a result of the reconstruction (modernization) conducted is to be made in the same Supplement.

In case the object of the fixed assets was taken out of service, VAT recovery sums are to be calculated basing on the cost corrected by the amount of the expenditure for reconstruction (modernization).

2. According to the Letters of the Federal Tax Service of the Russian Federation and the Ministry of Finance of the Russian Federation from 31.03.2009 No ShS-22-3/238@, the Federal Tax Service of the Russian Federation from April 15, 2009 No ShS-22-3/291@ the question on the procedure for the application of the property deduction concerning the incomes tax on natural persons in connection with the Federal Law from 26.11.2008 No 224-FZ coming into effect from January 1, 2009 was clarified. For instance, the Ministry of Finance explained that the tax-payer can apply the property deduction at the sum of no more than RUR 2 million in case the right for such a deduction evolved starting from January 1, 2009 and the expenses were made before this date.

3. According to the Order of the Federal Tax Service of the Russian Federation from April 1, 2009 No MM-7-6/228@ the “Format of the granting of tax declarations, accounts and other document acting as a basis for the calculation and payment of duties in fees in electronic form (on the basis of XML) (version 5)” was approved (for instance, the composition and the structure of the indices of the accounting balance, composition and structure of the indices on the reports on changing the capital etc.)

4. According to the Federal Law from April 5, 2009 No 45-FZ changes are introduced in article 4 of the Law of the Russian Federation from December 9, 1991 No 2003-1 “On



property taxes for natural persons”. The list of citizens having the right to get a taxation privilege was enhanced.

5. According to the letter of the Ministry of Finance of the Russian Federation from March 23, 2009 No 03-03-06/4/20 the question on the taking into account the insurance risks (sums of the insurance contributions) of an auditing firm making compulsory audit of the clients in order to tax its profits was clarified.

The Ministry of Finance of the Russian Federation, for instance, clarified that all the expenses of the auditor resulting from its failure to fulfill the conditions of the agreement cannot decrease the taxation base for the profit tax.

The position of the Ministry of Finance of the Russian Federation is based on the fact that, in accordance with the article 932 of the Civil Code of the Russian Federation the insurance of the risk connected with the responsibility for the violation of the agreement when making compulsory audit of the client’s account is accepted only in cases envisaged by the law. Insurance of liability for non-fulfillment or improper fulfillment of the contract liabilities is referred to the kind of the insurance of civil liability in accordance with article 32.9 of the Law of the Russian Federation from 27.11.1992 No 4015-1 “On organization of the insurance business in Russia” as compared with, for instance, the agreement on the insurance of the financial risk, whose expenditures can be ascribed to the reduction of the taxation base. The difference is that in the first case the risks and losses of the third party from the insured party activity are insured (that is why they are called the risks of the civil liability) and in the second case the insured insures his own risks (that is the possibility of losses as a result of the actions of the agreement’s counteragent).

6. According to the letter of the Ministry of Finance of the Russian Federation from March 18, 2009 No 03-03-06/1/164 the question on the possibility to attribute the expenses on servicing the temporarily closed down object (light, guarding etc) to the expenses for the purposes of profit taxation is clarified. In the opinion of the Ministry of Finance of the Russian Federation the expenses connected with the temporary close-down of the object of the immovable property are aimed at preservation of the property that will later give an income, that is why such expenses including the expenses for the guarding the temporary closed-down objects are regarded as economically justified for the purposes of enterprises’ profit taxation and can reduce the taxation base.

7. According to the letter of the Ministry of Finance of the Russian Federation from March 20, 2009 No 03-03-06/4/19 the question on the possibility not to include the residue of the unused reserve of payments by the end of the year in the non-sale profits of the organization but instead to take it into account when forming the reserve for reward payments for next year is clarified.

In accordance with paragraph 5 article 324.1 of the Tax Code of the Russian Federation the assignments for payment of the rewards as a result of the work during the year are made with the right of transfer to next taxation period of the reserve that was not used by the end of the taxation period. In order to transfer the unused reserve for the next year, in the opinion of the Ministry of Finance of the Russian Federation, one should define the way for the reservation and the procedure for the calculation of the of the maximum sum of the assignments in the reserve, as well as to justify the criterion according to which the rate of the residue to be transferred to the next taxation period (for instance the percentage from the profit or the sum per one employee) will be specified at the last date of the taxation period, since the procedure for such specification is defined in paragraph 4 article 324.1 of the Code only for the reserves for holiday payments, in the accounting policy of the organization. Only

in case there are the corresponding clarifications in the accounting policy of the organization and in case the enterprise will continue to make the reserve for the regular payment of the reward as a result of the work during the year the residue of the unused sum of the reserve may be included in the non-sale profits and be taken into account when forming the reserve for the payments of the rewards on the basis of the results of the work the next year.

8. According to the Decree of the Government of the Russian Federation from March 24, 2009 No 252 the changes are made in the decree of the Government of the Russian Federation from 28.06.08 No 485. The list of the organizations that give grants is enhanced. Earlier the government of the Russian Federation limited the list only by international organizations. At present foreign organizations are also included in the list.

9. According to the letter of the Ministry of Finance of the Russian Federal and the Federal Tax Service of the Russian Federation from March 20, 2009 No VE-17-5/63@ the letter of the Ministry for Health Care and Social Protection of the Russian Federation from 20.02.2009 No 194-13, received in connection with the inquiry from the Federal Tax Service of the Russian Federation (letter of the Federal Tax Service of the Russian Federation from 30.12.2008 No 5-2-06/00033) was referred to as guidelines for work.

The Ministry for Health Care and Social Development of the Russian Federation explained the application of the Regulations of the compensation for transport fees and for the luggage carriage to the place of holiday and back for the people working in the organizations financed from the budget and situated in the regions of the Extreme North and the regions of the equal status and members of their families established by the Decree of the Government of the Russian Federation from June 12, 2008 No 455. For instance, it was explained that the regulations do not establish the limitation concerning the necessary observance of the date for the employee and his family's departure and arrival during the annually paid holidays. The Labor code of the Russian Federation gives the employee a right to combine due holidays, including the holidays without preserving the wages, necessary to travel to the place of holidays and back.

In case the employee is not given the holidays without preserving wages necessary to travel to the place of holidays and back, the departure and the arrival can fall on holidays or weekends nearest to the holiday.

In each separate case in order to pay the compensation the question whether the employee spent his regular holiday in different places or passed the points by the way is solved by the administration of the organization on the basis of the explanatory note by the employee and the travel documents submitted. The compensations are not included in the labor remuneration and are a form of social allowances for the purposes of taxation.

10. According to the letter of the Federal Tax Service of the Russian Federation from March 25, 2009 No ShS-21-3/226 the procedure for the calculation and payment of the single social tax concerning the part due to be paid to the federal budget is clarified. The Federal Tax Service of the Russian Federation clarifies that in case the sum of the single social tax is less than the sum of the tax deduction in the form of the insurance contribution for the compulsory pension insurance, the sum of the single social tax due to be paid to the federal budget in the corresponding month will be nullified. This applies to the calculation of the single social tax paid to the federal budget both from the organization as a whole and from payments and other forms of remuneration charged for the benefit of come natural person.

Paragraph 2 clause 2 article 243 of the Code envisages that the sum of the tax deduction cannot exceed the tax sum due to be paid to the federal budget charged for the same period. There are no negative payments of single social tax to the federal budget formed and,

consequently, cannot be accepted as reduction of the calculated sums of the single social tax either for some employees or for the organization as a whole.

11. According to the letter of the Federal Tax Service of the Russian Federation from March 25, 2009 No 3-2-10/8 the question on the procedure for the filling the tax declarations for organizations' profit tax upon changing the procedure for tax payment and on submission of the corrected tax declarations is clarified.

In case in the territory of one and the same subject of the Russian Federation the second separated branch is created, the tax-payer is to choose one responsible separate branch out of two, and pay the tax through it. The payment of the tax through the separate branch chosen is to be made after the creation of the second separate branch and the choice of the responsible branch and is not to be connected with the beginning of the next taxation period.

The procedure for opening and closing of the record chart for the payments through the responsible authorized branch is to be made according to the procedure stipulated in the letter of the Federal Tax Service of the Russian Federation from 28.12.2005 No MM-6-02/2005.

12. According to the letter of the Federal Tax Service of the Russian Federation from March 23, 2009 No ShS-22-3/215@ the procedure for the application of VAT deduction for non-monetary operations in the transition periods of changes introduced in the Tax Code of the Russian Federation, including the periods of 2007-2008, 2008-2009 as well as the operations between customers and sellers with the use of promissory notes is elucidated.

Thus, in connection with the Federal Law from 26.11.2008 No 224-FZ coming into effect on 01.01.2009, changes were made to articles 168 and 172 of the Tax Code of the Russian Federation concerning the abolition of the compulsory payment of the monetary form of VAT during barter transactions, payment by property or by the promissory note of the customer. The Federal Tax Service of the Russian Federation elucidates that the taxation sums which are presented for the tax-payer upon him purchasing goods (works, services) taken into account starting with 01.01.2009 are to be deduced according to the procedure and on conditions envisaged by articles 171 and 172 of the Code, that is after these goods (works, services) were taken on balance, invoices and corresponding primary documents being available.

13. According to the letter of the Federal Tax Service of the Russian Federation from March 23, 2009 No ShS-22-3/216@ the question on the levy with VAT when carrying out building and assembly works for own consumption is clarified. On the basis of clause 10 article 167 of the Tax Code of the Russian Federation the moment for the defining of the taxation base when carrying out building and assembly works for own consumption is the last day of each taxation period. The deduction of the tax sums calculated by the tax-payer when carrying out building and assembly works for own consumption are made when the following requirements are met:

- the object being constructed is to be used in operations levied with the value added tax;
- the value of this object is to be included in expenditures (through capital allowances as well) when calculating the organizations' profit tax.

The Federal Tax Service of the Russian Federation clarifies different situations connected with the use of the objects built for own needs, including the case of its real use in the operations not levied with VAT. In this case the Vat that was previously ascribed to expenditures is to be recovered and paid to the budget during 10 years. ●

## REVIEW OF BUDGETARY LEGISLATION

M. Goldin

*In April a number of events took place in the field of budget legislation: corrections aimed at providing the balance of the federal budget as well as at optimization of the budget process in the environment of the financial crisis were introduced in the Budget Code of the Russian Federation; the indices to estimate the efficiency of operation of the executive bodies of the Russian Federation were adopted by the decree of the Government of the Russian Federation.*

According to the Federal Law from 09.04.2009 No 58-FZ “On making changes to the Budget Code of the Russian Federation and some legislative acts of the Russian Federation” in order to balance the federal budget and to optimize the budget process in the environment of the crisis the following changes were made in the Budget Code of the Russian Federation:

First, in connection with the considerable decrease of earnings to the incomes part of the federal budget forecast for 2009-2011, changes were made concerning the procedure for the use of the means of the Reserve Fund in order to finance the deficit of the federal budget. To meet this goal the action of some statements of articles 94 and 96.9 of the Budget Code of the Russian Federation establishing, for instance, the goal of the use of the means of the Reserve Fund was suspended.

In this connection, in 2009-2012 the Government of the Russian Federation receives the right to adopt decisions on the use of the means of the Reserve Fund of the Russian Federation and other remainders of the federal budget to make payments reducing the debt liabilities, to reduce borrowings and to balance the federal budget without making changes to the federal law on the federal budget;

Second, the norms of the Budget Code of the Russian Federation regulating the procedure for making changes in the federal law on the federal budget were changed. In order to enhance the possibilities to subsidize the measures on balancing the local budgets from the budgets of the subjects of the Russian Federation, it is established that up to January 1, 2012 the limitation (of no more than 10% of interbudgetary transfers) established by article 139.1 of the Budget Code of the Russian Federation may be exceeded by the amount of subsidies from the budget of the subject of the Russian Federation to provide the balance of the local budgets;

Third, in case in the current financial year the total incomes of the federal budget (excluding oil and gas earnings and the incomes from the placement of the means of the Reserve Fund and the Funds for National Welfare) decrease by more than 15% as compared with the volumes of mentioned incomes envisaged by the federal law on the federal budget for the current financial year and the planning period, the statements of the federal law mentioned concerning the planning period may be regarded as invalid. It should be noted that upon the submission of the project of the federal law on the federal budget for the current financial year that envisages recognition of the statements of the federal law on the federal budget concerning the planning period as invalid, no corrected forecast for social and economic development of the Russian Federation in the planning period is provided.

According to the decree of the Government of the Russian Federation from 31.03.2009 No 282 “On making changes to the regulations for the preparation and fulfillment of the

budget investments in the objects of capital construction of the state property of the Russian Federation not included in long-term federal target programs” the amount of the calculated sum of the objects of capital construction of the federal institutions, which the decision on the preparation and the fulfillment of the budget investments in the form of the act of the superintendant concerns, was increased from RUR 600 million to RUR 1.5 billion.

According to the Decree of the Government of the Russian Federation from 15.04.2009 No 322 “On measures to fulfill the Decree of the President of the Russian Federation from June 28, 2007 No 825 “On estimating the efficiency of the operation of the executive bodies of the Russian Federation” the list of the additional indices to estimate the efficiency of the operation of the executive bodies of the Russian Federation was defined.

The list mentioned was developed as a supplement to the List of the indices to estimate the efficiency of the operation of the executive bodies of subjects of the Russian Federation adopted by the Decree of the President of the Russian Federation from 28.06.2007 No 825.

The indices adopted characterize, for instance, the level of social and economic development of the subject of the Russian Federation, the situation in the field of the health care, education, provision of the citizens with dwellings, organization of the state and municipal management.

According to the Decree of the Government of the Russian Federation from 15.04.2009 No 322 the methods for the estimation of the efficiency of the operation of the executive bodies of subjects of the Russian Federation in the accounting period was also developed in order to prepare annual report of the Government of the Russian Federation to the President of the Russian Federation. ●

## RESULTS OF WORLD TRADE WITH GOODS AND SERVICES IN 2008 AND PROSPECTS FOR DEVELOPMENT OF RUSSIA'S FOREIGN TRADE

A.Pakhomov

*At the end of March of the current year the Secretariat of the World Trade Organization (WTO) published the analytical review on the results of the world trade in 2008 and the prospects for the development of the international trade in 2009. The review includes preliminary statistical data for world trade with goods and services from the point of view of regions and countries.*

According to the estimations made by the WTO analysts the increase in the world trade made only 2.0% in real terms in 2008 (the lowest figure for the current decade) as compared with 5.5% in 2007 and 8.5% in 2006. According to the forecasts of the World Trade Organization in 2008 the growth rates of the international trade were expected to decrease down to the lowest level of six preceding years but no less than 4.5%. As a result, average annual growth rates of the world trade made 5.7% in 1998-2008.<sup>1</sup>

WTO calculated the real growth of trade taking into account inflation in different countries and the dynamics of the currencies' exchange rates on the basis of the forecasts made by the statistics services of the UN and IMF. In 2008, nominally, the world export of goods increased by 15% and reached USD 15.8 trillion, and the world export of services- by 11% and made USD 3.7 trillion. In 2007 the corresponding growth rates of goods export were 15%, and of services export – 18%.<sup>2</sup>

In 2008 the place of the biggest exporter of goods was retained by Germany (USD 1.47 trillion, the share in the global export being 9.1%), which is followed by China (USD 1.43 trillion, 8.9%) and the USA (USD 1.31 trillion, 8.1%). The same countries hold the leading positions among the biggest importers: the USA (USD 2.17 trillion, the share being 13.2%), Germany (USD 1.21 trillion, 7.3%) and China (USD 1.13 trillion, 6.9%) . The more detailed information on the world rating of the leading exporters and importers of goods and commercial services are presented in the appended tables 3 and 4.

The recession of the world trade started in the second half of 2008 in connection with the sharp reduction in demand for goods and services. The slow-down of GDP growth resulted in the decrease of export and import growth rates in all regions of the world. It is forecast that the volume of the international trade will reduce by 9% in 2009. This will be the most dramatic decrease for the post-war period, which is accounted for by the global recession (according to the estimation by the WTO the world production may reduce by 2%) and the strengthening protectionist trends (for instance, the majority of G20 countries introduced different measures to limit import at the end of 2008 – the beginning of 2009).<sup>3</sup>

The current forecast is the most pessimistic for 62 preceding years, which is the period of GATT/WTO existence. It is envisaged that the trading crisis will concern primarily the developed countries in which producers and consumers traditionally attract considerable

1 «World trade 2008, Prospects for 2009: WTO sees 9% global trade in 2009 as recession strikes», WTO Secretariat Geneva, WTO\ PRESS\554, 24 March 2009, pp.1,7.

2 «World Trade 2007, Prospects for 2008: developing, transition economies cushion trade slowdown», WTO/PRESS/520/Rev.1, 17 April 2008, Geneva, pp. 2,7

3 The Wall Street Journal, 24 March 2009.

crediting funds. That is why in this group of countries the volume of trade can reduce by 10% in real terms, whereas in the developing countries the reduction will only be 2-3%. The WTO also warns that it is impossible to define real scale of the global recession: the drop of the world trade may be deeper, for instance, it is estimated to be 13% in the April forecast by the OECD.

According to the WTO rating (preliminary data), in 2008 the Russian Federation held the 9<sup>th</sup> place in the world by the export value volumes, which was USD 472 billion. It should be noted that the annual nominal growth rates went up to 33%. The share of Russia in the global export made 2.9% (in 2007, correspondingly, the 12<sup>th</sup> place and 2.5%). As to import value volume (USD 292 billion, growth rates of 31%) Russia remained in the 16<sup>th</sup> place, with the share in the total import reaching 1.8% (in 2007, correspondingly, 16<sup>th</sup> place and 1.6%).

Not taking into account the intraregional trade between 27 countries of the EU and some members of the group, Russia holds the 5<sup>th</sup> place as to goods export and the 10<sup>th</sup> place as to goods import in the world (7<sup>th</sup> and 10<sup>th</sup> places, correspondingly, in 2007). On the whole, the share of Russia in the world trade with goods and services in the previous year went up to 2.1% versus 1.9% in 2007.

In the rating of the countries exporting commercial services<sup>1</sup> in 2008 (USD 50 billion, growth rates of 29%) the Russian Federation held the 22<sup>nd</sup> place, its share being 1.3% (in 2006, correspondingly, the 25<sup>th</sup> place and 1.2%). As to the import of commercial services (USD 75 billion, growth rates of 29%), Russia retained the 15<sup>th</sup> place in the world, its share being 2.2% as compared with 1.9% in 2007.<sup>2</sup>

On the whole, the share of services in the aggregated Russian export made 9.6% in 2008, which is two times less than the average level in the world (19.3%). In the developed countries the share of services export makes on average 20-25%, which testifies the comparatively low realization of export potential of the sphere of services in Russia. Besides, the balance of trade with services of the Russian Federation has a chronic deficit since the beginning of the pervious decade.

*Table 1*

DYNAMICS OF RUSSIA'S POSITION IN WTO RATING AND ITS SHARE IN WORLD TRADE WITH GOODS AND SERVICES IN 2000-2008

	2000	2005	2006	2007	2008
Export of goods	17 -1.7	13-2.4	13-2.5	12-2.5	9-2.9
Import of goods	29-0.7	19-1.2	18-1.3	16-1.6	16-1.8
Export of services	31- 0.7	26-1.1	25-1.1	25-1.2	22-1.3
Import of services	22-1.2	17-1.6	18-1.7	16-1.9	16-2.2

\* the first number is the place in the rating, the second – the share as percentage

Source: calculated by the author on the basis of the WTO statistics over the corresponding years

Despite the steady increasing dynamics of the indices (see table 1), reflecting the quantitative growth of the foreign trade with goods and services, Russia faces the problems that require serious analysis and elaboration of new strategic approaches to the development of the foreign economic sphere. At the end of the current decade the Russian

1 The foreign trade with commercial services is defined as the fulfillment of paid works (services) that are not directly connected with the creation of material goods. So-called government services that are rendered (given) within the borders of the country constitute the major part of non-commercial services.

2 «World trade 2008, Prospects for 2009: WTO sees 9% global trade in 2009 as recession strikes», WTO Secretariat Geneva, WTO\ PRESS\554, 24 March 2009, pp. 19-21.

economy is confronted with long-term system challenges reflecting both the global trends and the internal barriers for the development that became considerably more acute in the period of the global crisis.

Table 2

## MAIN INDICES OF RUSSIAN FOREIGN TRADE IN 2008

Data	indices 2008, as USD billion				as percentage to 2007		
	turnover	export	import	balance	turnover	export	import
Federal Customs Service of the Russian Federation	735.0	468.1	266.9	201.2	133.2	133.0	133.6
Central Bank of the Russian Federation and Federal State Statistics Service	763.7	471.8	292.0	179.8	132.2	133.1	130.6
Ministry of Economy Development of the Russian Federation*	762.3	470.8	291.5	179.3	131.9	132.8	130.4

\* On the basis of balance-of-payments methodology

Source: composed by the author on the basis of the corresponding data

According to the data of the Federal State Statistics Service and the Central Bank of the Russian Federation the foreign trade turnover of Russia in 2008 made USD 763.7 billion, which is by 32.2% more than the figure of 2007. The positive foreign trade balance reached USD 179.8 billion. It should be noted that in 2008 export went up by 33.1% as compared with the figures over the corresponding period of 2007 and made USD 471.8 billion, and import – by 30.6% (USD 292 billion).

The turnover with the trading partners from non-CIS countries, whose share makes up more than 85% of the foreign trade, increased by 34% in 2008, making USD 628.5 billion, of which the EU countries account for USD 382.1 billion (52%). The foreign trade turnover with CIS countries (15%) went up by 29% and made USD 106.5 billion. The data given in estimations by the Ministry for Economic Development of the Russian Federation made in accordance with the balance-of-payment methodology are nearly the same.

It should be noted that the real growth rates of the foreign trade turnover, especially export, tend to slow down. As a result of correction of the indices of foreign trade by the Central Bank of the Russian Federation in 2008 the real export of goods exceeded the data of the Federal Customs Service of the Russian Federation by 1% (in 2007 – 1%), and real import – by 8.5% (in 2007 – 12%). Thus, if the WTO rating used customs statistics, Russia would again be among the leading trading countries in the world with regard to both export and import.

According to the corrected forecast by the Ministry of Economic Development it is expected that in 2009 export will drop by 45% and make USD 259.7 billion, and import will decrease by 20% - to USD 233.0 billion. Correspondingly, the foreign trade balance will remain positive, but will reduce by nearly 8% - to USD 26.7 billion.<sup>1</sup> Export growth rates are expected to be 7-15% in 2010-2012, while import is to grow by 9-11%. Taking that into account, it should be expected that having reached the record-breaking positions in the world rating in the previous year in 2009 Russia will take lower positions.

As compared with the corresponding period of the previous year in January-February 2009 according to the data of the Ministry for Economic Development of the Russian Federation the positive foreign trade balance of the Russian Federation reduced by 2.2 times

<sup>1</sup> The main indices of the corrected forecast for social and economic development of the Russian federation for 2009, Ministry for Economic Development of the Russian Federation, [www.economy.gov.ru](http://www.economy.gov.ru)



and made USD 15.2 billion. At the same time export of goods reduced by 1.8 times – down to USD 39 billion, which is accounted for by the sharp drop of prices for the main export goods and the contraction of the external demand for them.

Import of goods reduced by 35.5% and made USD 23.8 billion, import of machine-building production decreasing by 47.5%, of foodstuffs and materials for their production – by 21.8%, of production of chemistry industry – by 31.3%.

As compared with the corresponding period of the previous year, in the first quarter 2009 the external demand for Russian goods decreased, according to the data of the Ministry for Economic Development of the Russian Federation, by 45.4% (down to USD 60.1 billion) in terms of value and by 10% in terms of physical volume. Import of goods reduced by 36.2% and reached USD 38.4 billion, the foreign trade balance making USD 21.7 billion (USD 49.9 billion in the 1<sup>st</sup> quarter 2008).<sup>1</sup>

It is assumed at the same time that the Russian economy may liven up at the end of the year, which will be assisted by the growth of export earnings and the expansion of import substitution due to ruble devaluation.

At the same time the given forecast can be regarded as quite optimistic. On one hand the expansion of export will mainly be defined by the presence of the favorable situation (increase of prices) for the main kinds of the Russian export, which, in the environment of the global recession, does not seem self-evident. On the other hand, the dramatic drop of export at the beginning of the year was accounted for by the undefined situation in the dynamics of the investment and consumer demand in the country for the import goods. In the nearest future it is possible that the import by many trading positions will enhance, including due to the various forms of the government support for enterprises and organizations, which cast a doubt on the thesis of the considerable development of the import substitution.

The effect of devaluation can also be lower than expected taking into account the positive effect of such a process at the end of the 90-ies on the development of the domestic industry. It seems that the processes currently going and against ruble exchange rate decreasing in the environment of current economic crisis have not had a positive effect on the situation of the Russian economy and the dynamics of its foreign economic connections yet.<sup>2</sup>

The conclusion that follows is that without deep structural modernization Russia will not be able to solve the strategic challenges it faces, including those in the field of external economy. These reforms are to be started immediately taking into account the fact that many countries will come out of the crisis with renovated and more competitive economies, which will result in the change in the positions in the world trade with goods and services.

*Table 3*

LEADING EXPORTERS AND IMPORTERS IN WORLD TRADE WITH GOODS IN 2008 (AS USD BILLION AND AS PERCENTAGE)

	Exporting countries	Volume	Share	Change on the previous year		Importing countries	Volume	Share	Change on the previous year
1	2	3	4	5	6	7	8	9	10
1	Germany	1465	9.1	11	1	USA	2166	13.2	7
2	China	1428	8.9	17	2	Germany	1206	7.3	14

1 “On current situation in the economy of the Russian Federation as a result of the 1<sup>st</sup> quarter 2009”, Ministry of Economic Development of the Russian Federation, April 27, 2009, p.5, [www.economy.gov.ru](http://www.economy.gov.ru)

2 For more details see V. Mau “Devaluation in 1998 and 2009: different conditions”, *Vedomosti*, April 17, 2009

Table 3, cont'd

1	2	3	4	5	6	7	8	9	10
3	USA	1301	8.1	12	3	China	1133	6.9	19
4	Japan	782	4.9	10	4	Japan	762	4.6	22
5	Netherlands	634	3.9	15	5	France	708	4.3	14
6	France	609	3.8	10	6	UK	632	3.8	1
7	Italy	540	3.3	10	7	Netherlands	574	3.5	16
8	Belgium	477	3.0	10	8	Italy	556	3.4	10
9	Russian Federation	472	2.9	33	9	Belgium	470	2.9	14
10	UK	458	2.8	4	10	Republic of Korea	435	2.7	22
11	Canada	456	2.8	8	11	Canada	418	2.5	7
12	Republic of Korea	422	2.6	14	12	Spain	402	2.5	3
13	Hong Kong, China	370	2.3	6	13	Hong Kong, China	393	2.4	6
	- export supplies of domestic goods	17	0.1	-		- import for internal consumption	98	0.6	-
	- re-export	353	2.2	-					
14	Singapore	338	2.1	13	14	Mexico	323	2.0	9
	- export supplies of domestic goods	176	1.1	13					
	- re-export	162	1.0	13					
15	Saudi Arabia <sup>1</sup>	329	2.0	40	15	Singapore	320	1.9	22
						- import for internal consumption <sup>2</sup>	157	1.0	31
16	Mexico	292	1.8	7	16	Russian Federation <sup>3</sup>	292	1.8	31
17	Spain	268	1.7	6	17	India	292	1.8	35
18	Taiwan (China)	256	1.6	4	18	Taiwan, China	240	1.5	10
19	United Arab Emirates <sup>1</sup>	232	1.4	28	19	Poland	204	1.2	23
20	Switzerland	200	1.2	16	20	Turkey	202	1.2	19
21	Malaysia	200	1.2	13	21	Australia	200	1.2	21
22	Brazil	198	1.2	23	22	Austria	184	1.1	13
23	Australia	187	1.2	33	23	Switzerland	183	1.1	14
24	Sweden	184	1.1	9	24	Brazil	183	1.1	44
25	Austria	182	1.1	11	25	Thailand	179	1.1	28
26	India	179	1.1	22	26	Sweden	167	1.0	10
27	Thailand	178	1.1	17	27	United Arab Emirates <sup>1</sup>	159	1.0	20
28	Poland	168	1.0	20	28	Malaysia	157	1.0	7
29	Norway	168	1.0	23	29	Czech Republic	142	0.9	20
30	Czech Republic	147	0.9	20	30	Indonesia	126	0.8	36
	Total for 30 countries <sup>4</sup>	13120	81.4	-		Total for 30 countries <sup>4</sup>	13409	81.7	-
	World export, total <sup>4</sup>	16127	100.0	15		World import, total <sup>4</sup>	16415	100.0	15

- 1) Import for Singapore internal consumption is import deduced by re-export
- 2) Estimation by WTO Secretariat
- 3) Import in FOB prices
- 4) Including considerable re-export or import with the purpose of re-export

Source: WTO Secretariat, Press release, PRESS/554, Geneva 24 March 2009, p.19 (Appendix table 3 Merchandise trade: leading exporters and importers, 2008)

Table 4

LEADING EXPORTERS AND IMPORTERS IN WORLD TRADE WITH SERVICES IN 2008  
(AS USD BILLION AND AS PERCENTAGE)

	Exporting countries	Volume	Share	Change on the previous year		Importing countries	Volume	Share	Change on the previous year
1	USA	522	14.0	10	1	USA	364	10.5	7
2	UK	283	7.6	2	2	Germany	285	8.2	11
3	Germany	235	6.3	11	3	UK	199	5.7	1
4	France	153	4.1	6	4	Japan	166	4.8	11
5	Japan	144	3.9	13	5	China <sup>1</sup>	152	4.4	-
6	Spain	143	3.8	11	6	France	137	3.9	6
7	China <sup>1</sup>	137	3.7	-	7	Italy	132	3.8	12
8	Italy	123	3.3	12	8	Spain	108	3.1	10
9	India <sup>1</sup>	106	2.8	-	9	Ireland <sup>1</sup>	103	3.0	9
10	Netherlands <sup>1</sup>	102	2.7	8	10	Republic of Korea	93	2.7	12
11	Ireland <sup>1</sup>	96	2.6	8	11	Netherlands <sup>1</sup>	92	2.6	10
12	Hong Kong, China	91	2.4	9	12	India <sup>1</sup>	91	2.6	-
13	Belgium <sup>1</sup>	89	2.4	16	13	Canada	84	2.4	5
14	Switzerland	74	2.0	15	14	Belgium <sup>1</sup>	84	2.4	16
15	Republic of Korea	74	2.0	20	15	Singapore	76	2.2	6
16	Denmark	72	1.9	17	16	Russian Federation	75	2.2	29
17	Singapore	72	1.9	3	17	Denmark	62	1.8	16
18	Sweden	71	1.9	13	18	Sweden	54	1.6	13
19	Luxemburg <sup>1</sup>	68	1.8	5	19	Thailand	46	1.3	22
20	Canada	62	1.7	2	20	Australia	45	1.3	18
21	Austria	62	1.7	12	21	Brazil	44	1.3	28
22	Russian Federation	50	1.3	29	22	Hong Kong, China	44	1.3	7
23	Greece	50	1.3	16	23	Norway	44	1.3	12
24	Norway	46	1.2	13	24	Austria	42	1.2	8
25	Australia	46	1.2	15	25	Luxemburg <sup>1</sup>	40	1.2	8
26	Poland	35	0.9	20	26	Switzerland	37	1.1	10
27	Turkey	34	0.9	22	27	United Arab Emirates <sup>1</sup>	35	1.0	-
28	Taiwan, (China)	34	0.9	8	28	Saudi Arabia	34	1.0	-
29	Thailand	33	0.9	11	29	Taiwan, (China)	34	1.0	-2
30	Malaysia	30	0.8	5	30	Poland	30	0.9	25
	Total for 30 countries <sup>4</sup>	3135	84.1	-		Total for 30 countries <sup>4</sup>	2835	81.7	-
	World export, total <sup>4</sup>	3730	100.0	11		World import, total <sup>4</sup>	3470	100.0	11

<sup>1</sup> estimation by WTO secretariat

Source: WTO Secretariat, Press release, PRESS/554, Geneva 24 March 2009, p.21  
(Appendix table 5 Leading exporters and importers in world trade in commercial services, 2008)

## SOME ASPECTS OF IMPROVEMENT OF MEASURES TO CONTROL TRANSFER PRICING

N.Kornienko

*The article was prepared on the basis of the OECD Guidelines on Transfer Pricing, also taking into account the legislation and the practical experience of other countries.*

This article can be of interest for anyone making foreign-trade operations and operations with the companies interdependent with it, that is with the entities it controls or the entities that control it really or legally. In 2007 the Ministry of Finance of the Russian Federation promulgated the bill suggesting the significant change made to the statements of articles 20 and 40 of the Tax Code of the Russian Federation. The text of the bill was simultaneously published at the site of the Ministry of Finance of the Russian Federation for all concerned persons to discuss. The changes continued to be made in the bill up to April 2009 and the debates on it were rather heated. The present article considers the changes in the control of transfer pricing suggested by the Ministry of Finance of the Russian Federation comparing them with the existing statements of articles 20 and 40 of the Tax Code of the Russian Federation and with the leading world experience in this sphere.

The proposed bill follows the guidelines of the Organization for Economic Cooperation and Development (further, OECD).<sup>1</sup> The legislation on the control over transfer pricing of the majority of the countries, including the major trading partners of the Russian Federation (EU countries, Kazakhstan, the USA etc.) was developed taking into account these guidelines.

The following can be regarded as main characteristics of the bill:

- Defining of interdependent persons;
- Introduction of closed list of the controlled deals;
- Change in the methods for estimation (transparent and detailed methodology, introduction of interquartile range, list of methods is supplemented by two methods based on the profit;
  - Introduction of preliminary agreements on pricing;
  - Granting the right to prove the applied method of pricing by documents;
  - Introduction of new system of the tax-payer's responsibility.

When the control over transfer pricing is mentioned, several questions normally arise. When should the statements on transfer pricing be applied? What is the meaning of the control as a legal term and what does the category interdependent/dependent/ controlled parties mean? How should one search for comparable figures? How should one apply the methods based on the analysis and estimation of the profit?

According to the international practice it is mainly the principle, according to which for the taxation bodies to be able to re-calculate the taxes in order to prevent evasion from taxes or to duly reflect the real sum of incomes the deals are to be made between the interdependent entities. This principle is used by the existing versions of articles 20 and 40 of the Tax Code of the Russian Federation, and it is also preserved in the bill suggested

<sup>1</sup> Transfer pricing Guidelines for multinational enterprises and tax administrations), approved by the Committee on Fiscal Affairs, June 27, 1995 (hereinafter, Guidelines)

by the Ministry of Finance. At the same time the bill specifies and enhances the concept of “interdependence”, introducing, for instance, the right for the tax-payer to recognize itself as interdependent as counteragent, if there are grounds for it in case they are not envisaged directly in the article of the bill.

Usually the foreign legislation follows several criteria for recognition of the entities as interdependent for the purposes of taxation. The most widely spread criterion of the interdependence of the entities is the participation in the stock capital. In case there is no participation in the stock capital the parties can be recognized as interdependent if two or more persons act in coordination towards the organization they own together but do not control and/ or one of the entities in fact controls the other. For this purpose the legislation of the country usually includes a legal concept for recognition of interdependent/ controlled/ dependent entities, which account for the practical concepts of interdependent/ controlled/ dependent entities. Normally it is the fact of existence of controlling/ interdependent relations that has the crucial significance rather than the form of their realization. For instance, the following examples of ownership are regarded as factual joint control:

- Stocks, directly or indirectly belonging to the corporation, society or trustee fund are considered to belong to stockholders, participants or beneficiaries in proportion to the share of participation of each in the corporation, society or trustee fund;
- Natural person is regarded as an owner of stocks directly or indirectly belonging to his family (for example, brothers, sisters, spouse, relatives in the line of the ascent and direct descendants);
- One or more chains of corporations connected by the participation in stock capital with one associated company, on condition that “more than N% of stocks” of each corporation belong to one or more other corporations etc.

It should be noted that the volume of the ownership can differ from country to country from 5% to 100%.

However in contrast to widespread international practice the bill is not limited by the control only over the deals between the interdependent entities, it also suggests closed list of the controlled deals, which, on the one hand, will narrow the sphere of control when compared with the existing version of article 40 of the Tax Code of the Russian Federation, but enhances it when compared with the international practice. The matter concerns the ability of taxation bodies to control the correctness of prices in the majority of foreign trade deals, for which type of the deals the deals with the world exchange goods, intellectual property as well as trade with services are ascribed. The deals with the jurisdiction of the lowered taxation which are to be defined according to the list approved by the Ministry of Finance of the Russian Federation call for special attention. It should be noted that the introduction of the deals with the off-shore jurisdiction in the list of controlled deals is somewhat a support for the joint efforts of OECD member countries to struggle against the withdrawal of the incomes in the zones of the lowered taxation.

Undoubtedly, the abolition of the total control over all the deals whose price deviate by 20% to some direction will somewhat alleviate administrative and taxation burden on both the tax-payers and the taxation bodies.

The question on what deals are to be controlled with regard to the correct pricing is solved differently in different countries. Even within the association of OECD member countries there is no single solution to this problem. There are various combinations, some countries control not only the deals between the interdependent, but also between the independent entities but with exchange goods. However there is a unanimous intention to control the deals with off-shore jurisdictions.

In many countries the institute of the control over the correctness of pricing is combined with the institute of the consolidated tax-payer concerning the profit tax and the institute

of the controlled foreign companies. The Ministry of Finance of the Russian Federation has also developed and promulgated the bill on consolidated accounts for profit tax. It is planned to introduce new statements on control over the correctness of the pricing and consolidated taxation account for profit tax simultaneously. Such a “duet” will mean that if the tax-payer meets the criteria for consolidation it can evade from the control over its pricing concerning profit tax. The Ministry of finance of the Russian Federation has also declared the intention to develop the institute of the controlled foreign companies as well in three forthcoming years in the document on the directions of the fiscal policy. All these measures are in concordance with the progressive international experience in the field of control over transfer pricing.

The fact that the bill enhances the list of methods for estimation, supplementing it with two methods basing on profit – method of comparable profitability and method for profit distribution- can only be regarded as positive. Moreover the bill considerably elaborated the known methods from article 40 of the Tax Code of the Russian Federation. Besides defining the essence of these methods the bill suggests the basic methodology for each. In contrast to the current situation when there is no document establishing or recommending methodical basis for the application of any method, such a solution of the problem is quite a progress.

It should be acknowledged that in the majority for countries there are no special national methodical recommendations on application of one or another method. The countries also do not attempt to set a rigid hierarchy of the application of methods. However the majority for countries, being IECD members, legalized the OECD Guidelines on transfer pricing in their territory and that is why do not need to adopt special national guidelines. Some countries, such as the USA, for instance, adopted special Recommendations of the US Treasury on application of the methods.<sup>1</sup> Some countries, Kazakhstan, for instance, included the OECD Guidelines on methodology nearly fully in the law, providing the tax-payers and taxation bodies with the unified instrument.

Obviously, before the method is chosen the right task is to be set, the chosen method should be practically applicable and form the result corresponding to the conditions at the market, which represents the reasonable estimation of what the result would be if such deals had been made under market conditions. Besides, it is necessary for some legal criteria for the estimation of the correctness of the result obtained to exist. The attention should be called to the fact that despite the progressive nature of the methodology suggested by the bill, it lacks the distinctness as to the answer to the question on which of the received figures to be taken as the most correct and final result in order to calculate taxes on its basis.

It is also to be noted that the bill does not envisage the hierarchy for the application of the methods for the estimation, declining the archaic approach of article 40 of the Tax Code of the Russian Federation, which is currently in effect.<sup>2</sup> On the other hand, the taxation bodies usually chose the simplest methods to recalculate the price. That is why some reference points for application of the estimation methods should be established by recommendation. It is especially important under current conditions in Russia, where it is quite difficult to obtain the data on market prices. In this connection it would be purposeful to pay attention to the approach which was developed for this issue by the OECD. The OECD Guidelines and many countries are of opinion that each of the methods of estimation of transfer pricing is specific for the types of deals. OECD has revealed the influence of the

1 [www.irs.gov](http://www.irs.gov)

2 The version of article 40 of the Tax Code of the Russian Federation currently in effect envisages hierarchic use of the expenses method, the method for the comparable uncontrolled price and the method of the price of the followed sale without any specification as to the type of the deal

methods on the reliability and correctness of the results obtained. The recommendations of the OECD concerning all transactional methods advice to apply the separate analysis to each deal depending on its type. Thus, for instance, the expenses method is advisable when considering prices for supply of goods or rendering services. Method of the price of the followed sale is preferable for agreements connected with the sale, distributorship. Transactional methods based on the analysis of the profit are nearly always used in order to check the results obtained with the help of other methods.

The method of the comparable uncontrolled price which is recognized as the preferable in nearly all the situations if there are comparable data for uncontrolled market is worth dwelling on. Incase there are no comparable uncontrolled prices the analysis of the distribution of the functions and the risks between the parties can serve as a basis for determination of the profit margin. Thus, in most cases when there are no comparable data it is desirable to use the methods based on the analysis of the profit. The choice of the particular method depends on a number of factors. According to OECD Guidelines the taxation bodies should take into account five factors of comparability – characteristics of assets and services, analysis of functions, conditions of the deal, strategy of economic activity. Then the taxation body and the tax-payer should analyze 1) the degree of comparability of controlled and uncontrolled deals and 2) the quality of the available information.

The search for comparable parameters is very important. Since the principle of “arm’s length” is based on the comparison of the conditions of the deal between the companied in question with the conditions of the deal with third parties. This should result in solution of the problem of search for comparable deals and the search for the independent third parties making similar deals in similar branches. The comparability suggests that there is a reasonable degree of similarity between the economically significant characteristics. If there are no comparable deals according to the international practice it is recommended to define and calculate the corresponding deviations. It should be noted that the bill does not provide for such a case. The following can be regarded as sources for the data used to define, enhance and/or check the list of the comparable figures:

- Prices and quotations at the world exchanges, information from the reliable sources (trends in the branch, market research);
- Customs statistics, sources of information for the authorized public authorities and local authorities;
- Industrial and trading associations (review of branches, list of members)
- Branch analysts (market analysis, financial analysts, crucial factors and forecasts for development), mass media and publications of the branch (general information on the market, franchising references), the Internet (reference sites and sites of some companies)
- Databases

All the sources are united by the single feature of the possibility to be accepted as relevant in the court of law. Such a situation is included in the conditions of the existing article 40 of the Tax Code of the Russian Federation but it has not been clarified by the bill for future purposes. In foreign countries there special databases working on the commercial basis and including a broad spectrum of information on market prices, financial indices etc. however a similar company in the Russian Federation has been operating since recently, combining the data on Russia and Ukraine, Bureau van Dijk’s Ruslana. Its possibility now cannot be compared with those of the similar companies in Europe and at other world markets, thus, for instance the European taxpayers and taxation bodies have access for the data from:

- Bureau van Dijk’s Amadeus (20 million of companies) and OneSource Europe (more than 1 million of companies);

- French companies: Bureau van Dijk's Diane (more than 600 thousand of companies);
- Netherland companies: Bureau van Dijk's Reach (more than 150 thousand of companies);
- German companies: Bureau van Dijk's Daphne (more than 15 thousand of companies);
- UK copmanies: Bureau van Dijk's Fame (more than 625 thousand of companies)
- USA companies: Bureau van Dijk's Amadeus, Disclosure SEC and Corp/worldscope, Moody's, Stantard and Poors Compustant etc.

The forming database Ruslana mentioned includes no more than 1500 million of pieces of data on companies and they have not been updated at present, which excludes the possibility of their use in the court of law. Such sources of information mentioned in the bill cannot be recognized as relevant due to corresponding limitations of each individually. In this connection there arises the problem of using the confidential information, for instance, its protection by the tax secret (for instance data received during the examination of other taxpayers, information comprising commercial secret of the examined taxpayer and other information received during tax examinations) and the possibility to access it not only by the taxation bodies but also by taxpayers themselves.

There is no unanimous position in this respect in the world. For instance, in the USA the practice of the use of the confidential information to support the positions of the taxation bodies is rarely applied since it is not recognized by courts of law, while in other countries such as France, Germany, Canada, Australia and Korea it is possible to use confidential.<sup>1</sup> The taxation bodies however should be ready to support it with the data from official and available sources.

According to the international practice the taxpayers and taxation bodies use the indices of market prices in definite range – that is the market price should belong to the definite range. In many countries taxpayers and taxation bodies use so-called interquartile ranges and the ranges for price variations.<sup>2</sup> If prices belong to such range, there is no recalculation made according to the regulations of transfer pricing. Thus, in accordance with the existing regulations if the prices for the services mentioned do belong to the acceptable range,<sup>3</sup> the real price of the deal is recognized as market one.<sup>4</sup> Similarly, as to agreements on distribution of expenditures, the regulation, according to which the recalculation is not made in case the profit increased or decreased by up to 20% is in effect in the USA.<sup>5</sup>

Such approach is also suggested by the bill. Nevertheless this method is the most complicated to apply in practice with the sufficient degree of reliability, since the requirements for the data comparability for this method are much higher than for any other method. Besides, it is very difficult to find comparable uncontrolled prices due to the lack of the information because of the mentioned reasons. It should be noted that the method of the comparable uncontrolled price is usually used as a secondary method in the international practice to check the results obtained with other methods. In the bill presented however it is envisaged as an independent and “all-sufficient” method.

1 In France if there is more than one set of comparable data the taxation bodies represent such data in the form of the list of companies and the range of parameters not mentioning which indices belong to which company. However if the data is available only for few companies their names are not mentioned.

2 Interquartile range in the range of values from 25% to 75% of the set of comparable values

3 The amendments abolition the range of prices concerning services were adopted in the USA as long ago as October 2003. Instead such a regulation concerning services with smal margine there was a new method introduced – method of the simplified expenditure base

4 Regulations of the USA Ministry of Finance, Section 1.482-2(b).

5 Regulations of the USA Ministry of Finance, Section 1.482-7.



Thus, when applying any of the methods mentioned above the search for the comparable parameters should be made at the level of the deal. The draft of the law, however, does not define the possible actions of a taxpayer and taxation bodies, does not suggest the specification of the methods by types of deals, which will inevitably lead to disputes and will probably result in the leading methodology being inapplicable.

Due to the difficulty in search for the comparable deals many countries oftener apply the methods based on the analysis of the profit, with whose help one can define the profit gained from different deals.

The bill suggests introduction of the institute of the preliminary agreements on pricing (hereinafter, PAP) in the Russian Federation, which quite a progressive innovation. Preliminary agreements on pricing are concluded between a taxpayer and one taxation body (unilateral agreement) or several taxation bodies (bilateral/multilateral agreements). The bill envisages the introduction of only unilateral; agreement and only in the Russian jurisdiction. The problem accompanying the conclusion of unilateral PAP is that there are no guarantees of adoption of a definite method for transfer pricing by the taxation bodies of another country. In the USA about 2/3 of the agreements are bilateral. In some countries (France, for instance) it is the bilateral agreements that are mainly concluded. In many countries the preliminary agreements on pricing have been applied for a long time. The first PAPs were applied in the 1980-ies. By that time it was made clear that in order to make decision concerning some cases of transfer pricing, when considering and estimation multistep and multilateral agreements one could need several years. The procedure of PAP on the other hand enables taxpayers and taxation bodies to come to the agreement on the procedure for taxation of different deals, including the deals on the expenditure distribution, beforehand. PAP does not necessarily apply to all the deals and can be restricted to the deals with some counteragents. The bill discussed does not envisage such a limitation; neither does it envisage the agreement on the expenditure distribution.

In some countries PAP can be applied not only to forthcoming, but also to preceding taxation periods on condition that the details of such deals are similar to those concluded in the year of PAP being in effect. The bill does not envisage the possibility to spread the application of PAP to the previous years. The agreement can only be applied to the deals concluded in the forthcoming periods. Upon conclusion of a PAP, in most countries the taxpayer has to make annual reports on the operations to which PAP is applied. Such a report is a measure to control the observance of PAP conditions. Such an instrument is not envisaged by the bill.

The term of PAP effect is usually 5 years and in many countries the effect of the agreement can be spread to the previous years. The bill envisages conclusion of a PAP for a very short period – of 2 years – on condition that according to the very same bill the period for consideration of the documents can last for up to 1 year. It is obvious that in such circumstances the efficiency of the process will be little. High level of time and efforts expenses for negotiations will not be repaid during such a short period. It is desirable to prolong the possible effect of PAP up to 5 years. According to the bill, the submission of the application for PAP does not envisage the cessation of the control measures over the issues to which PAP can be applied. Such an approach would be quite purposeful since in the course of negotiations the taxation body will in fact check all the taxpayer's documents and additional control measures will be excessive for both parties. The granting to taxpayers the possibility to conclude PAPs is one of the significant innovations of the bill.

On the whole comparing the concept of the bill not only with the existing articles 20 and 40 of the Tax Code of the Russian Federation, but also with the progressive trends of the world practice one can note its main direction towards alleviating the tax and

administrative burden on taxpayers and the preconditions for the increase of the professional level of the taxation bodies. Usually, making such changes in the measures of control over transfer pricing the countries make special highly-qualified departments to which also the groups of officials considering PAPs belong. Such measures are accompanied with the decrease of the general level of confrontation between the taxation bodies and taxpayers, which is especially provided for by the introduction of PAP. It is however obvious that the bill has to be elaborated and in the version of April 2009 it can give neither taxation bodies nor taxpayers the opportunity to fulfill innovations as they were intended to by the authors of the bill. ●