

RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES 04'2010

MONTHLY BULLETIN:	
BASIC DEVELOPMENTS AND TRENDS	2
INFLATION AND MONETARY POLICY (P.Trunin)	4
FINANCIAL MARKETS (N.Burkova, E.Khudko)	8
REAL ECONOMY SECTOR: TRENDS AND FACTORS (O.Izryadnova)	18
FOREIGN TRADE (N.Volovik, K.Rezenkova)	21
THE STATE BUDGET (E.Fomina)	25
MORTGAGES IN THE RUSSIAN FEDERATION (G.Zadonsky)	37
CREDITING OF PEASANT (INDIVIDUAL PRIVATE) FARMS ON LAND MORTGAGE (N.Shagayda)	41
THE RUSSIAN DEFENSE SECTOR: RADICAL REFORMS ARE URGENTLY NEEDED (V.Zatsepin)	44
WORLD TRADE WITH GOODS AND SERVICES IN 2009 AND PROSPECTS OF RUSSIAN FOREIGN TRADE DEVELOPMENT (A.Pakhomov)	47
REVIEW OF ECONOMIC LEGISLATION (I.Tolmacheva)	54
REVIEW OF RF GOVERNMENT MEETINGS IN APRIL 2010 (M.Goldin)	56
REVIEW OF LEGISLATIVE DOCUMENTS CONCERNING TAXATION OVER MARCH–APRIL 2010 (L.Anisimova)	59
CHANGES IN REGULATORY BASIS FOR BUDGET PROCESS (M.Goldin)	62

RUSSIAN ECONOMY IN APRIL 2010: TENTATIVE INDICATORS AND MAJOR TRENDS

The most important developments of the political background in April were linked to the relations between Russia and its neighbors. The fall of Kurmanbek Bakiyev regime in Kyrgyzstan has once again demonstrated the weakness of some post-Soviet regimes; the Russian officials actually welcomed the overthrow of Bakiyev and demonstrated a willingness to provide political and financial support for the new government.

A meeting of Vladimir Putin, the Russian Prime Minister with Donald Tusk, the Polish Prime Minister at the Katyn Memorial on April 7 has demonstrated a significant softening of Moscow in its relations with Poland and the desire to mitigate the accumulated tension in their relationship and find common basis for cooperation in the energy sector (apparently, these changes prove the recognition the scale of the possible changes in the gas market by the Russian leadership).

Finally, another attempt to “reboot” were the agreements concluded between the Prime Minister Vladimir Putin and the new Ukrainian government on the reduction of gas prices in exchange for the agreement on the extension of the Russian fleet disposition in Sevastopol. Despite the fact that the agreement will result in a significant loss to the revenue of the Russian budget (actual price reduction will be achieved at the expense of export tax, i.e., due to federal budget revenues, rather than revenues of Gazprom), the agreement opened the way for discussions on other projects for expansion of economic cooperation, particularly in the nuclear and aircraft industries.

The leading role in the formation of trends in the macroeconomic sphere are, as always, the events in foreign markets. In April 2010, oil prices reached a new level and were consistently exceeding \$ 80 per barrel, and for the last three weeks in April remained at the level of \$ 86 per barrel. This means, in particular, that the rate of export duty on oil will rise again. Growth in revenues from energy sources exports indicates that the federal budget deficit for 2010 will be lower than the estimated indicators foreseen in the law and probably will not exceed 6% of GDP (against the estimated 6.8% of GDP). However, this trend remains unstable and is fully dependent on the market fluctuations in prices and demand for Russian exports, while maintaining significant risks to the budgetary system. At the same time, it is worth noting that the growth in oil prices in April has not led to the growth in stock indices as of the month results. Despite the fact that they remained in the scope of the post-crisis peaks and reached new psychological heights at the beginning of the month, their values at the end of April did not differ from the late March indicators. Such dynamics in April, however, was typical for majority of the global markets.

The trade balance in the I quarter of 2010, according to tentative estimates of the Bank of Russia has reached the values of the pre-crisis period - \$ 46 billion against \$ 18.8 billion in the I quarter of 2009 and \$ 49.9 billion in the I quarter of 2008. The export of the I quarter 2010 amounted to 83% of the exports in the I quarter of 2008 against the imports - 75% from the level of 2008. Therefore, in general, the overall recovery of imports in annual terms is still behind from export growth rate; the import volume in the I quarter amounted to 49.6% of exports, while in the pre-crisis 2007-2008 it amounted to 62-63% of exports, and in 2001-2006 it varied in the range of 51-57%. Herewith, in the I quarter of 2010 there was again a faster growth of imports: while export in February of 2010 has grown by 9.9% as compared with January, the import has increased by 36.3% in February. The increase in imports contributed to the continued strengthening of ruble.

In the I quarter of 2010 the ruble strengthening in real terms against dollar amounted to 3,8% and 12% against Euro. Accordingly, strengthening of the effective exchange rate in real terms in the I quarter made 7.3%. As of April results, the ruble against dollar remained practically unchanged, while the Euro rate continued to fall substantially at the background of the “Greek factor” and other negative news from the Eurozone.

Foreign currency and gold reserves demonstrate growth for the second consecutive month: from 26.03.2010 to 23.04.2010 they have grown by \$ 10 billion. Consumer Price Index since the beginning

of the month made 100.3%, and in general since the beginning of the year – 3.5%; in annual terms inflation fell down to 6.1%. Low inflation rate allowed the RF Central Bank to lower the refinancing rate again by 0.25 percentage points to 8%. As before, the possibility of reducing the rate of the Bank of Russia motivates by low inflation, and crediting the real sector was announced as the incentives for the rate reduction.

However, the previous steps in this direction have not led to the desired result: the banks are still very cautious in lending to the real sector due to the sustained risks and uncertainty in the prospects of the economy. As a result, banks are accumulating funds on deposits with the RF Central Bank in the form of the Bank of Russia bonds. In addition, recently the inflation has slowed down faster than the declining rates of the RF Central Bank, i.e., in real terms the rates were growing. Due to significant liquidity reserves of the banks, the rates on the interbanking credit market fell down below 4%. The rapid growth of monetary supply at the background of a significant budget deficit and a tentative renewal of capital inflow are likely to lead to a higher inflation rate in the second half of the year.

The Bank of Russia is trying to take under control the ruble exchange rate, preventing its strong fluctuations: buyes/sells about 700 million dollars in the currency market at each level of resistance in the two-currency basket, and then shifts this level by 5 kopecks. As a result, at the background of a favorable external economic environment, the speculators are able to earn on the tendency of ruble strengthening and on the difference in interest rates. In our view, such a mechanism of exchange rate policy does not contribute to the independence of the RF Central Bank monetary policy and to the transition to inflation targeting.

The dynamics in the real sector does not allow, as before, to speak of a steady trend in economic recovery. In the domestic market, the most significant impact on the economic situation was provided by the continued decline in investment activity. In the I quarter of 2010 investments in the fixed assets decreased by 4.7%, the scope of work in construction - by 8.1%. The factors that determined the low level of investment activity was the continued slowdown in housing construction, as well as the focus of enterprises on the least budget-consuming opportunities, in particular, more intensive utilization of production capacities. Savings on capital expenditures was accompanied by a slight increase in the demand for labor in the I quarter of 2009. As a result of a decreased significance of labor and capital factors, supported by the low dynamics of real wages growth, the economic situation was be governed by the action of inertial tendencies of 2009. Against the background of declining interest rates, growth in export revenue in the economy, the growth of liquidity in the banking sector and reduction of capital outflow in absolute terms, the low investment activity reflects a lack of business strategic plans for recovery from the crisis.

In the consumer market, with an increasing turnover of retail trade by 1,3%, there took place a reduction in the market of commercial services made 0.9% against the I quarter of 2009. At the background of decelerated inflation in the I quarter of 2010 to 3.2% against 5.4% in the I quarter of 2009, including foodstuffs up to 3.8% against 5.0% for non-food products to 0.9% versus 3.8% and commercial services to 5.4% against 8.5% a year earlier and with the growth of real income by 7.4%, the situation in the consumer market reflects low consumer expectations of the population.

Comparison of the dynamics of trade turnover as broken down by commodity groups and structure of the population expenses points to the lower expenses for current needs due to reduced purchases of non-food goods and services consumption. In the I quarter of 2010 index of retail trade turnover of food product group made 103.9% and non-food items - 98.9% against the relevant period of preceding year. The share of expenditures for the purchase of goods in the monetary income of the population has decreased in comparison with the previous year by 3.5 percentage points. The Specifics of consumer behavior in early 2010 was the sustained trend of savings accumulation and restrained behavior in the credit market. In this regard, it should be noted firstly, that real wages for the I quarter of 2010 have grown by 2,2% (while namely the wages of hired workers form the dominant part of the population income) and secondly, the sustained tension in the labor market .

Index of industrial production in the I quarter of 2010 as compared with the I quarter of 2009 amounted to 105.8% and 89.9% versus the IV quarter of 2009. In February and March of the current year, the rates of industrial production as compared with the same period of the last year reached the positive values and were respectively 104.8% and 115.3%. It is worth noting, that the output growth was observed in all aggregated economic activities. ●

INFLATION AND MONETARY POLICY

P.Trunin

In March 2010, the RF Consumer Price Index (CPI) continued its downward trend. It amounted to 0.6 % in comparison to the corresponding period of 2009 and to 1.3 % in February 2010. In April, the drop in inflation continued: according to our estimates, the April CPI was 0.4 – 0.5 %. However, a rapid increase in money supply that is taking place against the backdrop of a considerable budget deficit, growth in prices for energy carriers and a possible resumption of capital inflows will, most likely, result in an acceleration of inflation in the second half of the year. Given the existing situation, any further softening of Russia's monetary policy cannot be considered to be totally justified. At the same time, the RF Central Bank's attempts to control the exchange rate of the ruble may lead to a large-scale inflow of capital and a rise in inflation, and so deprive the Bank of Russia of any effective instruments of monetary policy.

In March, the Consumer Price Index was 0.6 % (see *Figure 1*). Thus, Russian inflation continued to decelerate: in March 2009 the CPI amounted to 1.3 %, while in March 2008 – to 1.2 %. The twelve-month CPI (April 2009 – March 2010) dropped to 6.5 % from the level of 7.2 % that was recorded by the end of February 2010. The largest contributor to the price rise in March was the increase in prices for food commodities (+ 1 %). The highest rise was noted in the prices of eggs (+ 10.1 %), fruit and vegetable products (+ 4.2 %), butter (+ 1.2 %) and alcoholic beverages (+ 1.1 %). At the same time, there was a drop in the prices of granulated sugar (–1.7 %), meat and poultry (–0.2 %), and macaroni products (–0.2 %).

March saw the continuation in the rise of prices for commercial services to the population (0.4 % by the end of the month). The highest rise was registered by passenger transport services (+ 1.3 %), medical services (+1.1 %), spa and health resort services (+ 0.8 %), and domestic services (+0.6 %). By contrast, there was a decrease in the prices of overseas travel services (– 0.7 %), pre-school education services (–0.3 %), and some types of housing and utilities services.

In March, there was a rise in the prices of nonfood commodities, which went up an average of 0.4 %. The fastest growth was registered by the prices of tobacco products (+1.7 %), clothes and underwear (+0.7 %), textile products (+0.6 %) and motor gasoline (+0.6 %). Prices for television and radio equipment went down an average 0.3 %, and those for pharmaceuticals – an average 0.5 %.

It should be noted that the high rates of the fall in inflation can be largely explained by the base effect, because at the beginning of 2009 there was a rise in inflation caused by the ruble's weakening. However, it can be expected that this effect will soon disappear because in the second half of 2009 there was a sharp deceleration in inflation caused by stagnation of aggregate demand and money supply. At present, recuperative processes are clearly gaining momentum in the economy, and money supply is once again rapidly rising, which creates potential inflation risks for the second half of 2010.

Apparently, the decline in inflation will continue throughout the next quarter. However, the rate of inflation will gradually increase with the resurgence of the economy and the growth in money supply caused by the Bank of Russia's support to the ruble and by the monetization of budget deficit. At the same time, Russia's CPI for 2010 will, most likely, be lower than in 2009.

In March 2010, the base consumer price index¹ amounted to 0.6 % (vs. 1.4 % in the corresponding period of the previous year). According to our estimates, the April CPI was 0.4 – 0.5 %.

¹ The base consumer price index reflects the inflation level on the consumer market less the seasonal factor (prices of vegetable and fruit products) and the administrative factor (tariffs on regulated services, etc.); it is calculated by the RF Statistics Service.

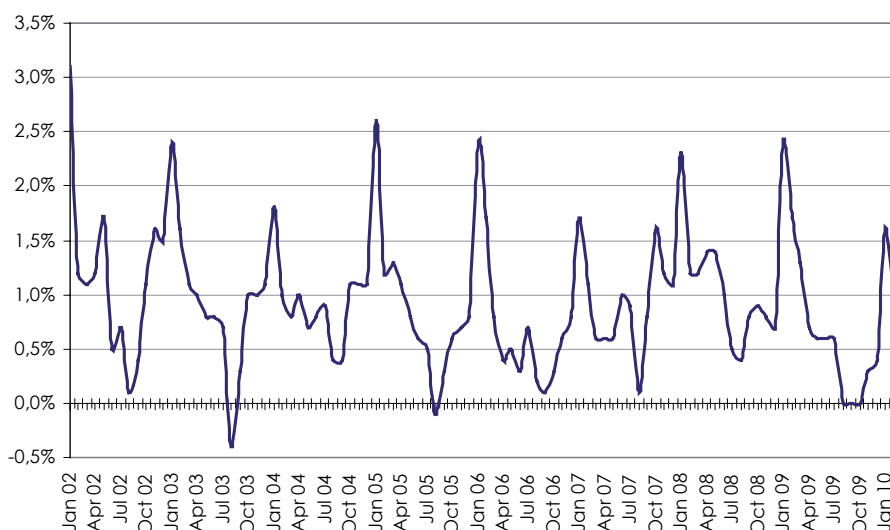
In the course of March, the RF monetary base in a broad sense¹ rose by 395.5 bn Rb to 6,363.9 bn Rb (+6.6 %). For reference: as of 1 March 2010 the volume of the monetary base in a broad sense amounted to 5,968.7 bn Rb. Let us consider the behavior of the monetary base in a broad sense by component.

As of 1 April 2010, the cash-in-circulation volume, including the cash balances of credit institutions, was 4.419 trillion Rb (+ 0.7 %, as compared to 1 March 2010), the correspondent accounts of credit institutions with the Bank of Russia amounted to 579.5 bn Rb (+ 4.3 %), mandatory reserves – to 167.7 bn Rb (+ 5.4 %), banks' deposits with the Bank of Russia – to 469.6 bn Rb (+ 21.4 %), and the value of the Bank of Russia's bonds held by credit institutions – to 735.9 bn Rb (+50.8 %). Thus, March 2010 saw the continuation of the rise in the excess reserves of commercial banks, resulting from the rapid increase in the volume of their liquid resources caused by the inflow of capital and the recovery in economic activity. Nevertheless, banks are still very cautious in granting credit to the real sector of the economy because of the persisting risks and the uncertainty concerning further economic development. As a result, banks persist in accumulating their funds on deposits with the RF Central Bank or in the form of Bank of Russia bonds.

The above-mentioned 0.7-percent increase in March of the cash-in-circulation volume, accompanied by a simultaneous 5.4-percent rise in mandatory reserves, resulted in a 2.3-percent growth, over the same month, of the monetary base in a narrow sense (cash + mandatory reserves)² (see *Figure 2*). At the same time, the volume of the international reserves of the RF Central Bank rose in March by 2.4 %. As of 1 April 2010 it amounted to 447 bn USD. In the first two weeks of April, the RF gold and foreign currency reserves increased by another 0.4 % –to 448.6 bn USD.

In March, Russia's net foreign exchange inflows continued to grow due to the persistently high prices for energy carriers. As a consequence, the real effective exchange rate of the ruble increased, in March, by 2.4 % and practically reached its pre-crisis maximum registered in November 2008 (see *Figure 3*).

In March, the foreign exchange market saw the US dollar to euro exchange rate becoming stabilized in response to indications that the EU would help Greece cope with its financial problems. As a result, by the end of March the US dollar dropped to 29.36 Rb, as compared to 29.95 Rb on 1 March. The weakening of both the US dollar and the euro against the ruble led to an 82-kopeck reduction in the value of the bi-currency basket³ over the course of March. As a result, by the end of March the euro dropped to 34.01 Rb.



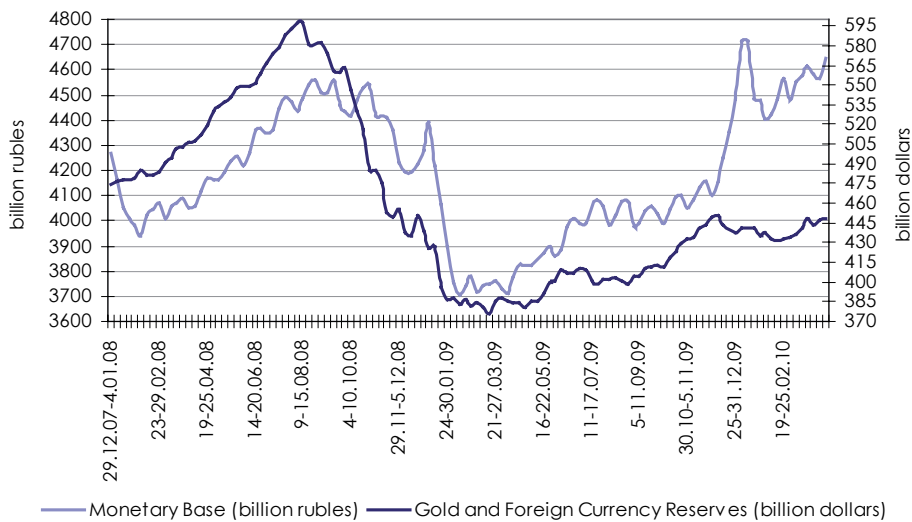
Source: RF Statistics Service

Figure 1. The growth rate of the CPI in 2002 – 2010 (% per month)

1 The RF monetary base in a broad sense, in addition to the cash-in-circulation issued by the Bank of Russia, and the residuals, on the accounts, of mandatory reserves of the funds in the national currency attracted by credit institutions and deposited with the Bank of Russia, includes the funds in corresponding accounts with credit institutions and bank deposits placed with the Bank of Russia.

2 It should be remembered that the monetary base in a broad sense is not a money aggregate; it is a characteristic of the Bank of Russia's liabilities denominated in the national currency. The monetary base in a narrow sense is a money aggregate (being one of the characteristics of the money supply volume), fully controlled by the RF Central Bank.

3 The bi-currency basket is an operational benchmark applied by the Bank of Russia for its exchange-rate policy. At present, the bi-currency basket is set at 0.45 euro and 0.55 USD.

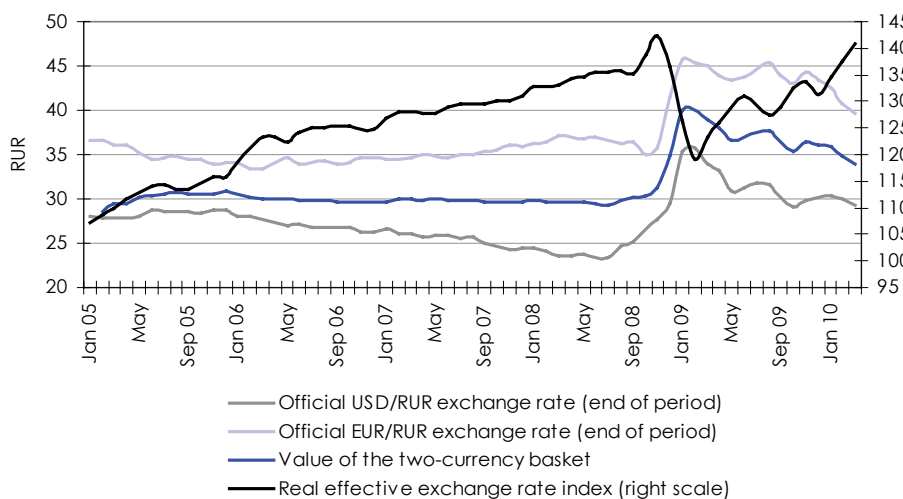


Source: RF Central Bank

Figure 2. Changes in the monetary base (in a narrow sense) and in the gold and foreign currency reserves of the Russian Federation in 2008 – 2010.

particular, according to the information provided by the Bank of Russia, the reason for the rate cut was the stable downward trend in inflation and the necessity to stimulate the credit activity of commercial banks for the purpose of speeding up the recovery of economic growth. Also, the RF Central Bank noted that the cut in interest rates would contribute to moderating the inflow of short-term foreign capital.

Thus, the Bank of Russia has once again – for the eleventh time in a row – relaxed its interest rate policy. The key factor behind the Bank of Russia’s ability to cut interest rates is the current slowdown in inflation compared to the previous year. However, the persisting rise in money supply and the base effect (in April, inflation began to rapidly decelerate) may put an end to the fall in the annual rate of Russian inflation. This situation makes it unlikely for interest rates to drop further by more than 0.25 – 0.5 p.p. It should also be noted that currently the rate of inflation has been falling more rapidly than the RF Central Bank’s rates. Thus, the rates have been rising in real terms. At the same time, interest rates on the interbank market have dropped below 4 % due to huge reserves of liquidity accumulated by banks.



Source: RF Central Bank, the authors’ estimates.

Figure 3. Indicators of the ruble's exchange rate behavior in January 2005 – March 2010¹.

On 26 March 2010, the Bank of Russia announced that the refinancing rate would once again be cut – from 8.5 % to 8.25 % per annum. Simultaneously, the RF Central Bank made an 0.25 pp. cut in a number of interest rates of the instruments for granting liquidity to the banking sector and in the rates of deposits attracted from credit institutions. The reasons for that decision, as stated in the press of the RF Central Bank, were practically similar to those that had been announced before the previous cuts in the rates. In

particular, according to the information provided by the Bank of Russia, the reason for the rate cut was the stable downward trend in inflation and the necessity to stimulate the credit activity of commercial banks for the purpose of speeding up the recovery of economic growth. Also, the RF Central Bank noted that the cut in interest rates would contribute to moderating the inflow of short-term foreign capital.

Therefore, as before the crisis, the RF Central Bank is once again being actually deprived of any effective instruments of monetary policy. In this respect, the ‘major culprit’ is the Bank of Russia’s policy on the foreign exchange market, which implies that at each resistance point the regulator in the person of the Bank of Russia buys / sells around 700 bn USD and then shifts this point by 5 kopecks. As a result, given the existing favorable external market situation, profiteers get an opportunity to make a lot

1 The January 2002 level is taken as 100.

of money from the ruble' upward trend and the interest rate differentials. In our opinion, this exchange-rate policy mechanism does not contribute to increasing the independence of the RF Central Bank's monetary policy and to a switch-over to inflation targeting.

On 19 March, the Bank of Russia announced that the credit risk limits set for credit institutions for the purpose of granting unsecured credits would be reduced from 1 May. In other words, the Bank of Russia is going to lower the upper limit of its unsecured credits to credit institutions. This step is aimed at gradually rolling back the anti-crisis measures designed to assist the banking sector. It should be noted that in the course of stabilization of the economic situation in the country, the indebtedness of credit institutions against unsecured credits has already reduced from almost 2 trillion Rb at the beginning of 2009 to 75 bn Rb in March 2010. Most credit institutions have done their best to repay their unsecured credits as soon as possible because of their high cost and the possibility to attract credits at better terms. Thus, it can be assumed that most of the remaining payables are accounted for by the banks whose situation remains strained. Given the RF Central Bank's course towards banking sector consolidation, it can be expected that the recently adopted measures will contribute to ousting non-effective banks from the market. ●

FINANCIAL MARKETS¹

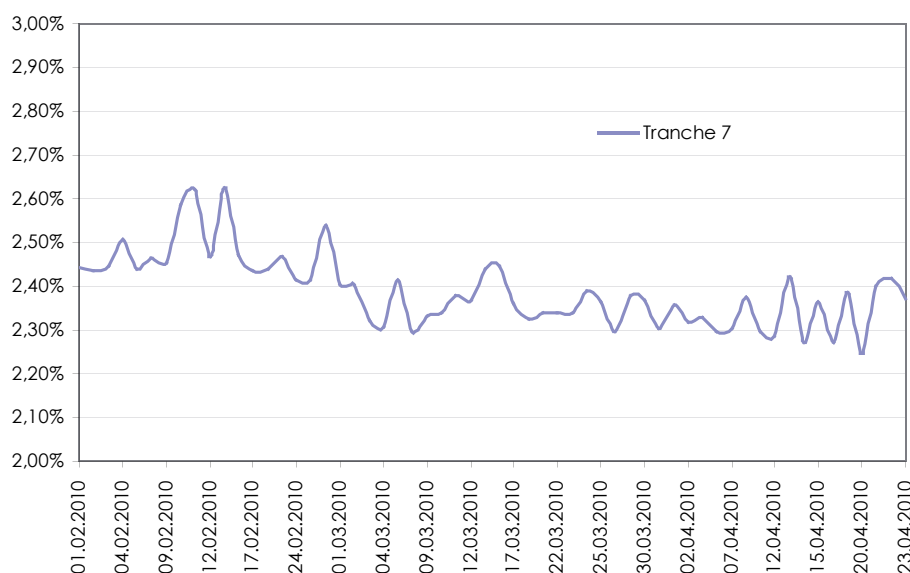
N.Burkova, E.Khudko

In April there was volatile dynamics in the Russian financial market under the impact of both, external and internal factors. The RF involvement of the new loans in foreign markets, the volatility of the global economy, fears about the financial sustainability of Greece, the closing air transportation in Europe, increased domestic and external debt of Russia up to the I quarter of 2010 contributed to the decreased trading volume in the market of public securities by 2.7-fold. However, the positive financial results of several major international companies for the I quarter of 2010, upgrading of the Standard & Poor's long-term credit ratings of 14 Russian banks, the IMF amendment of the forecast of GDP growth in Russia for 2010 from 3.6 per cent to 4 per cent, growth of the Russian international reserves have contributed to the support of the corporate securities market and an increase in average daily turnover by 5 per cent. In the corporate bond market April was a period of stabilization. Among the most positive developments there should be noted the growth of IPOs. However, the major problem in the bond market is the failure of the issuers to perform their obligations to the bondholders.

Government securities market

In April, Russian Eurobonds have demonstrated general volatile trends at the background of volatility in the global financial markets, Russia appearance at the external debt market after the twelve-year interval with the aim to raise new loans through the placement of government Eurobonds and decreased rates of the Central Bank interest. Activity in the secondary markets has decreased by 2.7 times as compared with the preceding month.

As of April 25, the Russian Eurobonds RUS-28 yield to maturity has decreased as compared with the level of March 28 from 5.81 to 5.73 per cent per annum (by 1.41 per cent), RUS-18 – from c 4.76 to 4.69 per cent per annum (by 1.37 per cent), and RUS-30, on the contrary has grown from 4.99 to 4.69 per cent per annum (by 0.34 per cent). Eurobond RUS-10 was redeemed on March 31, 2010, the amount of redemption made 341.77 million dollars.



Source: "Finmarket" Information Agency data

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

31, 2010, the amount of redemption made 341.77 million dollars.

In addition, on April 22 there were placed the RF Eurobonds by five-year and ten-year tranches RUS-15 and RUS-20: the amount of placements were 2 and 3.5 billion dollars, the average weighted yield were 3.74 per cent and 5.08 per cent per annum, the price of placement – 99.48 per cent and 99.36 per cent, the coupon scope – 3.63 per cent and 5 per cent per annum, maturity date – April 29, 2015 and 2020, accordingly. According to the international rating agencies Fitch Ratings and

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

Standard & Poor's, those Russian Eurobonds are rated as BBB.

As of April 25, the yield to redemption of RUS-15 made 4.06 per cent, and RUS-20 – 5.25 per cent. As of the same date, an upward trend was observed in the yields of external currency debt bonds. Thus, the yield to redemption of the seventh tranche of external currency debt bonds has increased from 2.30 to 2.37 per cent per annum (by 3.4 per cent) (see *Figs 1–2*)

Within the period from March 29 to April 25 the total turnover of the secondary market of government bonds amounted to approximately RUR 139.86 billion with an average daily turnover of RUR 6.99 billion (about RUR 433 billion with an average daily turnover of RUR 18.83 billion in March), which means the downgrading of an average monthly turnover by 2.7 times.

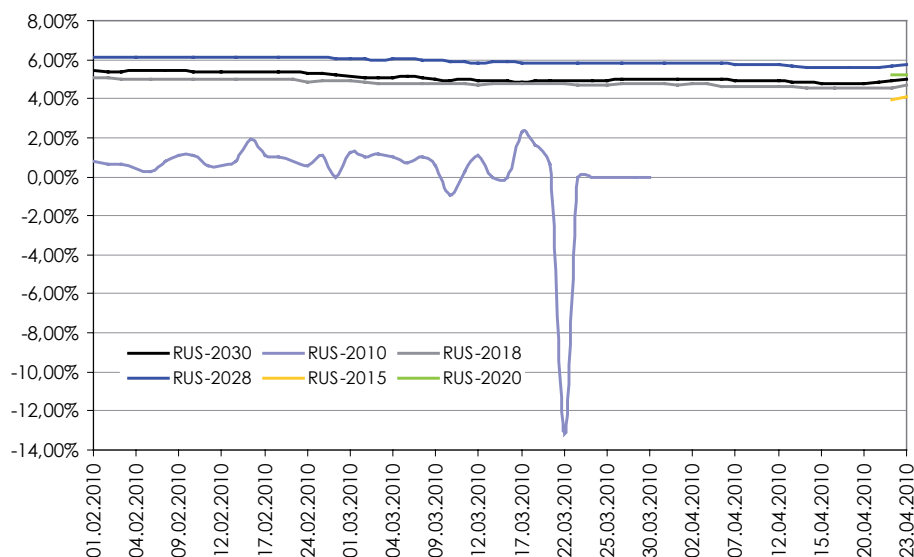
In the period from March 29 through April 25, like in preceding month, there were no auctions on government bonds placement at the primary government bonds market. However, in the period under review there were two auctions for government bonds additional placement in the secondary market (four auctions a month before). Thus, on April 14, there was an auction for government bonds additional placement series 25072 for the amount of RUR 6 042.42 mln. Actual placement volume was RUR 2 036.73 mln with an average weighted yield of 5.98 per cent per annum. On April 21, there was an auction for government bonds additional placement series 25073 for the amount of RUR 11 132.37 mln, with an average weighted yield of 5.97 per cent per annum. Therefore, the actual volume of placement for the period under review was 22 per cent versus the estimated level (52.63 per cent a month earlier), which demonstrates a decreased interest of the investors to additional placements in the government bonds market. This trend reflects a downgrading dynamics in the government bonds market.

As of April 25, the volume of government bonds market made RUR 1,490.93 bn at face value and RUR 1 508.42 bn at the market value (as compared with RUR 1,487.93 bn and RUR 1,494.73 bn accordingly as of March 28). The duration of the government bonds market portfolio was 1 616.95 days, having decreased by 1.13 days as compared with the preceding month (as of March 28).

Stock market

Stock market situation

In April, in contrast to the previous month, trading volumes in the stock market showed some increase at the background of the sustained volatility of the global financial markets, strengthening of the RF national currency, reduction of the RF Central Bank refinancing rate since March 29 to 8.25 per cent, growth of the foreign currency reserves of Russia, changes in the international rating agency Standard & Poor's forecast on the long-term credit ratings of 14 Russian banks from the "negative" to "stable", the maintained level of unemployment in Russia in March 2010 (8.6 per cent), as well as Russian trade surplus, amounting to 34.4 billion dollars as of January–February 2010, the revised IMF estimates for GDP growth in Russia in 2010 from 3.6 per cent to 4 per cent, on the one hand, and growth of external and domestic Russian debts as of the I quarter of 2010 to 473.7 bn dollars and 1.87 trillion rubles, accordingly, net capital outflow from Russia in I quarter of 2010,



Source: "Finmarket" Information Agency data

Fig. 2. Yields to maturity of the Russian Eurobonds with maturity in 2010, 2015, 2018, 2020, 2028 and 2030 in February – April 2010

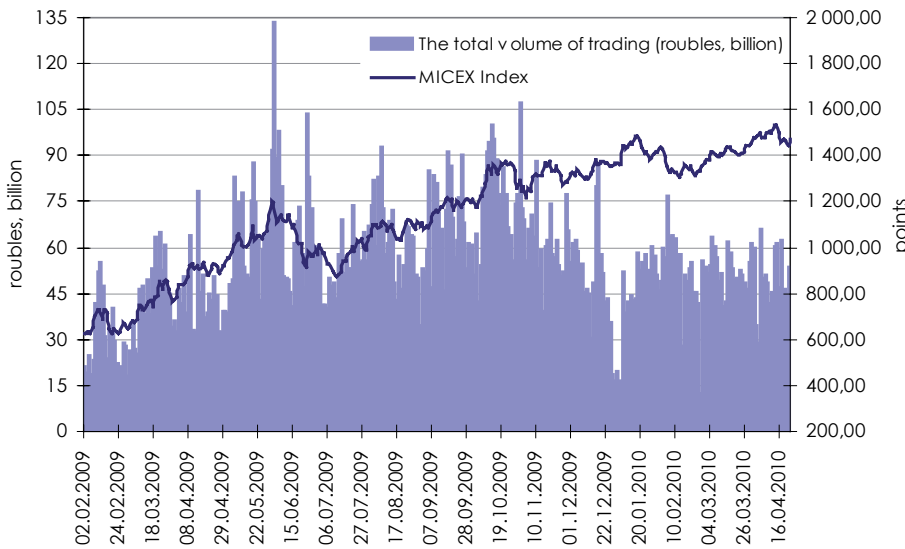


Fig. 3. Dynamics of MICEX Index and trading volume

index has reached on April 15, having reached 1 530.93 points (1,435.31 per cent points in the preceding month) (Fig. 3). In general, within the period from March 29 to April 25, the MICEX index has increased by 3.68 per cent, what makes about 52.08 points in absolute terms (within the year, from April 26, 2009 to April 25, 2010, the MICEX index has been upgraded times 1.6). Over the same period, the turnover of trades in securities included in the MICEX index, made about RUR 1 102,89 bn at an average daily turnover of RUR 55.14 bn (against RUR 1 210,8 bn with an average daily turnover of RUR 52.64 bn in the preceding period). Therefore, the investors' average daily activity in the stock market in April has grown as compared with the preceding period by 5 per cent. The indicators of maximum and minimum daily turnover in the market trades made, accordingly, RUR 66.13 bn (as of April 6), and RUR 28.63 bn (on April 5).

As of the month results (from March 29 through April 25), the “blue chips” securities have shown volatile trends. The leaders in growth were Gazprom, whose shares have increased by 6.35 per cent, GMK Nor Nickel (3.81 per cent), and Rosneft (2.98 per cent). Some less upgrading rates were noted in securities of Gazprom Neft (1.92 per cent), LUKOIL (1.72 per cent) and Tatneft (0.34 per cent). At the same time, other blue chips demonstrated a decline. Thus, Rostelecom securities have decreased by 1.54, VTB Bank (6.06 per cent) and (10.12 per cent). They were followed by VTB Bank, Sberbank of Russia, and Mosenergo, which decreased by 2.48 per cent, 1.22 per cent and 1.04 per cent accordingly. The least decline by 0.46 per cent was demonstrated by Surgutneftegas (Fig. 4).

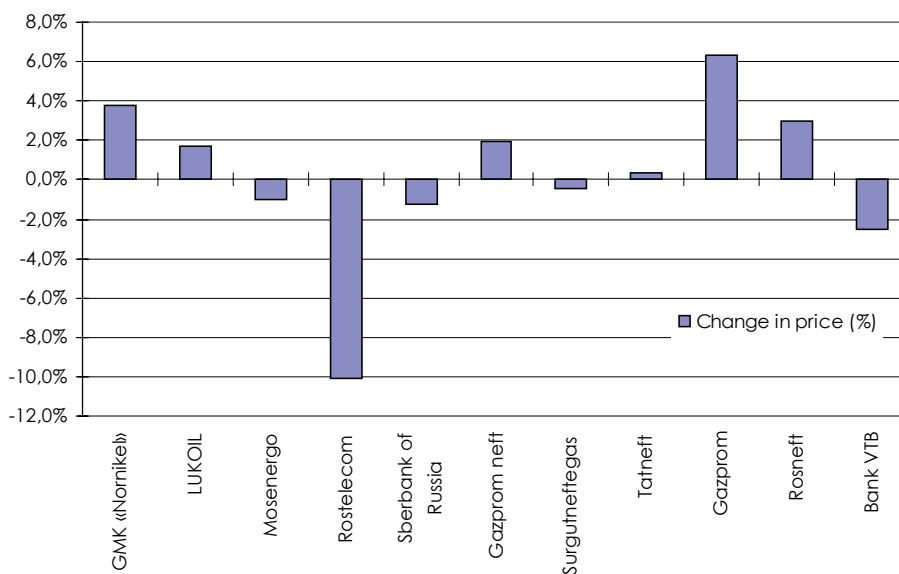


Fig. 4. Dynamics of the Russian Blue Chips from March 29 to April 25

according to preliminary estimates, in the amount of 12.9 billion dollars, the deficit of the federal budget on the basis of the I quarter 2010 in the amount of 307.6 bn rubles, or 3.2 per cent of GDP, on the other hand.

All those factors contributed to the volatile dynamics of the Russian financial market within the month. MICEX index has reached the minimum value for the period of April 22 – 1 443.36 points (against 1 356.27 points in the preceding month). The maximum value the MICEX

index has reached on April 15, having reached 1 530.93 points (1,435.31 per cent points in the preceding month) (Fig. 3). In general, within the period from March 29 to April 25, the MICEX index has increased by 3.68 per cent, what makes about 52.08 points in absolute terms (within the year, from April 26, 2009 to April 25, 2010, the MICEX index has been upgraded times 1.6). Over the same period, the turnover of trades in securities included in the MICEX index, made about RUR 1 102,89 bn at an average daily turnover of RUR 55.14 bn (against RUR 1 210,8 bn with an average daily turnover of RUR 52.64 bn in the preceding period). Therefore, the investors' average daily activity in the stock market in April has grown as compared with the preceding period by 5 per cent. The indicators of maximum and minimum daily turnover in the market trades made, accordingly, RUR 66.13 bn (as of April 6), and RUR 28.63 bn (on April 5).

As of the month results (from March 29 through April 25), the “blue chips” securities have shown volatile trends. The leaders in growth were Gazprom (23.3 per cent of the total turnover), “Sberbank of Russia” (23.23 per cent), GMK “Nor Nickel” (8.52 per cent), LUKOIL (6.02 per cent), and Rosneft (5.22 per

cent). Herewith, the significantly reduced demand for the shares of Sberbank of Russia led to the return of Gazprom to the top leader for the first time since March 2009. The total volume of transactions with the shares of those five «blue chips» was about 66 per cent (all «blue chips» – 73 per cent) of the total trades in shares at the MICEX stock market during the period from March 29 to April 25, what indicates a decrease in investors' interest in securities of the leading Russian companies (in March the share of operations with the “blue chips” accounted for 82 per cent)..

According to MICEX information, as of April 25, the top five leaders of the domestic stock market in terms of capitalization were: “Gazprom” – RUR 4 100,96 bn (RUR 3 815.70 bn a month earlier), “Rosneft” – RUR 2 548.33 bn (against RUR 2 427.19 bn), “Sberbank of Russia” – RUR 1 829.49 bn (against RUR 1 843.09 bn), “LUKOIL” – RUR 1 445.37 bn (against RUR 1 395.3 bn) and GMK “Nornickel” – RUR 1 047.03 bn (against RUR 975,63 bn) .

Herewith, a greater rate of capitalization growth of GMK “Nornickel” in April led to forcing out from the fifth place of leaders Surgutneftegaz (RUR 1,036.34).

Futures and Options Market

In April the total turnover in the MICEX futures market has declined by 10 per cent as compared with the preceding month. Thus, in the period from March 29 through April 25 the total turnover in the MICEX (futures) market made approximately RUR 92.63 bn (451.81 thousand of transactions, 1.53 mln of contracts) against approximately RUR 103.15 (466.23 thousand of transactions, 1.95 mln of contracts) in March.

The largest volume of trading in April, like a month before, was observed in contracts for futures and equity instruments, amounting to RUR 73.72 billion (450.25 thousand of transactions, 0.98 mln of contracts). Herewith, futures for the MICEX index in the short-term MICEX market section in terms of the volume of trade were followed by contracts for «Sberbank of Russia», Gazprom, Nornickel and LUKOIL shares. It should be noted, that the value of the MICEX index (the price of transactions) for June and September 2010 was in the range of 1,440–1,500 points.

The second place in terms of trading volume within the month was taken by foreign currency futures (RUR 16.27 bn). Herewith, contracts for the US dollar were in the first place in terms of trading in the MICEX futures market, followed by futures contracts for Euro and for Euro/USD rate. It is worth noting that prices of futures contracts, concluded in April for RUR/USD futures in the MICEX market were within RUR/USD 29.2–29.4 for June, RUR/USD 29.5–29.8 for September, RUR/USD 29.8–30.4 for December. Trading volume in futures for commodity assets within the period has decreased by 27 per cent (from RUR 3.62 billion to RUR 2.64 billion). There were no contracts for interest rate in April.

Similar trends were observed in the RTS FORTS futures market, where the investors' activity in April has also somewhat decreased as compared with the previous month (by 9 per cent). Thus, in the period from March 29 through April 25 the total market turnover of futures and options in RTS was about RUR 1 839.08 billion (7.57 million of transactions, 37.62 million of contracts) as compared with about RUR 2 097.3 billion (9.11 million of transactions, 45.11 million of contracts) in March. The greatest demand among the market participants, as before, was demonstrated in futures: trading volume in them during the period under review amounted to RUR 2 032.57 billion (7.47 million of transactions and 35.47 million of contracts). In the first place in terms of futures trading volume were the futures contracts on the RTS index, which were followed with a significant margin by the futures contracts for dollar–ruble rate and for the shares of Sberbank of Russia and Gazprom. It should be noted that in the futures market of RTS FORTS prices of the recent transactions, concluded on futures contracts for the date of execution on June 15, were within RUR 29.3–29.7/ USD, on September 15, 2010 – RUR 29.4 – 29.9 USD, and on December 15, 2010 – RUR 29.7–30.1/ USD. The value of futures for the RTS index (based on the prices of recent contracts) for June 15, 2010 was estimated on average at 1 550–1 620 points, for September 15, 2010 – 1 550–1 640 points. Options enjoyed far less demand, the turnover made about RUR 72.73 bn (101.35 thousand transactions and 2.15 mln of contracts). The maximum daily turnover in the short-term RTS futures market in the period under review made RUR 138,79 billion (as of April 22), and minimum was RUR 49.22 bn. (on April 5).

External factors behind the Russian stock market dynamics

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

- placement by Greece the seven–year bonds worth Euro 5 billion under 6 per cent per annum;
- increased global oil prices up to 86 dollars per barrel in the first half of April;
- opinion of the “Big Twenty” that the global recovery is occurring faster than expected;
- willingness of the EU and the IMF to provide a loan totaling to Euro 40 billion to Greece;
- growth of China foreign currency reserves as of the I quarter of 2010 results by 47.9 billion dollars, to 2.5 trillion dollars;
- information on the net profit of the U.S. bank Citigroup in I quarter of 2010 in the amount of 4.4 billion dollars (against 1.6 billion dollars in the I quarter of 2009); Bank of New York Mellon Corp. – 559 million dollars (against 322 million dollars); Morgan Stanley – 1.4 billion dollars (a loss of 578 million dollars); company Johnson&Johnson – 4.5 billion dollars (against 3.5 billion dollars) ; Coca–Cola Co. – 1.61 thousand dollars (by 20 per cent more than the indicator of the similar period of preceding year); Intel – 2.4 billion dollars (against 647 million dollars); Volkswagen corporation – Euro 473 million (against Euro 243 million);
- extended number of jobs by 162 thousand in non–agricultural sectors of the U.S. economy in March 2010;
- increase interest rate by the Reserve Bank of Australia from 4 per cent to 4.25 per cent, the Reserve Bank of India upgrading of the rate under REPO transactions from 3.5 per cent to 3.75 per cent;
- agreement on strategic partnership Renault, Nissan and Daimler automakers;
- growth of UK GDP, according to tentative estimates, in the I quarter 2010 by 0.2 per cent in comparison with the IV quarter of 2009.

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

- international rating agency Standard & Poor confirmation of the long–term credit rating of Great Britain at AAA with a ”negative” outlook;
- rating agency Standard & Poor's confirmation of the long–term and short–term credit rating of Iceland under obligations in foreign currency at the level BBB–/A–3., as well as downgrading of Iceland rating for obligations in national currency to the level BBB/A–3; forecast on ratings is ”negative”;
- reduced rating of Fitch Ratings in regard to Greece long–term default issuer rating from BBB + to BBB–, outlook – ”negative” due to deteriorating economic prospects of the country;
- reduced sovereign credit ratings by Moody's Investors Service agency of Greece from the level of A2 to A3 and a warning about the possibility of their further downgrading against the background of the problems with the country domestic debt;
- instituting legal proceedings by the USA Securities and Exchange Committee (SEC) against the investment bank Goldman Sachs due to the accusation of fraud with the use of derivative mortgage securities;
- financial losses of international airlines in connection with the closure of the airspace as a result of volcanic eruptions in Iceland and the cancellation of a large number of air flights;
- unemployment growth in the EU countries in February 2010 by 0.1 per cent to 10 per cent;
- balance of trade deficit in China in March 2010 in the amount of 7.24 billion US dollars (last time the deficit was recorded in 2004);
- sustained value of the GDP in the Euro Zone in the IV quarter of 2009 as in the previous quarter;
- plans of Japan Airlines to reduce 16, 500 jobs.

All those factors have generally resulted in the volatile dynamics of the global stock indices in April, as of the month results. Herewith, the markets of the developed countries were demonstrating both, a general increase in the indices by 1–6 per cent, as well as a decrease by 0.7–1 per cent, At the same time, in the developing markets there was observed an increase in the basic stock indices by 1–5 per cent, with the exception of the Chinese Shanghai Composite index, which has declined

by 2.5 per cent. Herewith, there was observed an increase in the basic stock market indices as compared with early January 2010 results (See *Table 1* and *Fig. 5*).

Table 1

DYNAMICS OF THE GLOBAL STOCK INDICES (AS OF APRIL 25, 2010)

Index	Ticker	Value	Dynamics within the month(%)	Dynamics since the year beginning(%)
MICEX (Russia)	MICEXINDEXCF	1 467.62	3.68	7.12
RTS (Russia)	RTSI	1 602.99	5.47	10.96
Dow Jones Industrial (USA) Average (USA)	DJI	11 204.28	3.26	7.44
NASDAQ Composite (USA)	NASD	2 530.15	5.64	11.50
S&P 500 (USA)	SPX	1 217.28	4.35	9.16
FTSE 100 (UK)	FTSE	5 723.65	0.36	5.74
DAX-30 (Germany)	DAX	6 259.53	2.28	5.07
CAC-40 (France)	CAC	3 951.30	-0.94	0.38
Swiss Market (Switzerland)	SSMI	6 767.97	-1.04	3.39
Nikkei-225 (Japan)	NIKKEI	10 914.46	-0.74	3.49
Bovespa (Brasil)	BUSP	69 509.50	1.20	1.34
IPC (Mexico)	IPC	33 853.69	2.13	5.40
IPSA (Chile)	IPSA	3 836.02	2.32	7.11
Straits Times (Singapore)	STI	2 988.49	2.83	3.14
Seoul Composite (South Korea)	KS11	1 737.03	2.32	3.22
ISE National-100 (Turkey)	XU100	58 338.36	3.05	10.44
BSE 30 (India)	BSE	17 694.20	0.28	1.31
Shanghai Composite (China)	SSEC	2 983.54	-2.49	-8.96
Morgan Stanley Emerging Markets Free Index	EFM	812.07	3.01	3.74

* – Versus index indicator valid on March 28, 2010.

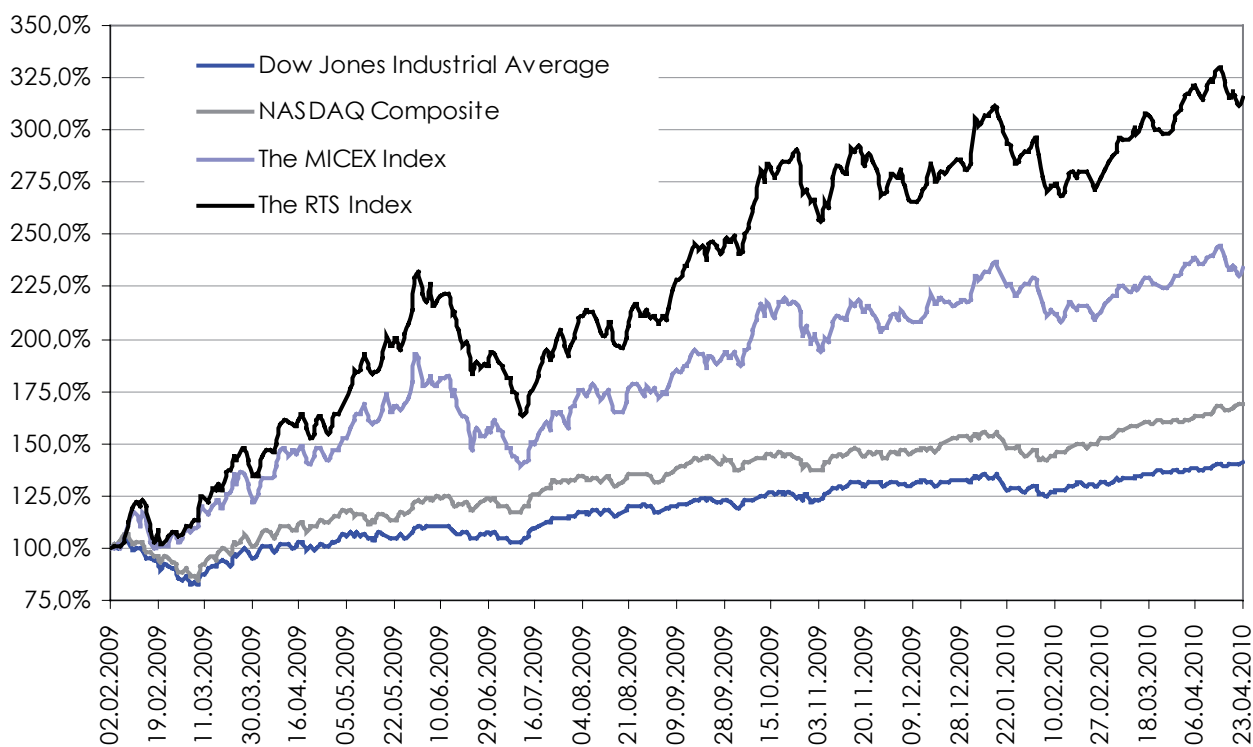


Fig. 5. Dynamics of the main USA and Russian stock indexes (in per cent to the date 02.02.2009)

Corporate News***ОАО “VTB Bank”***

On March 30, VTB Group (VTB Bank and its subsidiaries) has disclosed its audited financial results under IFRS for 2009: net loss made 59.6 billion rubles.; capital adequacy ratio – 20,7 per cent.

ОАО «Газпром»

On March 30, “Gazprom” started construction of a marine pipeline section “Dzhubga – Lazarevskoe – Sochi”, which is scheduled for completion in June 2010. On April 9, there was started the construction of “Yuzhny Potok” gas pipeline. On April 21 supplements to the contract for the supply of gas to Ukraine were signed between “Gazprom” and “Naftogaz Ukraine”, providing an increase of annual gas supply in 2010 up to 36.5 billion cubic meters, as well as providing about 30 per cent discount for gas payments to Naftogaz. On April 24, ОАО “Gazprom” and OMV signed a basic agreement on cooperation in the framework of the project “Yuzhny Potok” in the territory of the Republic of Austria.

ОАО «Газпром Нефт»

In April, IR Global Rankings recognized ОАО “Gazprom Neft” the best company in terms of disclosure financial reporting among global oil sector participants.

ОАО «ЛУКОЙЛ»

On March 24 “LUKOIL” has disclosed its consolidated financial reporting under U.S. GAAP for 2009: net profit amounted to 7,011 million dollars, which is by 23.3 per cent lower than in 2008, EBITDA – 13,475 million dollars, having decreased by 14.7 per cent. In addition, in April, ОАО “LUKOIL” became a winner of the All-Russian contest “Best Russian Enterprises. Dynamics, Efficiency, Responsibility–2009” in the nomination “For Consistency In The Development Of Non-Financial Reporting”, as well as it was recognized as the best among Russian companies in the area of investor relations as per the survey of opinions, performed by the “Institutional Investor” magazine.

ОАО «Mosenergo»

On April 16 «Mosenergo» has disclosed an audited consolidated financial reporting under IFRS for 2009: net profit amounted to 1,658 million rubles (by 19.3 per cent lower than the indicator of 2008).

ГМК «Norilsk Nickel»

On April 23 ordinary registered shares of ГМК «Norilsk Nickel» have been included in the quotation list “A” of the MICEX first-level.

ОАО «Rostelecom»

On March 30 the international rating agency Standard&Poor’s has confirmed long-term credit rating of ОАО “Rostelecom” at the level of “BB” with “stable” forecast as a result of stable financial standing and maintaining of the dominant position in the market of telecommunications. On March 31 ОАО “Rostelecom” has disclosed its audited performance results under RAS for 2009: net profit amounted to 5,101.6 million rubles (or 27.9 per cent lower than a year earlier); index OIBDA (revenues less expenses for regular activities before depreciation) – 12,089.3 mln rubles, profitability under OIBDA – 19.7 per cent. In addition, in April, ОАО “Rostelecom” was recognized as the best provider of telecommunications services for public needs in 2009.

Сбербанк of Russia

On March 29 Sberbank of Russia and ООО “Volkswagen Financial Services RUS” announced the launch of a joint program of new cars Volkswagen, Audi and Skoda crediting. On April 7 Sberbank of Russia has signed an agreement with the Government of Moscow on participation of Sberbank in the “Muscovite’s Social Card” providing for the implementation of organizational and technical measures to expand the capacity of Muscovites social security cards for the purposes of

public and municipal services in electronic form. On April 8 the international ratings agency Fitch Ratings has assigned a rating of the DB to AO “Sberbank” (Kazakhstan): long-term issuer default ratings (IDR) in foreign and national currency «BBB-», short-term IDR «F3», individual rating “D/E”, support rating “2” and National Long-term rating «AA (kaz)»; the forecast for long-term IDR and National Long-term rating – “Stable”. On April 15 Sberbank of Russia has disclosed financial reporting under RAS for the I quarter of 2010 (unconsolidated data): net income totaled to 43.2 billion rubles against 0.3 billion rubles for the I quarter of 2009, assets increased by 2.2 per cent to 7,270 billion rubles. Russian enterprises were granted credits in the amount of about 800 billion rubles; capital adequacy ratio was approximately 21 per cent. Since April 19, Sberbank of Russia has reported the abolition of all tariffs and fees for the issuance of credit, loan application processing, for the servicing of credit account, as well as a number of other fees.

Corporate bonds market

The volume of the Russian domestic stock market (as per nominal value of shares in circulation, denominated in national currency) in April of the current year, has somewhat grown again and at the end of the month reached RUR 2 466.3 bn, which is more than the relevant indicator of preceding month by 1.7 per cent¹. The total number of emitters and emissions in circulation and denominated in the national currency has decreased again from 663 to 650 emissions and from 378 to 368 emitters. There is still one emission of bonds in circulation, denominated in Japanese yens and two emissions denominated in US dollars.

In April the activity of foreign investors in the secondary corporate bonds market has somewhat decreased, though the volume of trading is still one of the highest indicators within the last two years. Thus, the trading volume in the MICEX market in the period from March 29 to April 23 of the current year amounted to RUR 107.4 billion (for comparison, from February 24 to March 26, the trading volume was equal to RUR 133.7 billion)². In the period under review on the MICEX Stock Exchange there were committed 22.2 thousand of transactions in bonds, which is below the average level of the last few months.

In the current month the trend to growing index of the Russian market of corporate bonds IFX-Cbonds, which was observed since the beginning of 2009 was continued. Within the period from March 25 through April 23, the index has grown by 2.1 per cent points (or 0.8 per cent), having reached the highest level since the beginning of its assessments. The effective yield, upon significant decrease in March (exceeding 1 percentage point) remained at practically the same level (see *Fig. 6*). Therefore, to date, the yield to maturity on corporate bonds has stabilized at the pre-crisis level.

The duration of corporate bonds market portfolio dynamics has somewhat declined and made 729 days (in late March the duration was equal to 756 days).

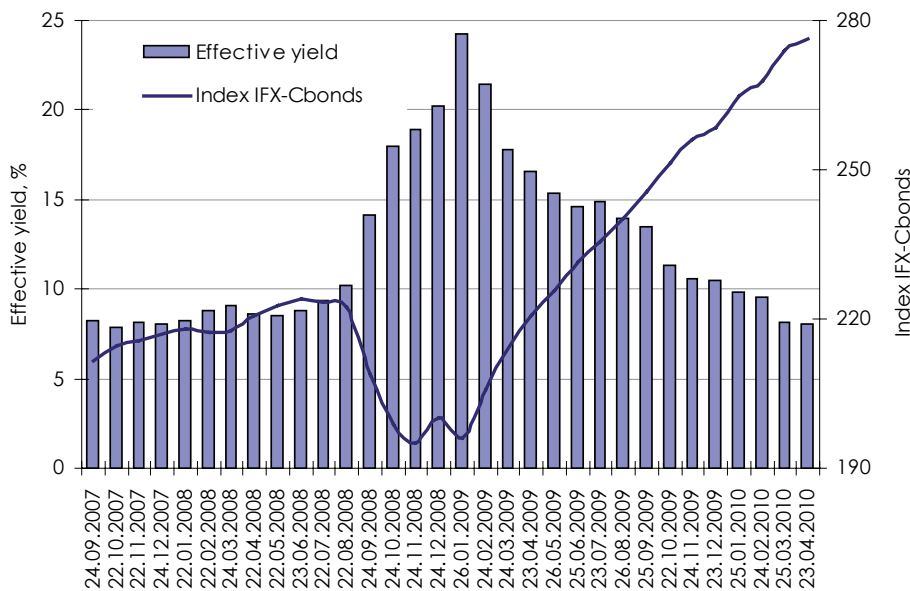
The total number of registered corporate bonds emissions has increased in comparison with the previous month has been significantly reduced. Thus, in the period from March 26 through April 23, twelve emitters have registered 21 bond emissions for the total amount of RUR 91.9 billion (for comparison, from February 26 through March 25, eight emitters have registered 25 emissions amounting to RUR 145.0 billion). More than 50 per cent of the registered issues were again exchange bonds, which recently of great interest the large public companies because of the rapid procedure of placing in the open market. The largest share of the reported emissions were seven series of bonds of OAO “Gazprom Neft” for the total amount of RUR 50 billion and two series of OAO “Aeroflot” bonds of in the amount of RUR 12 billion³

The dynamics of primary bond market is extremely unstable after the expressed growth of primary bond emissions market at the end of preceding year, at the I quarter of 2010 this indicator has declined again, but in April has grown again nearly twice, having reached the maximum value since the beginning of the year. Thus, in the period from March 26 through April 23 there were placed 18 corporate bonds emissions, including 10 stock bonds issues totaling to RUR 83.3 billion (for comparison, from February 25 through March 25 there were placed 12 bonds emissions for the total amount of RUR 42.5 billion

1 As per Rusbonds information

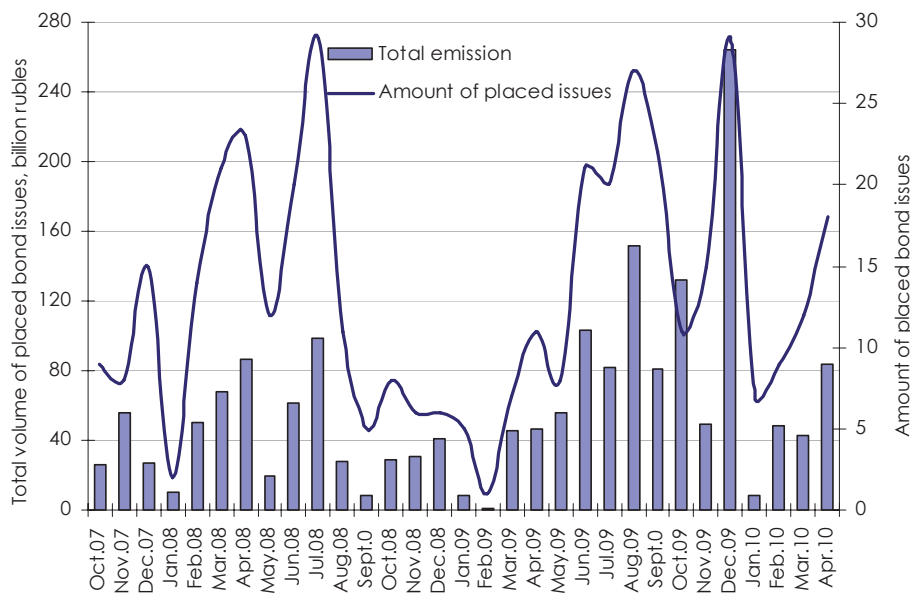
2 As per “Finmarket” Information agency.

3 Rusbonds data.



Source: Cbonds data.

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



Source: Rusbonds data

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

(See Fig. 7). During the period under review the largest bond issues were placed by OAO “Gazprom Bank” (two series of bonds worth RUR 20 billion) and OAO “EvrazHolding Finance” (two series of stock bonds worth RUR 15 billion) and OAO “Aeroflot” (two series of stock bonds worth RUR 10 billion).

In the period under review six emissions of “RUSAL Bratsk Aluminum Works” were recognized as invalid by the Federal Financial Monitoring Service (FFMS) due to non-placement of any security (versus three emission offered for public placement in the preceding period)¹.

Within March 26 through April 23, twenty four emitters were supposed to redeem their bond issues totaling to RUR 26.3 billion. However, three emitters have announced a technical default on repayment of their bond loans, totaling to RUR 2.5 bn (against four emitters, announced a technical default on repayment of their bond loans, totaling to RUR 4.0 bn in preceding period). In May 2010, fourteen issues of corporate bonds redemption for the total amount of RUR 24.7 bn are expected.² From March 26 through April 23, the real default on bonds coupon

yield redemption was announced by four emitters for nine emissions (since February 25 through March 25 – 10 emitters for nine emissions). In regard to two emissions, the emitters managed to reach agreement with bondholders to restructure the debts. However, if the situation with the performance of current debt liabilities has improved in April as compared with March, the situation with the return of investment to investors at maturity of the loan, on the contrary, is worsened. A real default on bonds redemption of the nominal value of their bonds was announced by six emitters for seven emissions, including OAO “Amurmetal”, OAO

1 FFMS of Russia data
 2 По данным компании Rusbonds

“Mirax Group” (in the preceding relevant period five emitters filed to redeem their loans in the framework of technical default)¹.

Since April 16 of this year, the new edition of the Standards for securities emission and registration of securities prospectuses have entered into force, approved by the Order of Federal Financial Monitoring Service of Russia № 07–4/pz–n from 25.01.2007. To improve the reliability of the debt instruments, one more measure was introduced: to submit to the Federal Financial Monitoring Service of Russia at the stage of state registration of issue and at the stage of state registration of the report on the outcome of the bonds emission secured by a pledge, a document containing the estimates of net assets value of the commercial organization that provides the guarantee. This innovation was due to the entry into force of the amendments to the Federal Law “On securities market”. ●

1 Cbonds data

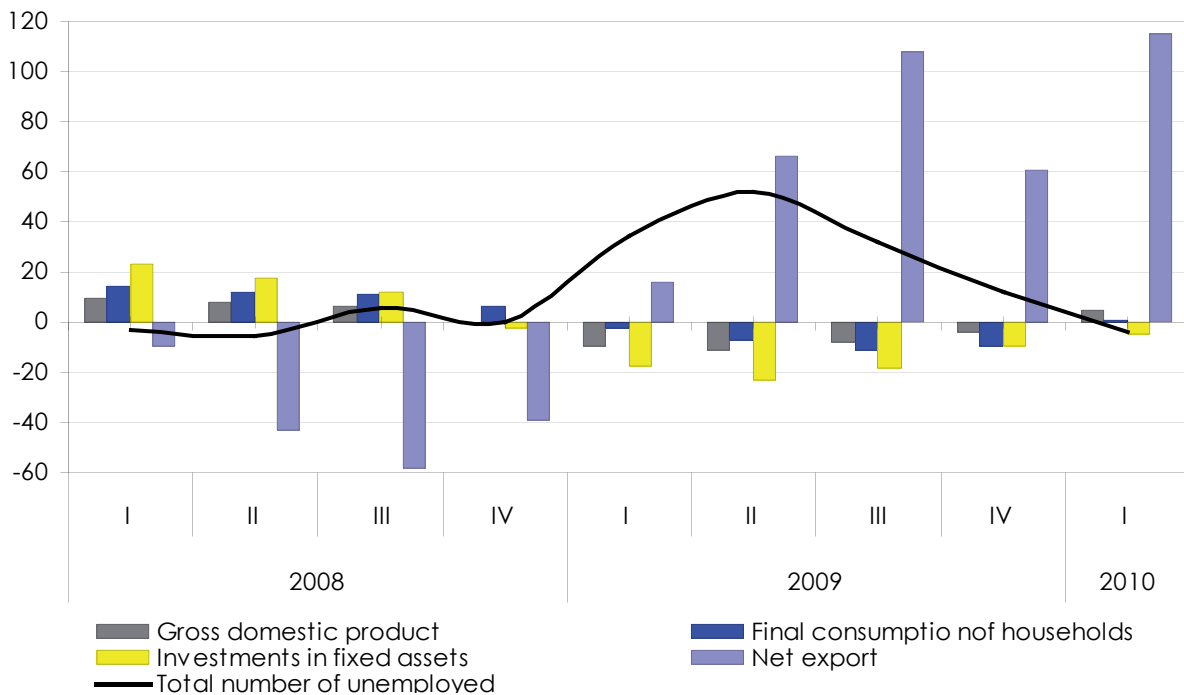
REAL ECONOMY SECTOR: TRENDS AND FACTORS

O.Izryadnova

According to the preliminary data of the RF Ministry for Economic Development, in the 1st quarter 2010 the GDP went up by 4.5%, output in industry growing by 5.8%, including that in minerals production – by 6.7%, in manufacturing industries – by 5.2%, in electricity, gas and water production and distribution – by 7.1%. Taking into account the fact that in the 1st quarter 2009 there was the most dramatic fall of output, the upsurge at the beginning of the current year was mainly due to the low base. The analysis of the economy development in the 4th quarter 2008 – 1st quarter 2010 demonstrates that at the moment it is the growth of external demand that is the main factor contributing in recession. At the domestic market the economic situation was still considerably influenced by the reduction in the investments in fixed assets by 4.7% versus the 1st quarter 2009 as well as the slack dynamics of the consumer market.

According to the preliminary data of the RF Ministry for Economic Development, in the 1st quarter 2010 the GDP went up by 4.5% versus the corresponding period of the previous year as compared with the drop of 9.4% a year ago. At the beginning of 2010 the macroeconomic situation was formed under the influence of the factors formed in the second half of 2009: the expansion of external demand, moderate dynamics of consumer market, low investment activity and high level of unemployment.

The analysis of economy development in the 4th quarter 2008 – 1st quarter 2010 demonstrates that at the moment the main factor contributing in recession overcoming is the growth of external demand. As a result of 2009 the growth of the net export in the GDP made 56.8%. This figure had positive dynamics throughout the whole year. According to the preliminary data for the 1st quarter 2010 the Russian export in value terms rose by 59.3% versus the corresponding period of



Source: Federal State Statistics Service; 2010 – preliminary estimation

Fig. 1. Change in GDP Dynamics as Broken by Components of Use and total Number of Unemployed in 2008–2010, as percentage to the corresponding period of the previous year

the previous year, import – by 17.7%, foreign trade balance – by 2.1 times – from USD 19.6 billion to USD 40.8 billion.

The reduction in the investment activity continued to dominate the economic situation at the domestic market. Over the 1st quarter 2010 the investments in fixed assets decreased by 4.7%, the workload in construction – by 8.1%. It should be taken into account that the continuing reduction of housing construction rates, as well as focus of the enterprises on less capital intensive directions for production expansion, for instance, at the expense of the facilities load increase that were the factors determining low investment activity. It should be noted that the economy from the capital costs was accompanied by some increase of the demand for the work force if compared with 1st quarter 2009, when the maximum of the unemployment and the number of part-time workers, those on the leave because of the administrative initiatives was observed. As a result of “exchange” between labor and capital factors, supported by slack dynamics of real wages growth, the economic situation was defined by the action of inertial trends of 2009. Besides, against the background of interest rates reduction, increase of export earnings, rise of banking sector liquidity, increase of the volumes of funds attracted by credit organization and reduction in absolute scale of capital outflow down to USD 12.9 billion versus USD 35.0 billion in the 1st quarter 2010, low investment activity testifies that the business does not have steady expectations concerning quick recovery from the crisis.

At the consumer market, the retail trade turnover increasing by 1.3%, the contraction of paid services market made 0.9% versus the 1st quarter 2009. The inflation rates slowing in the 1st quarter 2010 down to 3.2% versus 5.4% in the 1st quarter 2009, inflation of foodstuffs being 3.8% versus 5.0% and for non-food goods – 5.4% versus 8.5% a year ago, the real incomes of the population growing by 7.4%, the situation at the consumer market reflects low consumer expectations of the population.

Comparison of the goods turnover dynamics by the kinds of goods and the structure of population expenditures indicates that the expenses of the population for the current needs at the expense of the reduction of non-food goods purchase and services consumption. In the 1st quarter 2010 retail trade turnover index for foodstuffs made 103.9% and for non-food goods – 98.9% versus the corresponding period of the previous year. The proportion of expenses for goods purchase in the monetary incomes of the population reduced as compared with the previous year by 3.5 percentage points. The sustention of the trend for the growth of savings and the restraint at the credit market was characteristics for the consumers’ behavior at the beginning of 2010. In this connection it should be noted, first, that in the 1st quarter 2010 real wages went up by 2.2%, and it is labor remuneration that forms the dominating part of population incomes, and, second, that the tension at the labor market sustains.

In the 1st quarter 2010 in concordance with the preliminary data on population monitoring concerning the unemployment problems, 6.6 million or 8.7% of economically active population is unemployed were classified (according to ILO methodology as the unemployed). At the state unemployment services there were 2.2 million registered as unemployed, including 1.9 million receiving unemployment benefit. As compared with the 4th quarter 2009 the total number of the unemployed went up by 8.2%, and registered – by 8.5%.

Index of industrial production in the 1st quarter 2010 as compared with the 1st quarter 2009 made 105.8% and 89.9% versus the 4th quarter of 2009. In February and March of the current year the rates of industrial production versus the corresponding period of the previous year became positive and made 104.8% and 115.3%, correspondingly. It should be noted that the growth of production was observed for all consolidated types of economic activities. Index of minerals production made 106.7% versus the 1st quarter 2009, of manufacturing industries – 105.2%, of electricity, gas and water production and distribution – 107.1%. Oil production went up by 5.3% versus the 1st quarter 2009, and gas production – by 18.4%.

It was the recovery of monthly positive dynamics of manufacturing industries versus the corresponding months of 2009 that was a positive moment in the first months of 2010. In the manufacturing industries the differentiation of the production output rates in natural terms remains high. Taking into account the fact that the 1st quarter of 2009 accounted for the most dramatic output

drop, low base defined the upsurge of the rates at the beginning of the current year, but does not give enough grounds to talk about the steady dynamics of economy recovery.

Table 1

PRODUCTION INDICES AS BROKEN BY TYPES OF ECONOMIC ACTIVITIES IN THE 1ST QUARTERS 2007-009, AS PERCENTAGE VERSUS THE CORRESPONDING PERIOD OF THE PREVIOUS YEAR

	2007	2008	2009	2010
Industry	107.2	106.2	85.7	105.8
Minerals extraction	104.0	100.7	96.2	106.7
Fossil fuels extraction	103.8	102.7	100.4	106.3
Minerals extraction excluding fossil fuels	107.9	92.2	96.2	111.1
Manufacturing industries	114.5	108.7	79.2	105.2
Production of foodstuffs, including beverages	113.7	106.4	96.7	103.8
Textile and sewing	110.8	102.6	78.8	110.0
Leather, leather goods and footwear	118.7	106.6	83.0	125.6
Wood processing and timber goods	111.0	115.6	70.8	112.1
Pulp and paper, publishing and printing	110.8	107.8	82.0	106.8
Coke and oil products	106.0	105.0	96.3	105.2
Chemistry	110.6	103.7	77.6	127.6
Rubber and plastic goods	124.1	130.4	82.7	119.6
Production of other non-metal mineral commodities	125.8	108.6	67.8	108.3
Metallurgy industry and production of finished metal goods	108.2	108.6	72.3	107.9
Machinery and equipment	126.0	116.4	74.3	100.4
Electric, electronic and optical equipment	123.7	93.3	56.6	131.2
Transport vehicles and equipment	116.4	114.4	64.5	109.0
Other industries	112.9	118.6	79.3	114.6
Electricity, gas and water production and distribution	93.3	105.6	94.9	107.1

Source: Federal State Statistics Service

On the basis of the existing trends the RF Ministry of Economic Development suggests specifying the forecast for 2010 in May. According to the basic forecast of the RF Ministry of Finance the GDP as a result of the year was estimated to be in the range of 3-3.5%, oil prices being USD 68-69 per barrel. Taking into account the growth of the economy, in January-March the possible GDP growth in 2010 may make 4%.

The IMF also reconsidered the forecast concerning Russia's GDP dynamics. The analysts of the Fund optimistically estimate the economy situation in Russia this year and have increased the GDP growth forecast from 3.6% to 4%. ●

FOREIGN TRADE

N.Volovik. K.Rezenkova

Improvement of the situation at the world market and ruble strengthening have resulted in a significant increase of the main Russia foreign trade indices at the beginning of 2010.

The World Trade Organization in 2010 expects the volume of the world trade to rise by 9.5% after the record-breaking (in the past 65 years) recession of the previous year. Taking into account the current forecasts for the growth of the world GDP as well as the stability of oil prices and the exchange rates of the main currencies, the WTO predicts that the export of the developing countries will increase by 11% in 2010, the export of the developed countries going up by 7.5%.

The Russian foreign trade turnover calculated on the basis of the balance of payments methodology made USD 46.1 billion in February 2010, which by 43.8% exceeds the corresponding figure of 2009. Export made USD 30.6 billion, which is by 64.7% more than a year ago. As compared with the previous month export went up by 9.9%.

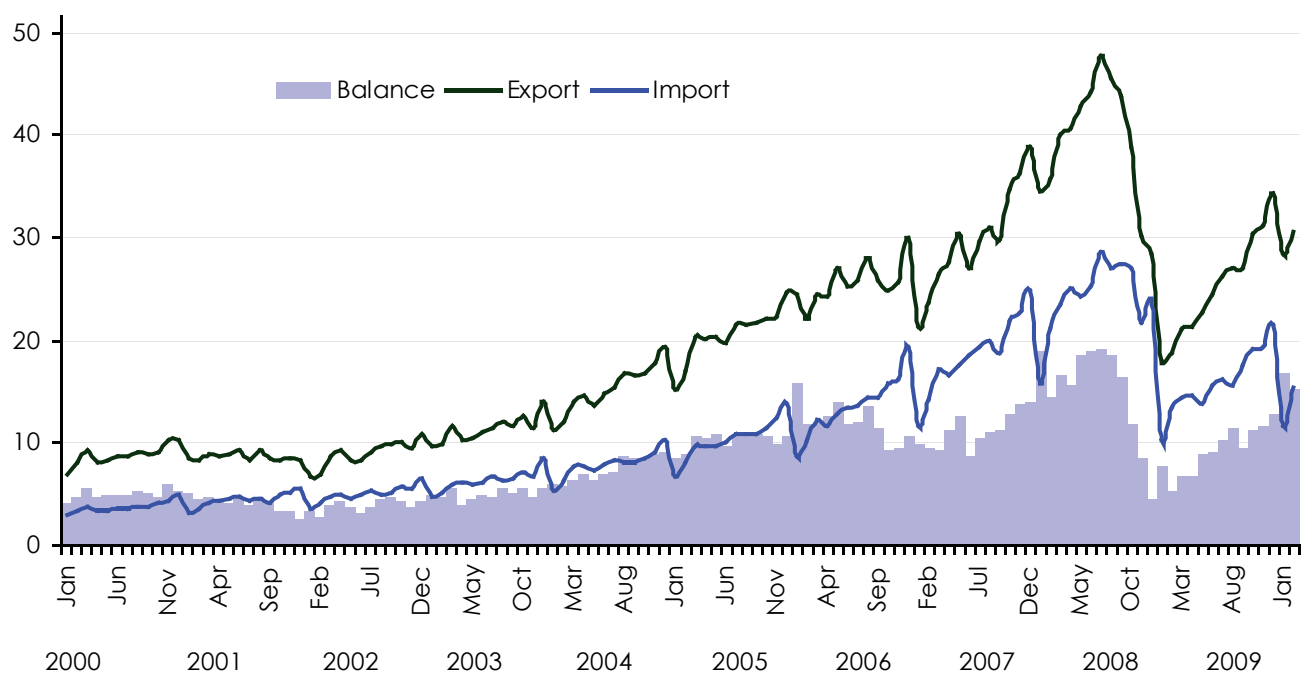
The growth of export value was mainly due to the rise of world prices for raw materials. The proportion of the raw materials in the Russian export has not reduced as compared with the pre-crisis period, its dynamics being totally dependent on the unstable prices and demand on the external markets.

Table 1

GOODS EXPORT INDICES (FEBRUARY 2010 AS PERCENTAGE VERSUS FEBRUARY 2009)

	Of physical volume	Of average prices
Export (total)	121.1	119.6
to non-CIS countries	124.1	121.3
to CIS countries	105.5	108.6

Source: Ministry for Economic Development



Source: Central Bank of the Russian Federation

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

At the beginning of 2010 the physical volumes of the Russian export were also observed to grow. It was the export to non-CIS countries that grew at faster rates.

Negative news about the situation in the world economy (Greece's problems with budget and debt difficulties of some European countries) caused the process for crude oil to drop at the beginning of February. However against the background of expectations for the global demand to recover (primarily in China) the prices for oil had started to grow by the beginning of February. The decrease in oil reserves and the increase of facilities load in the USA have considerably supported the market. The earthquake in Chile was an additional factor for the prices increase. On the whole as a result of February the price for oil grade Brent reduced by 3% versus January, however when compared with February 2009 the growth made 70.5%.

In February 2010 the price for oil grade Urals made USD 72.7 per barrel, which is by 1.7 times more than the level of February 2009, but is 4.2% below the level of January 2010.

Starting with March the prices for oil at the world market have been fluctuating in the range from USD 70 to 80 per barrel. At the beginning of April the price for oil set a new half-year maximum and exceeded USD 85 per barrel.

Starting with May, 1st export duty rate for Russian oil may rise up to USD 281-284 per ton, or by nearly USD 15. Thus, export duty rate for oil has been increasing for the second month in the row. From March, 1st it was lowered for the first time since the beginning of the year – to USD 253.6 per barrel, and then it continued to increase. The maximum of USD 495 per barrel was achieved in August 2008.

By the middle of February the sharp drop of prices for non-ferrous metals, caused by the measures of the government of China concerning the toughening of the credit and monetary policy, ceased and the earthquake in Chile provoked panic at the market, which resulted in the recovery of prices growth.

The prices for metals in February have considerably exceeded the levels of the previous year. According to the data of the London Metal Exchange the prices over the year have increased: by 2.1 times for copper, by 1.8 times – for nickel, by 1.5 times – for aluminum, by 35.5% - for ferrous metals; versus January 2010 the prices for copper dropped by 7.3%, for aluminum – by 8.3%, whereas prices for nickel went up by 2.9% and for ferrous metals – by 0.6%.

Table 2

AVERAGE MONTHLY WORLD PRICES IN FEBRUARY OF CORRESPONDING YEAR

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Oil (Brent), USD/barrel	10.8	26.9	27.2	20.3	32.1	30.9	44.8	59.7	58.26	92.66	43.87	74.79
Natural gas, USD/1 million BTU	2.036	2.828	5.642	2.260	6.367	5.407	6.242	6.128	7.606	8.58	4.414	5.35
Petrol, USD/gallon	0.524	0.934	0.882	0.616	1.045	1.045	1.37	1.734	1.662	2.48	1.262	2.16
Copper, USD/ton	1414.8	1779.1	1811.4	1601.5	1705.9	2759.0	3254	4982	5671.1	7887.7	3314.7	6848.18
Aluminum, USD/ton	1188.1	1584.2	1602.1	1370.8	1428.04	1685.6	1883	2455	2759.14	2776.9	1330.2	2048.93
Nickel, USD/ton	4629.4	10269.6	6544.6	6042.7	8619.64	15178.3	15350	14979	41154.5	27955.5	10409	18976

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

In February 2010 Russian import was equal to USD 15.4 billion, which is by 14.8% more than a year ago or by 36.3% more than in January of the current year. The import growth was assisted by the strengthening of real ruble exchange rate, which, according to the calculation of the RF Ministry for Economic Development made 2.4% over February of the current year.

At the beginning of 2010 the import prices both from CIS and non-CIS countries were observed to increase. The physical volumes of import from CIS countries exceeded considerable the supplies from non-CIS countries.

Table 3

GOODS EXPORT INDICES (FEBRUARY 2010 AS PERCENTAGE VERSUS FEBRUARY 2009)

	Of physical volume	Of average prices
Import (total)	112.9	101.4
To non-CIS countries	108.5	100.9
To CIS countries	148.6	104.5

Source: Ministry for Economic Development

It is the chemistry industry, which increased the import of goods in annual terms by 30.8%, and foodstuffs production, in which import growth made 26.2%, that were the leaders of import recovery both in February and January 2010. The growth of import supplies volumes in foodstuffs production is mainly accounted for by the growth of consumer demand together with the recovery of reserved. The importers of chemistry goods renew the stocks only against the background of lower prices and expectations for the recovery of internal demand.

The recovery rates of textile and footwear import are also on the rise, this kind of import exceeding the Figures of February 2009 by 16.1%, which can be accounted for by not only the rise of import physical volumes, but also by the growth of import prices.

One should mention the sharp growth of the goods of light industry import. Thus, the growth of textile and sewing goods as compared with January of the current year went up by 16.7%.

The decrease in motor vehicles import is still continuing. Over the first two months of 2010 the import of passenger cars versus the corresponding period of the previous year reduced by 45.8%, and of trucks – by 35.7%.

At the same time the import of components for cars is increasing rapidly. In January-February 2010 the growth of import for this position made 46.6% versus January-February of the previous year.

As a result of anticipating growth of export, the balance of the Russia's foreign trade turnover was positive and made USD 15.2 billion, having risen by nearly 3 times versus the balance of USD 5.1 billion in February 2009. Thus, already at the beginning of the current year the surplus of the trade balance has returned to the pre-crisis level. For reference, the average monthly balance of foreign trade in 2008 was USD 14.9 billion, and in 2007 – USD 10.9 billion.

In March 2010 Russia and the USA agreed on the renewal of American pork supply to the Russian market, which were limited according to the decision of the Federal Service for Veterinary and Phytosanitary Supervision (Rosselkhoznadzor). It was the violation of veterinary requirements adopted in Russia, which exclude the presence of antibiotics in meat, by the American suppliers, that was the reason for the ban. As a result of negotiations a new veterinary certificate was adopted, which will allow guaranteeing that the American pork corresponds to the Russian regulations.

Now the USA Agricultural Marketing Service and Food Safety and Inspection Service will carry out export inspection of the enterprises that which to supply pork to Russia, and the suppliers chosen by them will be approved by Rosselkhoznadzor.

The supplies to Russia account for only 6% of the volume of pork export from the USA, making approximately USD 275 million. In 2008 they nearly doubled as compared with 2007, reaching 127 thousand tons. In 2010 Russia reduced quotas for pork import taking into the account the development of domestic production. The total quote makes 472 thousand tons, and the USA share – 57.5 thousand tons. Nevertheless the American producers have already estimated the opening of the Russian market, which was the fifth in the volume before the ban, as positive.

Russia is not the only country that has limited American pork export. At the end of April China closed its market for this kind of goods in connection with swine flu epidemic. Despite the promises on the resumption of pork export, given in December, the supplies have not started yet. The volumes of pork supplies to Canada and the European Union have also reduced.

Starting with January 1, 2010 the ban for the poultry export from the USAA has been in effect in Russia, which was due to discrepancy between the veterinary standards of production. The main

controversy concerns the level of chlorine in the chicken supplied. Despite the consultations that has been held since January 19, 2010 between the USA officials and businessmen and Russian core organizations, the agreement on supplies resumption has not been reached.

In March 2010 the USA Congress was presented with new reports of the administration on phytosanitary and technical obstacles in the foreign trade. They concern the problem spots and obstacles in USA trade relations with other countries.

The part of the report that deals with Russia is criticizing. According to it, the deficit of the USA in the trade with Russia in 2009 made USD 12.8 billion, which is by USD 4.6 billion less than a year ago. Over the year, American export to Russia reduced by 42.3% to USD 5.4 billion, and Import reduced by 32% down to USD 18.2 billion. Russia holds 32th place among the biggest export markets of the USA.

The document, following the account of the last year's events, connected with the creation of Customs Union of Russia, Belorussia and Kazakhstan in the context of expected accession to the WTO, mentions that the USA expect Russia to provide additional information on its trading plans for 2010, including the intentions concerning the resumption of work on WTO accession and regulation of bilateral trading issues.

Besides the further action of Russia on accession to the WTO against the background of creation of the Customs Union, the problem of ban for chlorine-processed poultry import to Russia remains the most vague moment in Russian-American trading relations.

Russia, however, intends not only to decrease the dependence on the foreign supplies but to start poultry export to Europe. Starting with 1998 domestic production has been growing by 14-16% annually. In 2010 it is expected that the growth of production will make more than 300 thousand tons in laughter weight. Already in the 1st quarter 2010 poultry production went up by approximately 15% versus the 1st quarter 2009.

The association of poultry producers (Rosptitsoyuz, Union of Russian Poultry Producers) has developed the program "Development of poultry industry up to 2020". The main goals of the program are to provide for the demand of the population in the domestic production and poultry export to other countries. According to the forecast parameters, the poultry production in the country will increase from 2.5 million tons in 2009 to 4.5 million of tons in 2020, eggs production – from 39.3 billion to 50 billion.

According to the program, in order to regulate the market of poultry for the period up to 2020, it is necessary, for instance, it is necessary to create the infrastructure of wholesale markets of poultry, consider the issue of inclusion of the branch into the system of eggs, poultry and poultry products purchase for federal and regional needs, expand the chain of stores. As to the field of customs and tariffs regulation the timely regulation of import supplies of poultry is necessary up to the complete refusal from import. ●

THE STATE BUDGET

E.Fomina

In April 2010, a preliminary estimation was made of the results of the federal budget's implementation in this year's first quarter. Owing to a positive foreign economic situation, there have emerged some grounds for believing that federal budget deficit in 2010 will turn out to be lower than the corresponding index envisaged in the law. Thus, it is expected that the drop in the federal budget balance will be no more than 6 % of GDP against the previously planned figure – 6.8 % of GDP. However, thus favorable trend still remains unstable and fully dependent on the fluctuations in the levels of prices and demand for Russian export commodities, which is fraught, as before, with some serious risks for this country's budgetary system.

An analysis of the main parameters of the execution of the general government budget for January – February 2010.

According to the preliminary estimates of the budget's execution in January – February 2010, the revenue volume in the *general government budget* dropped by 3.6 p. p. of GDP on the corresponding period of 2009, while the expenditure volume also declined – by 1.4 % of GDP. According to the data published by the Federal Treasury, the general government budget surplus registered this years in January – February amounted to 3.9 % GDP, which is by 2.1 p. p. of GDP lower than the general government budget surplus index for the corresponding period of 2009 (see *Table 1*). At the same time, both the revenue and expenditure volumes in the general government budget in this year's first two months increased in absolute terms. This fact can be explained by the higher growth rate of GDP as compared to that of budget parameters.

Table 1

THE EXECUTION OF BUDGET REVENUE AND EXPENDITURE AT ALL LEVELS OF AUTHORITY IN JANUARY - FEBRUARY 2009 AND 2010

	January - February 2010		January - February 2009		Deviation, p. p. GDP
	in bn Rb	as % of GDP	in bn Rb	as % of GDP	
Federal budget					
Revenue	1,308.3	21.1	1,220.3	23.2	-2.1
Expenditure	1,477.8	23.9	1,087.8	20.7	+3.2
Deficit (-) / Surplus (+)	-169.5	-2.7	132.5	2.5	-5.2
Consolidated budgets of RF subjects					
Revenue	689.8	11.1	639.9	12.2	-1.1
Expenditure	606.1	9.8	548.8	10.4	-0.6
Deficit (-) / Surplus (+)	83.7	1.4	91.1	1.8	-0.4
General government budget					
Revenue	2,001.4	32.3	1,889.6	35.9	-3.6
Expenditure	1,757.7	28.4	1,572.2	29.8	-1.4
Deficit (-) / Surplus (+)	243.7	3.9*	317.4	6.0	-2.1
For reference: GDP, bn Rb	6,190.0		5,268.0		

* The markedly high general government budget surplus, as compared to the indices demonstrated by the federal budget and the budgets of RF subjects, can be explained by the altered procedure for the transfer of money to off-budget funds, which now bypass the federal budget.

Source: RF Ministry of Finance, IET estimates.

When analyzing the revenue component of the general government budget over recent years, it should be borne in mind that in 2009 the budgetary system was receiving the revenues from the management of the 'oil and gas' funds for the years 2008 – 2009. In January 2009, the corresponding receipts amounted to 271.0 bn Rb (approximately 3.2 % of GDP). In January 2010, investment-linked revenues were as follows: 52.0 bn Rb (transferred to the federal budget as a result of managing the Reserve Fund's resources); 40.4 bn Rb (transferred to the federal budget from the Bank of Russia as a result of managing the National Welfare Fund's resources); 33,5 bn Rb (resulting from managing the National Welfare Fund's resources kept in *Vneshekonombank*; 6.9 bn Rb of that amount were transferred to the federal budget, and the rest of it – to the National Welfare Fund). The total amount of the investment-linked revenues transferred to the general government budget in January – March 2010 was approximately 126 bn Rb (or about 1.3 % of GDP). In order to get a comprehensive picture of the Russian budgetary system's revenues, they should be 'cleansed' of the additional transfers relating to the revenues of earlier periods.

In the course of the first months of 2010, the resources of Russia's budgetary system were formed under the influence of a relatively favorable external market situation with regard to prices and demand for Russian exports. Thus, the rise in prices for major energy carriers displayed by world markets in early 2010 and the concurrent increase in demand for products of the oil and gas sector on the part of importer countries considerably increased the federal budget's receipts from *tax on mineral resources extraction and its revenues from foreign trade* by comparison with the previous year (*Table 2*). The general government budget's receipts from the said taxes rose by 1.4 p.p. of GDP and 1 p.p. of GDP, respectively.

In conditions of a steady growth in world oil prices, the rates of export duties on crude oil have been adjusted upward on a monthly basis. On 1 March 2010, the rate of export duty on oil will be additionally increased by 12 USD per ton. Thus, the rate of this duty will amount to 281 – 284 USD per ton. This measure will certainly conduce to further growth of the oil and gas revenues of the federal budget.

At the same time, the zero rate of export duty on oil extracted from the oil fields of East Siberia, initially introduced from 1 December 2009, will be preserved for one more month, beginning from 1 May 2010. This tax benefit is granted to 22 oil deposits. According to the data published by the RF Ministry of Finance, if this measure is extended until the end of 2010, the contraction of the revenue side of the federal budget could amount to approximately 120 bn Rb¹.

Unlike oil and gas revenues, non-oil and gas revenues have been demonstrating a certain downward trend. In January – February 2010, the general government budget's receipts from *tax on profits of organizations* declined both in absolute and relative terms. In relative terms, the volume of this tax amounted to 1.2 % of GDP vs. 1.7 % of GDP in the same period of 2009. That was largely a result of the changes introduced in the procedure for calculating and paying the said tax. Prior to 2009, economic agents paid the tax on profits of organizations on a quarterly advance basis, and it was not infrequent for them to pay it in advance, basing their calculations on the volume of profits gained in better periods. Beginning in 2009, there emerged a possibility for them to pay this tax on a monthly basis in accordance with actual profits. At the same time, the January – February 2009 volume of the federal budget's receipts from tax on profits of organizations reflected the activity of organizations at the end of 2008. Therefore, in order to properly analyze these indicators for the said periods, one should take it into strict consideration that they are not fully comparable.

The reduction in the general government budget receipts from tax on profits of organizations was accompanied by a drop in its receipts from *personal income tax (PIT)*, which declined to 3.5 % of GDP marking a 0.4 p.p. drop compared to the corresponding period of the previous year. However, there was a slight, 2.9-percent growth in PIT receipts in absolute terms on the corresponding period of 2009, caused by the February 2010 increase in real wages. At the same time, since the beginning of the year, the index of real disposable incomes of the population has risen 8.1 % on the corresponding period of the previous year. It should be admitted that this rise was mostly due to the January 2010 valorization of pension payments. Overall, it could be noted that, despite the recorded modest growth in the incomes of the population, their growth rate has been significantly lagging behind the growth rate of GDP throughout the period under consideration.

1 <http://www1.minfin.ru/ru/press/speech/index.php?id4=9554>

Table 2

DYNAMICS OF THE TAX BURDEN LEVEL AND THE REVENUES FROM THE MAIN TAXES IN RF GENERAL GOVERNMENT BUDGET IN JANUARY – FEBRUARY 2009 AND 2010 (AS % OF GDP)

	2 months, 2010	2 months, 2009	Deviation, p. p. GDP
Tax burden level (1 + 2 + 3)	28.9	28.5	+0.4
Tax revenues (1), including:	18.0	19.3	-1.3
Tax on profits of organizations	1.2	1.7	-0.5
PIT	3.5	3.9	-0.4
SST*	0**	2.0	-
VAT	6.5	6.9	-0.4
Excise	1.1	0.95	+0.15
Tax on mineral resources extraction	3.7	2.3	+1.4
Insurance contributions to mandatory pension insurance (2)	4.0	3.3	+0.7
Revenues from foreign trade (3)	6.9	5.9	+1.0

- less insurance contributions to mandatory pension insurance.
 - ** from 2010 onwards, SST is transformed into insurance contributions to be transferred to off-budget funds.
- Source: RF Ministry of Finance; Rosstat; IET estimates.

The January – February 2010 volume of budget receipts from VAT also dwindled. The fall in the general government budget's receipts from this tax amounted to 0.4 p.p. of GDP (*Table 2*). At the same time, they considerably grew in absolute terms. Their rise was caused by the improved administration of VAT and by a relative resurgence of the business activity of economic agents – as compared to the previous year. However, it should be taken into consideration that VAT for Q IV 2009 was to be carried forward to January 2010.

The January – February 2010 decline in the revenues of the general government budget has forced the authorities to begin curbing *budget expenditure* growth. As a result, the general government budget's expenditure dropped by 1.4 p.p. of GDP (*Table 3*). At the same time it should be noted that in absolute terms, the volume of budget expenditures during the first two months of 2010 slightly rose on the corresponding period of the previous year. That was largely a result of their accelerated spending within the framework of the financial year.

Table 3

THE EXECUTION OF THE GENERAL GOVERNMENT EXPENDITURE BUDGET IN JANUARY – FEBRUARY 2009 AND 2010, AS % OF GDP

	January – February 2010		January – February 2009		Deviation, p.p. of GDP
	bn Rb	as % of GDP	bn Rb	as % of GDP	
Expenditure, total	1,757.7	28.4	1,572.2	29.8	-1.4
Including					
Nationwide issues	151.9	2.5	151.3	2.9	-0.4
Of these, servicing of state and municipal debts	43.2	0.7	35.4	0.7	0
National defense	128.4	2.1	123.8	2.4	-0.3
National security and law-enforcement activity	172.2	2.8	160.9	3.1	-0.3
National economy	138.3	2.2	202.9	3.9	-1.7
Housing and utilities system	58.4	0.94	57.9	1.1	-0.16
Environment protection	2.2	0.04	1.7	0.03	+0.01
Education	187.5	3.0	169.8	3.2	-0.2
Culture, cinematography and mass media	31.7	0.5	30.6	0.6	-0.1
Public health care and sports	167.1	2.7	167.9	3.2	-0.5
Social policy	719.9	11.6	504.9	9.6	+2.0

Source: RF Treasury, IET estimates.

According to preliminary estimates, the largest deviation from last year's volumes was registered under the 'Social Policy' item, with social allocations from the general government budget having increased by 2 p.p. of GDP on the corresponding period of 2009. Itemized in accordance with the current budget functional classification, the expenditures under all the other budget items displayed a downward trend. The largest negative deviation from last year's parameters was registered under the 'National Economy' item, with the expenditures having fallen by 1.7 p.p. of GDP. Under the rest of budget items, negative deviation did not exceed 0.5 p.p. of GDP.

The execution of the RF Federal Budget in Q I 2010

According to the on-line data published by the RF Ministry of Finance, the January – March 2010 revenues of federal budget amounted to 20.1 % of GDP, representing a drop of 0.3 p.p. of GDP from the same period of 2009. However, federal budget revenues increased in absolute terms.

The Q I rise in the federal budget's receipts in absolute terms was due to a number of factors, including the growing revenues of the oil and gas complex that boosted budget receipts from tax on mineral resources extraction and revenues from foreign trade. At the same time, the implementation of a number of innovations in the tax administration system resulted in a certain deceleration of the growth rate of the federal budget's non-oil and gas revenues compared to the year 2009.

Over the period under consideration, the federal budget's expenditure increased by almost 2.5 p.p. of GDP on the corresponding period of the previous year – to 23.3 % of GDP (Table 4). However, the expenditure growth in Q I 2010 does not seem to portend a general rise in expenditure by the results of the year. That growth was largely the result of an acceleration in budget spending and in a faster reception of budget funds by their end-recipients. The year 2010 marks the beginning of a sharp reduction in the volume of allocations to anti-crisis measures: thus, in 2009, more than 1.2 trillion Rb in budget funds was spent on implementing the anti-crisis program, while the volume of budget funds planned to be allocated for these purposes in 2010 amounts to 195 bn Rb (139 bn Rb of that amount has already been distributed). It is planned that anti-crisis funding from the federal budget will be discontinued by 2012. According to some forecasts, it is precisely by 2012 that the Russian economy is going to completely exit from the crisis. It should be noted that previously the Russian authorities had planned to roll back the anti-crisis measures more smoothly, by gradually cutting their financing until 2015.

As a result of the multidirectional change displayed by the federal budget's parameters over Q I 2010, the federal budget deficit rose to 3.3 % of GDP vs. 0.4 % of GDP in 2009. At the same time, according to preliminary estimates, the non-oil-and-gas deficit amounted to more than 12 % of GDP. The hugeness of the non-oil-and-gas deficit indicates the existence of significant public expenditures not covered by the oil and gas revenues of the federal budget. Potentially, this state of affairs can result in a considerable weakening of Russia's budgetary system.

Table 4

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

	January – March 2010 г.		January–March 2009 г.		Execution of 2010 budget, as % of an- nual budget revenue and expenditure	Deviation	
	bn Rb	as % of GDP	bn Rb	bn Rb		bn Rb	p.p. of GDP
Revenue, including:	1,953.3	20.1	1,732.7	20.4	28.1	220.6	- 0.3
Revenues from oil and gas	877.6	9.0	509.1	6.0	27.5	368.5	+ 3.0
Deductions to Reserve Fund and National Welfare Fund (Stabilization Fund)	0	0	205.1	2.4	–		
Expenditure, including:	2,260.9	23.3	1762.4	20.8	22.9	498.5	+ 2.5
interest	71.1	0.7	63.8	0.8	23.4	7.3	- 0.1
non-interest	2,189.7	22.6	1,698.6	20.0	22.9	491.1	+ 2.6

Table 4, cont'd

	January – March 2010 r.		January–March 2009 r.		Execution of 2010 budget, as % of annual budget revenue and expenditure	Deviation	
	bn Rb	as % of GDP	bn Rb	bn Rb		bn Rb	p.p. of GDP
Federal budget surplus (deficit)	- 307.6	- 3.2	- 29.7	- 0.4	22.9	- 277.9	- 2.8
Non-oil-and-gas deficit	- 1,185.2	- 12.2	- 538.8	- 6.4	19.3	- 646.4	- 5.8
GDP estimates	9,701.0		8,482.8				

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

The 2010 federal budget deficit has been primarily covered from domestic sources, in particular the Reserve Fund. Over the first three months of 2010, its volume shrank by 277 bn Rb, down to 1,553 bn Rb. The Reserve Fund's direct allocations to the budget amounted to 169.5 bn Rb. In the course of the same period, the National Welfare Fund shrank by 139 bn Rb, down to 2.63 trillion Rb (Table 5).

Table 5

THE DYNAMICS OF THE FORMATION AND USE OF THE OIL AND GAS REVENUES
IN THE FEDERAL BUDGET IN JANUARY – MARCH 2010 – 2009, BN RB

Index	Fund residuals, end of 2009	Approved for 2010 budget	Received in January – March 2010	Allocated in January – March 2010		Fund residuals, end of March 2010
				on maintaining well-balanced federal budget	on oil and gas transfer	
Oil and gas revenues in federal budget	x	2057.2	877.6			X
Areas for allocating oil and gas revenues:	x	x				X
Oil and gas transfer	x	2,531.1	877.6			
Reserve Fund	1,830.5	5,147.5	0	169.0	0	1,553.3
National Welfare Fund	2,769.0	x	26.5	-	-	2,630.3
Total	4,599.5	x	904.1	169.0	0	4,183.6

* residuals as recalculated at the exchange rate as of March 2010

Source: Federal Treasury.

Table 6 shows the dynamics of execution of the expenditure side of the federal budget in the first 2 months of 2010 in accordance with the functional classification of budget expenditures. The dynamics of execution was more robust than in 2009. As regards the expenditure side as a whole, the positive deviation from the corresponding period of the previous year amounted to 2.8 p.p. The largest positive deviation was registered under the 'Interbudgetary Transfers' item. Spending under this item increased by more than 9 p.p. This impressive growth in interbudgetary transfers was primarily due to the current year's significant growth in pensions and to the accelerated allocation of resources to the Pension Fund.

The rates of spending under the 'National Defense', 'National Security and Law-Enforcement Activity' and 'Education' items were also higher than in the corresponding period of 2009, with the positive deviation amounting to between 0.7 p.p. and 2.2 p.p.

However, the rates of execution of the 'Public Health Care and Sports' and 'Servicing of State and Municipal Debts' items of expenditure were lower than last year. As of March 2010, these expenditure items had been executed 1.7 – 3.2 p.p. behind last year. By comparison with the

corresponding period of 2009, the largest drop in the rate of financing was registered under the 'National Economy' item of expenditure. It amounted to almost 9 p.p.

Table 6

FEDERAL BUDGET EXECUTION IN CASH TERMS IN JANUARY - FEBRUARY 2009 AND 2010,
AS A PERCENTAGE OF ANNUAL BUDGET REVENUE AND EXPENDITURE

	January – February 2010	January – February 2009
Budget expenditure, total	14.9	12.1
Including		
Nationwide issues	8.3	8.6
Servicing of state and municipal debts	11.8	15.0
National defense	10.2	9.3
National security and law-enforcement activity	12.9	12.2
National economy	5.3	14.2
Housing and utilities system	5.9	2.5
Environment protection	9.6	5.7
Education	10.3	8.1
Culture, cinematography and mass media	10.5	10.2
Public health care and sports	6.4	8.1
Social policy	9.3	9.0
Interbudgetary transfers	24.9	15.7

Source: RF Ministry of Finance; IET estimates.

According to on-line data of the RF Ministry of Finance, in January – March 2010, ministries and departments received 99.8 % of the federal budget allocation planned for that period¹. At the same time, the ministries and departments released to their subordinate establishments only 59 % of the planned expenditure allocations. In particular, these establishments did not receive the full volume of funds planned for financing the implementation of federal target programs. One of the reasons for delay in allocating funds to the end-recipients of budget resources is the deficiency of legal and administrative procedures: out of the 107 government normative acts necessary for budget execution, only 97 have been adopted so far.

An Overview of the Main Developments in the Sphere of Budgetary Policy in April 2010

It was planned that, in April 2010, the RF Ministry of Finance would submit, to the RF Government, a draft document on Russia's tax policy priorities in 2011 - 2013². In fact, this document will comprise the initiatives in the field of tax policy stated in March. However, some of those initiatives have been considerably altered from their original form. Thus, the financial authorities have taken the decision that the transitional period for insurance contributions to off-budget funds should not be extended to 2011, and that the rate of insurance contributions should be increased from 26 % to 34 %. This marks a departure from the previous position of the RF Ministry of Finance repeatedly stated by its representatives throughout 2009. According to the now abandoned concept, the rate of insurance contributions should be gradually risen to 32 % by the year 2011 (by way of preserving the existing rate of contributions to the Federal Mandatory Health Insurance Fund) and then to 36 % by the year 2012. If this measure had been realized in its original form envisaging a gradual rise in the rate of insurance contributions, the load on enterprises would have been significantly reduced. If the rate is increased to its upper limit from the year 2011, the expected increase in contributions to off-budget funds could fail to materialize.

Instead of granting universal tax relief, the main parameters of Russia's tax policy for the next three years will be focused on granting pin-point tax preferences to individual sectors and types of businesses. The load on the wages funds of innovative companies, residents of zones for technical

1 <http://www.rbc.ru/rbcfreenews/20100412155428.shtml>

2 <http://www.rg.ru/2010/04/12/innovator-poln.html>

development, and small enterprises at higher educational establishments and research centers will amount to 14 % until 2020. The load on the wages funds of the mass media will be 26 %, with a gradual rise in the period until 2015. Also, it is planned to grant tax benefits to entities engaged in modernization. At the same time, in April, the authorities announced the forthcoming creation of a special council of experts for the purpose of identifying innovative enterprises – potential recipients of tax benefits. However, it is most likely that these measures will benefit only a very small number of enterprises. Thus, according to Aleksandr Shokhin, President of the Russian Union of Industrialists and Entrepreneurs, ‘in the whole of the country, only about 200 companies will be able to take advantage of these benefits’.

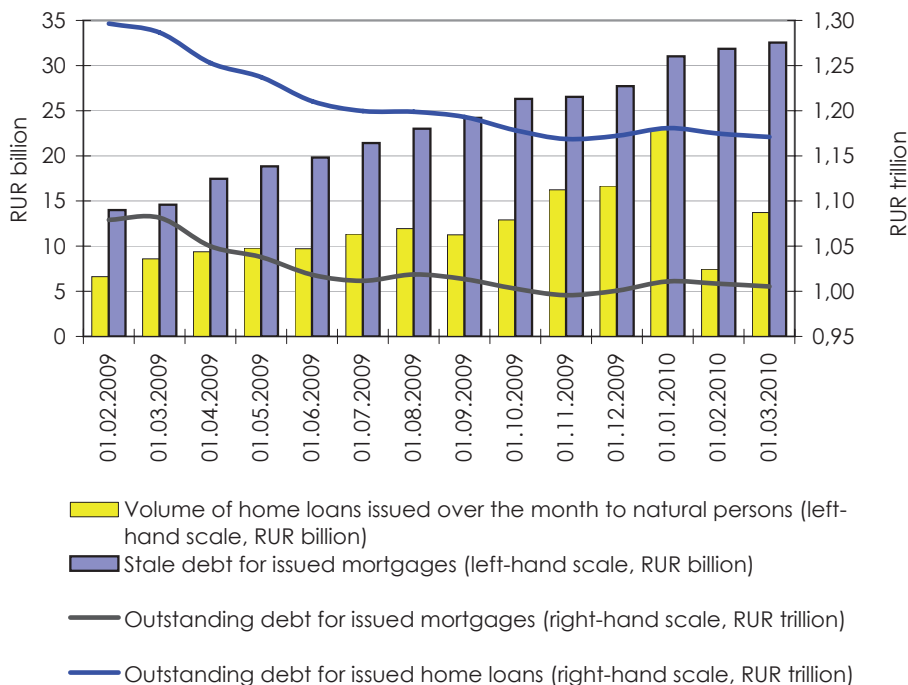
In April 2010, it was announced that 1 October could become the permanent date for submitting draft three-year federal budgets to the State Duma¹. In 2009, the date for submitting the draft federal budget for 2010 – 2012 was shifted from 26 August to 1 October. Now this measure can become a permanent norm with corresponding alterations being introduced in the RF Budget Code.

The substantiation for this decision has been the fact that the basic forecast parameters of the federal budget can usually be determined with greater precision if it is formed at a later date: by 1 October, adjusted macro-parameters will, as a rule, already become available, tax policy priorities will have been approved, and the volumes of federal target programs will be properly adjusted. ●

1 <http://minfin.ru/ru/press/speech/index.php?id4=9522>

MORTGAGES IN THE RUSSIAN FEDERATION

G.Zadonsky



Source: data of the Central Bank of the Russian Federation

Fig. 1. Dynamics of Mortgages Issue

ary 2009 by 59.8% and made 13725 credits worth RUR 16.162 billion (fig. 1). The volume of home loans issued in February 2010 made RUR 19.310 billion (181014 credits) and exceeded the volume of February 2009 by nearly two times – by 98.7%. The outstanding debt both for the mortgages and for home loans fluctuates – around RUR 1 trillion for mortgages and around 1.18 trillion – for home loans. Nevertheless the stale debt is still increasing. For home loans it made RUR 36.3 billion, and for mortgages – RUR 32.5 billion.

The volume of mortgages issued in February 2010 exceeded by nearly 60% the volume of credits in February 2009. However this positive fact can hardly be considered as an evidence for the starting considerable growth of the mortgages market. Sberbank has abolished all the tariffs and commission fees when issuing a credit and for the first time in the Russian bank practice the credit rate is the only parameter defining the cost of borrowed funds for clients.

According to the data of the Central Bank of the Russian Federation the volume of mortgage credits issued for natural persons over February 2010 exceeded the corresponding figure of Febru-

Table 1

AVERAGE MARKET RATES FOR MORTGAGE CREDITS, %

Credit product	January 2010		February 2010		March 2010	
	min	max	min	Max	min	max
Credit in rubles for purchase of a flat at the secondary housing market	14.69	18.33	14.28	17.78	13.85	19.02
Purposeful credit in rubles on mortgage of the present object of immovable property	17.03	20.76	17.01	20.61	16.69	21.19
Credit in US dollars for purchase of a flat at the secondary housing market	11.05	14.19	10.77	13.95	10.55	15.49
Purposeful credit in US dollars on mortgage of the present object of immovable property	12.59	15.77	12.30	15.95	12.32	17.50

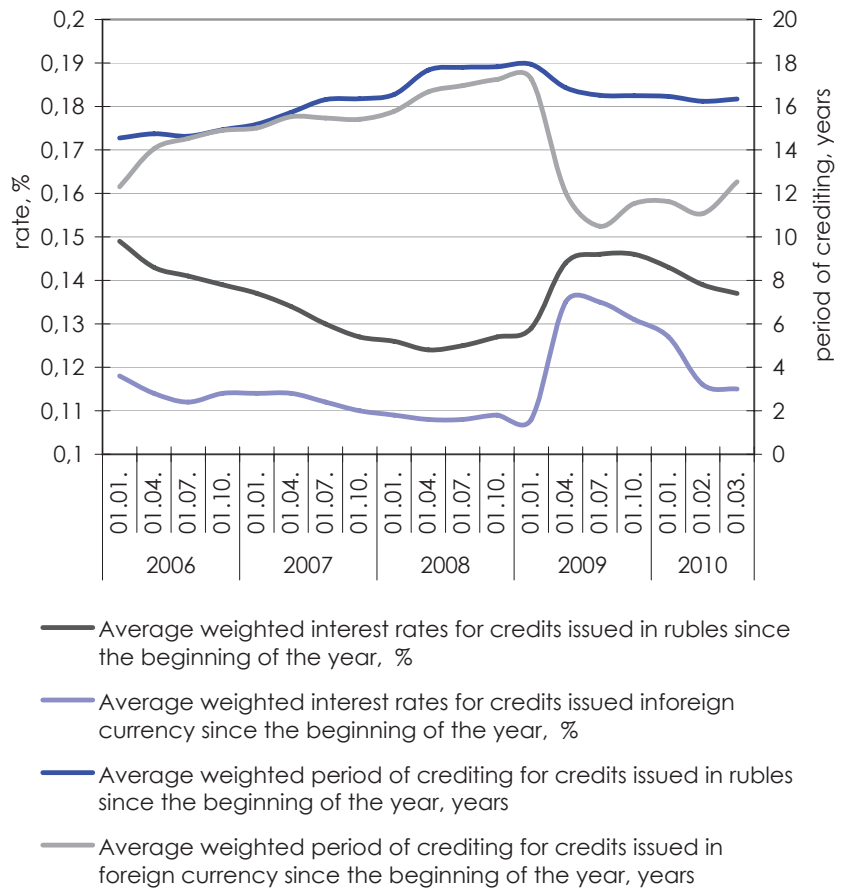
Source: according to the data of Kreditmart

According to the data of the Central Bank of the Russian Federation the average weighted both for home loans and mortgages issued since the beginning of the year are decreasing and as on March 1, 2010 made 13.7% and 11.5%, correspondingly. Average weighted period of crediting for mortgages issued in rubles still tends to decrease and made 16.3 years as on March 1, 2010. The situation with the period of crediting for mortgages issued in foreign currency is less definite, for them, as on March 1, 2010 the period of crediting made 12.5 years (fig. 2).

On March 29, 2010 the Central Bank of the Russian Federation has lowered refinancing rate to 8.25%, and from April, 19 Sberbank of Russia decreased minimum rates for home lending programs to 10.5% (in rubles) and 8.8% (in foreign currency).

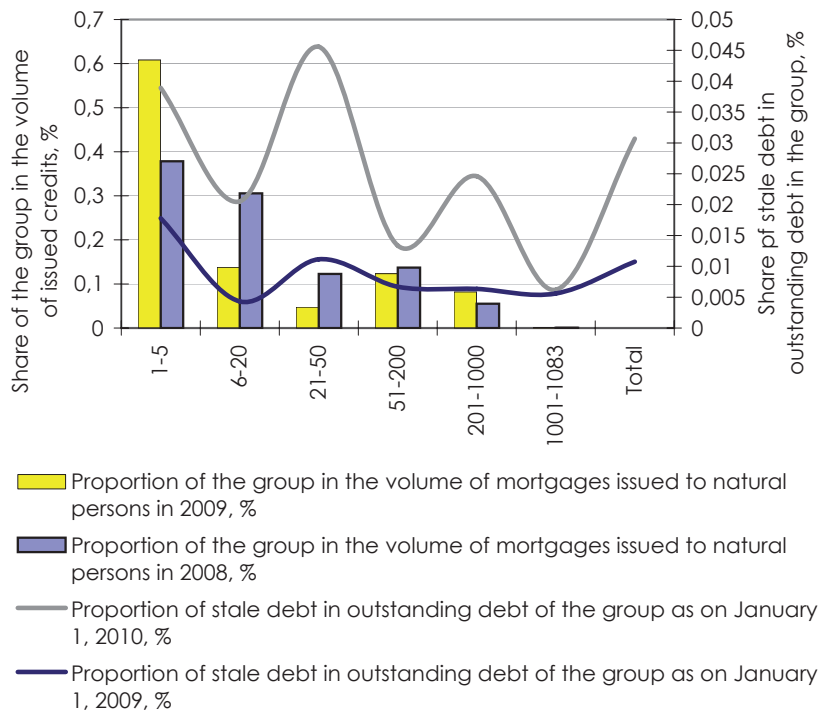
According to the data of Kreditmart the average market rates of mortgages in rubles in March 2010 reduced by 0.58 percentage points as compared with February 2010 and made 16.72% (17.30% in February 2010); as compared with February 2009 (18.82%) the decrease of the rate made 2.1 percentage points. As compared with February 2010 the average market interest rates for credits in US dollars reduced by 0.02 percentage points down to 13.27%; as compared with February 2009 (15.01%) the decrease made 1.74 percentage point.

Analyzing the data of 2008 and 2009 (fig. 3) one can conclude that as compared with 2008 in 2009 the maximum proportion of stale debt share in the outstanding debt in the groups of crediting organizations ranked by the volume of assets is shifting from the first five largest banks to the third group, while the total amount of stale debt is increasing. The first group, however, has lowered the propor-



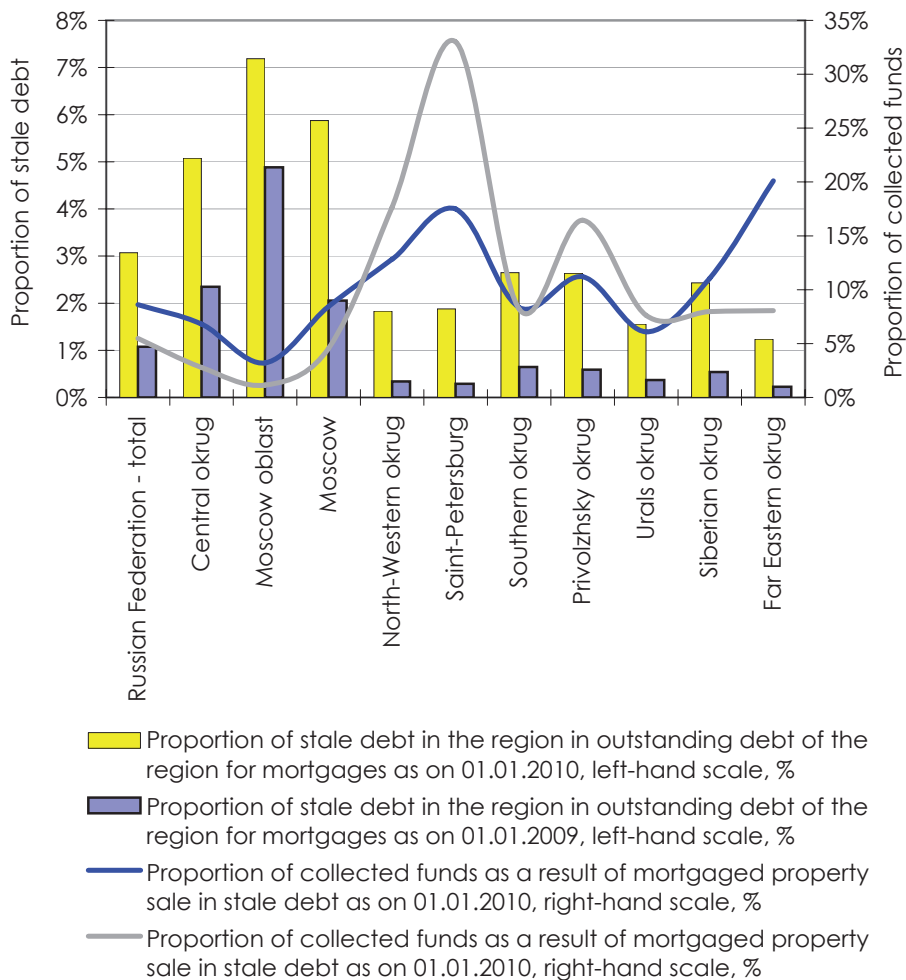
Source: data of the Central bank of the Russian Federation

Fig 2. Average Weighted Data for Mortgages issued Since the Beginning of the Year, in rubles and in Foreign Currency



Source: data of the Central Bank of the Russian Federation

Fig. 3. Dynamics of Volumes of Issued Mortgages and Stale Debt by Groups of Crediting Organizations Ranked by Volume of Assets in 2009



Source: data of the Central Bank of the Russian Federation

Fig. 4. Regional Dynamics of Stale Debt and Volumes of Collected Funds for Mortgages as a Result of Mortgaged Property Sale

tion of stale debt as compared with 2008.

Regional dynamics of mortgage crediting in 2008 and 2009 testifies that both in 2008 and 2009 it is in Moscow oblast where the portfolio of mortgages has highest risks. Saint-Petersburg has yielded the leadership concerning the proportion of funds collected as a result of sale of the mortgaged property to the Far Eastern okrug (fig. 4). On the whole over 2009 the volume of funds collected from borrowers as a result of the sale of mortgaged property made RUR 2674.2 million versus RUR 629.7 million in 2008.

The proportion of credits in foreign currency in the debt for mortgage credits is still decreasing and as on March 1, 2010 made 19.19% (fig.5). The proportion of credits in foreign currency in the volume of mortgages issued over the quarter also keeps decreasing. As on March 1, 2010 this proportion made 5.85% versus 6.52% over the 4th quarter 2009.

Table 2

SOURCES OF REFINANCING OF MORTGAGES (CHOSE IN ACTION)

Source of refinancing	01.01.2010			
	Number of organizations units	Volume of refinanced mortgages (chose in action)		
		Total	in rubles	in foreign currency
1. Refinancing of mortgages with the sale of pool of mortgages (chose in action)	180	65 402 281	53 810 023	11 592 258
1.1 Crediting organizations	41	13 686 065	10 328 276	3 357 789
1.2 Specialized organizations - residents	123	41 575 844	36 721 219	4 854 625
1.3 Specialized organizations- non-residents	4	8 943 825	5 563 981	3 379 844
1.4 Other organizations	10	1 130 188	1 130 188	0
1.5 Managing companies of unit investment trusts, general funds of bank management	2	66 359	66 359	0
2. Refinancing of mortgages with maintenance of the assets on the books of crediting organization	1	15 000 000	15 000 000	0

Source: data of the Central Bank of the Russian Federation

The volume mortgages refinancing in 2009 (RUR 80.4 billion) made 81.2% of the volume of 2008 (RUR 99.02 billion). The proportion of AHML in 2009 accounts for RUR 28.77 billion or 35.78% of the total (the proportion of 2008 was 26.69%). AHML refinances only ruble credits and its share in 2009 in the volume of ruble credits makes 41.81%.

In January and February 2010 volumes of mortgages refinancing by Agency for Home Mortgage Lending is considerably lower the peak level of December 2009 (fig. 6). The data of January 2010 and January 2009 are close – the volumes of refinancing in 2010 are 2.7% more than in January 2009. However in February 2010 the volume of mortgages refinance by the Agency for Home Mortgage Lending are 17.7% higher than in February 2009.

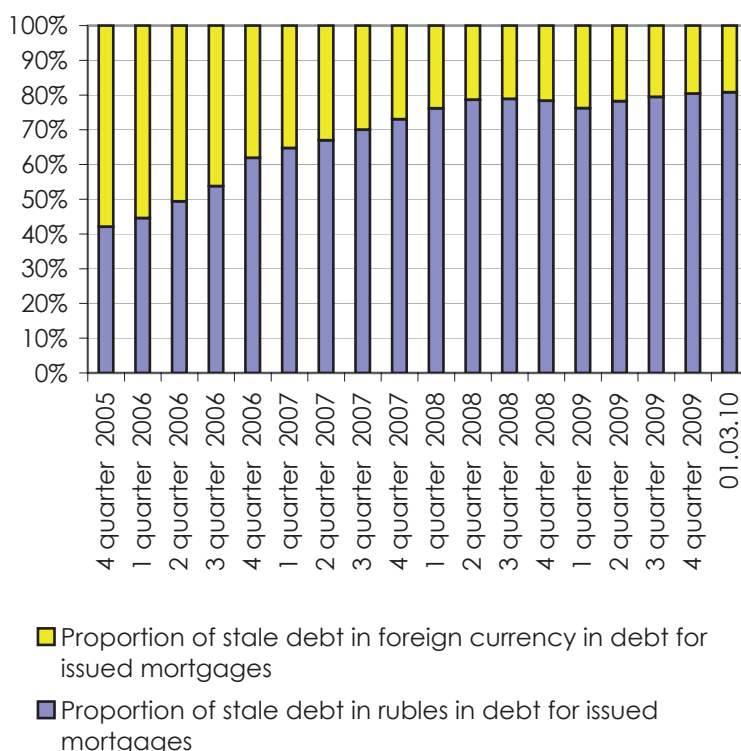
In April 2010 the Presidium of the Supreme Arbitrary Court of the Russian Federation recognized the attempt to attract the monetary funds of citizens that participate in share housing construction by the construction firms before state registration of share participation contracts between shareholders and contractor as illegal.

Federal Service for Insurance Supervision on March 25, 2010 accepted an application of the Insurance company AHML for the license for reinsurance activity.

In April 2010 the state corporation “Bank of development and foreign economic activity” (Vnesheconombank) and OJSC Agency for Home Mortgage Lending concluded a Crediting agreement on granting RUR 40 billion at the rate of 9.5 per annum up to June 1, 2020. The funds are directed to fulfillment of the Program for stimulating crediting of economy-class housing construction and purchase in concordance with the commission of the Government committee on promotion of steady development of the Russian economy.

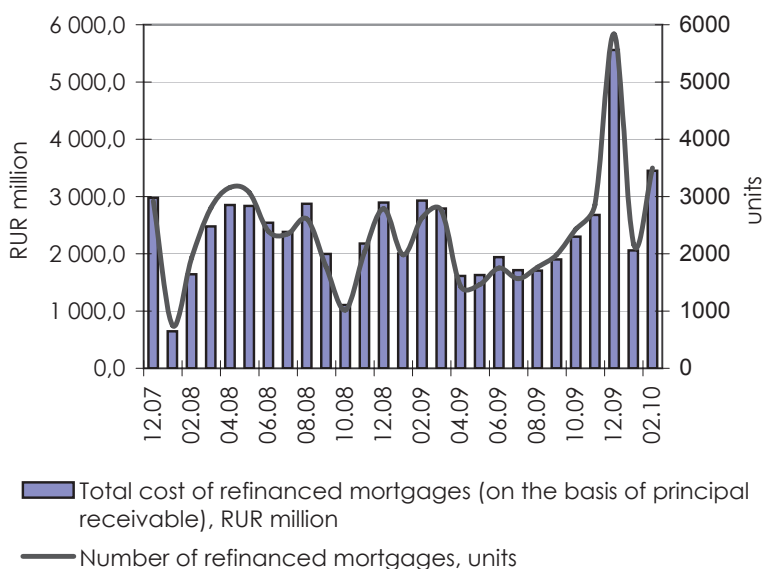
According to mass media, AHML has already concluded an agreement on financing of 11 banks that are crediting construction of 19 economy-class objects in such cities as Kazan, Naberezhnye Chelny, Arkhangelsk, Kemerovo, Novosibirsk, Samara, Saratov, Krasnodar, Nizhniy Novgorod etc.

Agency for home mortgage lending is planning to introduce new credit product “variable rate” in 2010, which interest rate depends on the refinancing rate of the bank of Russia. In case the rate



Source: data of the Central Bank of the Russian Federation

Fig. 5. Ratio of Debt for Mortgages in Foreign Currency and in Rubles



Source: data of open joint-stock company Agency for Home Mortgage Lending

Fig.6. Monthly Volumes of Mortgages Refinancing by OJSC Agency for Home mortgage Lending

is increased sharply in order to protect the borrower and the creditor one way is to restrict the changes of variable rate by the range from 5% to 20% and another way is to fix the borrower's payment, which is compensated when the refinancing rate is changes by the corresponding change in the period of crediting.

Starting with April 19 Sberbank abolishes all the tariffs and commission fees "for credit issue", "for consideration of application", "for managing credit account" and some others, and for the first time in the Russian banking practice the credit rate is the only parameter defining the cost of borrowed funds for the client. ●

THE PROCESS OF PRIVATIZATION AND THE SITUATION WITH REGARD TO OWNERSHIP RELATIONS

G.Malginov, A.Radygin

The preliminary results of 2009 have confirmed the assumption that the financial and economic crisis would produce a negative impact on the process of privatization. In 2009, the RF Federal Agency for Federal Property Management (Rosimushchestvo) netted 1.93 bn Rb in proceeds from privatization of state property (vs. 7.19 bn Rb a year earlier). In March, there occurred a noteworthy event: Rosimushchestvo released information that, for the first time since 1991, the Registry of State Property could be considered definitive and its formation completed.

The preliminary results of 2009 have confirmed predictions that the financial and economic crisis would produce a negative impact on the process of privatization. The 2009 privatization program was seriously undermined by a sharp contraction in effective demand caused by the worsening investment capabilities of potential buyers of state property. As a result, a number of huge sales had failed to materialize. Slight revival of activity in privatization sales was observed only from late summer – early autumn 2009. Under these conditions, the authorities took the decision to discontinue multiple (repeated) auctions as well as to no longer sell property objects at descending prices or without price declaration, because such auctions and sales, on the one hand, could not sufficiently contribute to the revenue side of the federal budget, and on the other, could result in underpricing. Potential investors expressed their interest in the auctions in 10 % of cases vs. about 30 % in previous years.

According to Head of *Rosimushchestvo* Yu. Petrov, in 2009 the total amount of his agency's proceeds from privatization of state property was 1.93 bn Rb (vs. 7.19 Bn Rb a year earlier). This information was forwarded by Petrov to the deputies of the State Duma in his report during the 'Government's Hour' on 24 February 2010¹. In his turn, Deputy Head of *Rosimushchestvo* Yu. Medvedev stated, in his 30 March 2010 interview to *Rossiiskaia Gazeta*, that in 2009 the agency privatized only 52 blocks of shares, half of which (26) were those that had been announced for sale in accordance with the forecast privatization plan of the previous year². For reference: in 2008, their numbers were 209 and 135 respectively. It should be mentioned that the 2009 year plan envisaged the sale of shares in 287 joint-stock companies.

There was a considerable drop in those budget revenues that were directly derived from the results of current economic activity, that is, the dividends paid by joint-stock companies with state stakes and part of the profits gained by federal state unitary enterprises (FSUEs). Against this background, a relatively better situation was observed with regard to revenues from leasing-out federal property (a slight decline) and land (growth) when the State, while being the rent receiver, was actually not involved in organizing the business processes of the lessee companies, and its relationships with those companies were determined in accordance with the agreements that were concluded, as a rule, for a specified term, with the lease rate being specified in advance.

However, on the whole, in contrast to 2008, revenues from renewable sources were no longer playing the role of a buffer: their indexes only slightly exceeded those recoded in the early 2000s (when the 1999 Concept of State Property Management and Privatization in the RF was only beginning to be implemented), while proceeds from privatization and sales of various properties dropped to their lowest point since 2000.

In 2009, the main trends in ownership relations were as follows:

– a slowdown in the privatization process (in comparison with 2008, the budget revenues from privatization received by *Rosimushchestvo* have dropped 3.7 times, while the number of sold blocks of shares has fallen fourfold);

1 www.rosim.ru, 12.03.2010.

2 www.rosim.ru, 30.03.2010.

– renewable sources of proceeds continued to be predominant in the general structure of federal budget revenues from privatization and management of state property; their share has been rising on the annual basis throughout recent years (even when taking into account the revenues from sales of various properties carried out by agencies other than *Rosimushchestvo*);

– the continuing integration of assets belonging to the State – the scale of which was comparable with that of the year 2008 (on the whole, in 2009, the objects designated for privatization by way of contributing assets into the authorized capital of vertically integrated structures included shares in 109 joint-stock companies and 216 federal state unitary enterprises, while a year earlier privatization had encompassed 65 state unitary enterprises and blocks of shares in 250 joint-stock companies, without taking into account the enterprises and the shares in the joint-stock companies designated for inclusion in the Open-End Joint Stock Company *Oboronservis* and State Corporation *Rostekhnologii* (which was then being formed) and for contribution into the authorized capital of Open-End Joint Stock Company *Atomenergoprom*);

– the emergence, in the Russian legal field, of a new legal organizational form - a state company that was designed to manage the use of state property; the first representative – and so far the only one – of this legal category has been the company *Rosssiiskie Avtomobil'nye Dorogi* (Russian Motor Roads, *Avtodor*), the nation-wide operator of the federal road network. The company has been assigned to render state services and to execute some other powers in the field of road communications by way of using state property on the basis of trust management;

– a change in the approach to state corporations (SC) whose creation had been one of the new directions for the property and structural policy of the State in the preceding two years. The November 2009 Presidential Message to the RF Federal Assembly clearly indicated that in the future all state corporations should be transformed into joint-stock companies controlled by the State, while the state corporations with a fixed time limit for their operation should be liquidated on the expiry thereof. At the same time the Message did not set any specific timelines for the above transformation of state corporations;

– minimization of the government's direct property expansion in the course of implementation of anti-crisis measures, when recapitalization at the expense of budget resources was offered largely to the companies in which the state is a sole or majority stockholder (e. g. *Agenstvo po Ipotekhnomu Zhilishchnomu Kreditovaniyu* (the Agency for Housing Mortgage Lending), *Rosssiiskie Zheleznye Dorogi* (Russian Railroads), *Rosselkhozbank*, *Rosagrolizing* and the system-forming defense companies), while the potential of a possible indirect increase of the public sector with the help of the banks and development institutions acting as the government's agents with regard to provision of support to individual companies has remained largely unrealized.

Bearing in mind the formal character of the State's representation on the boards of directors of many companies with state stakes, where top executives still have the upper hand, the authorities have begun to reduce the number of officials on the boards of directors of state companies while simultaneously increasing the number of professional directors¹. The replacement process was begun nearly two years ago by *Rosimushchestvo* in cooperation with the RF Ministry of Economic Development and Trade in pursuance of the assignment of the RF President resulting from his meeting with representatives of the Russian Union of Industrialists and Entrepreneurs in April 2008.

According to Deputy Minister of Economic Development and Trade Alexandra Levitskaya, in 2009 the State on the whole secured the election of 619 professional directors to the managerial bodies of more than 270 joint-stock companies with state stakes, including 38 out of the 46 joint-

¹ In accordance with the existing tradition of the corporate governance of joint-stock companies with state stakes, the boards of directors' members elected by a vote of the voting shares owned by the State as a shareholder can be divided into the following categories: (1) representatives of the State's interests – civil servants whose official status obliges them to vote in accordance with the owner's directives; (2) representatives of the State's interests – non-civil servants (professional agents) who are obliged to vote in accordance with the owner's directives on five specific issues only, and are free to vote at their own discretion on all other issues (this mechanism for safeguarding the State's interests emerged as early as 1996 but was not widely used until quite recently); (3) independent directors voting on the basis of their own professional experience and judgments; these should be appointed in accordance with the established selection criteria. According to representatives of *Rosimushchestvo*, for the sake of generality, persons belonging to the second and third categories can be called 'professional directors'.

stock companies entered on the special list¹ of highly important companies in regard to which, as far as the most crucial issues are concerned, the position of the State as a shareholder was to be determined by the Government itself or by its Chairperson or, on his or her assignment, by the Deputy Chairperson of the Government.

One of the noteworthy recent events was the March 2010 statement issued by *Rosimushchestvo* to the effect that, for the first time since 1991, the Registry of State Property should be considered definitive and its formation completed. This news has clearly illustrated the actual quality of the government's administration of economic policy even in the sphere of its direct competence. Suffice it to say that almost twelve years have already passed since the confirmation of the *Regulation on Federal Property Registration and on Keeping the Register of Federal Property* by Decree of the RF Government, of 3 July 1998, No 696²; not to mention the fact that such information was already urgently needed as early as the first half of the 1990s – or at least until mid-1994 when voucher privatization had already been completed but the general process of privatization was still going on at a relatively intense rate. At the same time, the definitiveness of the register in its present form is open to question because *Rosimushchestvo* itself admits that approximately 1.5 thousand juridical persons have so far failed to submit information on whether or not they have any federal property at their disposal.

Thus, according to *Rosimushchestvo*'s official data, as of 1 January 2010, the Register of Federal Property comprised 1,276,572 objects of movable and immovable property (vs. 1,293,788 a year earlier) and 126,721 land plots (vs. almost 67 thousand by the beginning of 2009). So, it can be stated that, over 2009, the number of federally-owned objects of movable and immovable property dropped only in purely symbolical terms (by 1.3 %), while the number of land plots listed on the Register of Federal Property increased nearly twofold.

This dynamics could be considered expectable. According to the data contained in the above-mentioned report by Yu. Petrov, *Rosimushchestvo* considers the degree of completeness of its work pertaining to registration of federal property rights to land plots to be high. Thus, by early 2010, the property right of the Russian Federation had been registered with regard to 6,765 land plots of agricultural designation with a total area of 41.6 mln hectares, which accounts for more than 85 % of their total number and area. It had also been registered with regard to the 20,893 forest plots with a total area of 41.6 mln hectares previously owned by agricultural organizations, which accounts for 44.4 % of their total number and 94.4 % of their total area.

On the whole, state registration of the Russian Federation's property right to land plots is planned to be completed in 2010, which clearly cannot be said of the other initiatives put forth in the sphere of land relations (e. g. delimitation of state land ownership by level of public authority, the 'dacha amnesty, etc.).

At the same time the number of commercial organizations using state property in one way or another has considerably reduced.

Thus, according to representatives of *Rosimushchestvo*, at present about 3 thousand federal state unitary enterprises fall under the category of 'federal property'³, while, judging by the *Forecast Plan (Program) of Federal Property Privatization for the Year 2010 and the Main Directions of Federal Property Privatization for the Years 2011 and 2012* confirmed by Decree of the RF Government, of 30 November 2009, No 1805-r, as of 1 January 2009 the Russian Federation was the owner of the property of 3,765 federal state unitary enterprises.

As of the beginning of 2010, the number of federally owned blocks of shares in joint-stock companies (2,646 – according to the Register of Federal Property) was more than 20 % lower than the number of those joint-stock companies (3,337) where the Russian Federation was a shareholder as of the beginning of 2009. It should be noted that such a considerable drop took place against the backdrop of microscopic privatization sales of state-owned blocks of shares although, quite

1 www.economy.gov.ru, 13.04.2010.

2 Became invalid in connection with the issuance of Decree of the RF Government, of 16 July 2007, No 447, 'On Improvement of Property Registration', in accordance with which federal property registration should be carried out on the basis of a new Regulation.

3 www.rosim.ru, 02.04.2010.

naturally, the process of their inclusion into the authorized capital of integrated structures (and their withdrawal for other reasons) was going on uninterrupted.

Judging by the above data, the volume of state-owned property and the content of the anti-crisis measures taken by the State has made possible the materialization of a number of privatization scenarios, depending on the Russian economy's prospects to achieve an exit from the global financial and economic crisis and on the necessity to cover the budget deficit. This multiplicity of possible scenarios is reflected in the great variability of the parameters of the privatization program for the current year.

The Forecast Plan of Federal Property Privatization for the Year 2010, initially approved by the RF Government in late November 2009, comprised blocks of shares in 449 joint-stock companies as well as 56 other property objects owned by the State Treasury of the Russian Federation, including objects of immovable property and sea and river vessels. The document also mentioned the completion of privatization of about 250 federal state unitary enterprises whose privatization procedures started in 2009. Taking into account the additions introduced in mid-March 2010, the objects designated for privatization by this year's privatization program include 690 joint-stock companies, 230 federal state unitary enterprises and 74 treasury-owned properties.

The variability of the financial parameters of the 2010 privatization program is also very substantial. Despite the initial favorable predictions that in 2010 revenues from sale of federal property could amount to about 100 bn Rb, the official forecast of the current year's federal budget revenues from privatization puts the figure at 18 bn Rb. However, if the RF Government takes the decision to privatize shares and other investment-attractive property, the volume of revenues from sale of federal property could become significantly higher – in excess of 70 bn Rb. Between 54 and 55 bn Rb of that amount could be generated from selling federally-owned blocks of shares in 28 joint-stock companies – if the latter are excluded from the list of strategic enterprises and joint-stock companies.

In late 2009, in order to stimulate the process of privatization, the RF Ministry of Economic Development and Trade drafted a package of alterations and amendments to the existing *Law on Privatization* that were designed to extend the time horizon of the privatization for the planning period, to upgrade the information support for privatization and to promote the application of electronic bidding in the course of privatization transactions.

The same trend is reflected in the Ministry's March and April 2010 proposals stipulating for a radical reduction in the list of strategic enterprises and joint-stock companies, for the development of the institution of independent directors (consolidation of this concept in the RF *Law on Joint-Stock Companies*, the introduction of the institution of a self-regulating organization of independent directors, the imposition of a maximum term of independent directorship (5 years), the establishment of a corresponding consultative council of experts at the RF Ministry of Economic Development), and the introduction of alterations to the normative legal acts regulating a number of aspects of the development of the State's position as a shareholder. ●

CREDITING OF PEASANT (INDIVIDUAL PRIVATE) FARMS ON LAND MORTGAGE

N.Shagayda

The expansion of crediting on land mortgage is envisaged by various legislative acts and state programs of agricultural development. But in practice cases of such crediting of not only peasant (individual private) but also of corporate farms are very few. The situation is due both to the general economic conditions and to the specific factors. Its analysis shows that at present land cannot serve as a commonly used collateral for peasant (individual private) farms.

Peasant (individual private) farms (hereinafter referred to as PFs) have more difficulties in accessing credit resources as compared with corporate farms due to the lack of available collateral. At the same time actually all of them own land that could be used as a loan security. Since 2005 there is a legislative basis for extending loans on agricultural land mortgage. In order to foster such practice in 2006 it was included in the Priority national project “Development of the agrifood sector” in the framework of supporting smallholder farming. But shortly after that the binding of such lending to smallholder farms discontinued since the crediting on mortgage was incorporated in the State program for agricultural development and regulation of agricultural and food markets in 2008–2012 (hereinafter referred to as the State program). But in practice cases of granting mortgage loans not only to PFs but also to corporate farms are very few. For instance, in the period from January 1, 2006 to January 1, 2009 Rosselkhozbank issued only 222 credits on farmland mortgage to the total amount of 7 billion rubles although as different from other banks it gets state funds for this purpose. 203 more credits to the total amount of 3.7 billion rubles were extended in 2009. In 2009 credits on land mortgage accounted for only about 1% of all credits granted in the framework of the State program.

Credits on mortgage of land plots are extended by many banks. But these are mostly plots under buildings that are also pledged as security. Bank survey showed that cases of such crediting are few although banks regard land as one of the possible collaterals.

The share of PFs and household farms in the total amount of mortgage loans issued by Rosselkhozbank to agricultural producers of all types is less than one half¹. An implicit evidence of that is also the average size of extended credits: while at the start of the Priority national project it didn't exceed 7 million rubles (then principal borrowers were PFs), by January 2009 it surpassed 31 million rubles (since most credits were extended to corporate farms). In the crisis 2009 the average size of credits fell down to 18 million rubles.

So, on the one hand, there is a need for mortgage credits, but on the other hand, PFs do not take such credits. There are common hurdles to the spreading of agricultural land mortgage in farms of different organizational and legal types. The principal of them is the lack of the very object of mortgage – a land plot. It certainly exists physically; there are entitling documents issued in the course of land reform². But plots do not meet the requirements set to collateral. Banks require that an applicant submit documents confirming his property rights to the plot that beginning from 1998 are issued by bodies authorized to register titles to land and transactions with it. It's impossible to get such documents by simply submitting certificates issued to owners before 1998 although they “...have equal legal force with entries in the Unified State Register of Titles to Real Estate and Transactions Therewith”³. To obtain a certificate of 1998 pattern one has to enter information on earlier acquired title to his land plot in the United State Register. In its turn, to do that one has to collect all documents to the plot including cadastre passport. Although the Cadastre Chamber does not doubt that a

1 V.N.Khlystun. Crediting on land mortgage: opportunities and barriers. Theses of report at the Russian agrifood forum. September 23, 2008.

2 The most part of PFs were created before 1995.

3 As stated in Paragraph 9, Article 3 of Federal Law “On enforcement of Land Code of the Russian Federation” of October 25, 2001.

farmer cultivates his own land plot, in compliance with its regulations it issues passports indicating that “the plot area is declarative and needs more precise definition when establishing boundaries”. The title registration bodies do not accept cadastre passports with such notes and require documents stating the exact area of a land plot that one cannot get without boundary definition works. A farmer is thus forced to pay from 3 to 7 thousand rubles per hectare for such works, to lose time (from 3 to 6 months) and to make up to 10 visits to different offices that work not each and not full day. One more problem common for agricultural producers of all types is the problem of evaluating land plots since the market of land in the country has not formed as yet. Appraisers charge a high price for their work and establish the value of land plots by “either spinning it out of thin air or basing on cadastral estimate” the exactness of which is also questionable.

There are also hindrances specific for PFs:

1. Unclear legal status of an individual farmer. At present there are PFs registered as legal bodies; PFs whose heads are registered as individual entrepreneurs; PFs the heads of which are equated with individual entrepreneurs. The Federal Law “On peasant (individual private) farms” regulates relationships only in the latter. All other forms of PFs are not subject to regulation by this law despite being quite legitimate. Therefore, it’s not clear how can one take decisions on accepting their land as collateral, what is the responsibility of farm members, etc. There is a risk for a bank that in case the land is subjected to distress, the decision on its mortgage can be contested since the procedures of decision making in two of the three currently existing forms of PFs¹ are not established. If land is offered as collateral by such problematic (as regards their legal status) farms, it’s easier for a bank to decline their applications.

2. High share of non–operating PFs. The Agricultural Census revealed that only 51.7% of PFs were engaged in production activities.

3. Disproportionate distribution of PFs by regions. 25% of currently operating land–based PFs in Russia are situated in Dagestan, Kabardino–Balkariya, North Ossetiya, Ingushetiya and Chechen Republic². But they cannot mortgage their land since its privatization in these regions is forbidden and land remains state property.

4. The level of education of PFs’ members hindering wider use of mortgage. About 24% of PFs’ heads have higher education and 32% – special secondary education³. As different from corporate farms, PFs do not have specialists who could day after day enquire about terms of mortgage credits, then update documents on land plots, evaluate and ensure them, negotiate with banks, register mortgage agreements. An individual farmer is normally engaged in agricultural production and has no workers available for such purposes: the number of employed in 80% of PFs and farms of individual entrepreneurs ranges from 1 to 4 persons⁴. Besides, case studies show that in order to mortgage his plot for receiving a loan a farmer has to visit not the local bank office in his district but the oblast affiliate of “Rosselkhozbank”. So, the complicated procedure of mortgaging agricultural land, the high share of PFs’ heads having only secondary education, the lack of workers available for going through the mortgage credit formalities and the remoteness of bank offices are additional hindrances to the development of land mortgage in PFs.

5. Low activity of PFs in obtaining credits. This activity was estimated by calculating the share of farms–borrowers from Rosselkhozbank⁵ in the total number of regional PFs engaged in farming⁶. This indicator depends not only on financial sustainability of PFs in a region but also on their need for credits, the capability of farm heads to go through the required formalities to obtain a credit, credit availability, etc. Only in one region of the Russian Federation – the Jewish autonomous oblast – 2/3 of operating private farmers use credits. In 7 oblasts almost 1/3 of PFs use credits (Tomsk, Astrakhan, Vologda, Tula, and Kursk oblasts and the Khakass Republic). In 20 regions of Russia the share of PFs benefiting from credits ranges from 10 to 20% of their total number. In other regions of the country not more than 1 out of 9 private farmers or individual entrepreneurs uses credits. In the

1 Hereinafter the term “PFs” refers to all forms of such farms.

2 All–Russian Agricultural Census of 2006. Rosstat.

3 Ibid.

4 Ibid.

5 Rosselkhozbank. Data on crediting in the framework of the State program.

6 All–Russian Agricultural Census of 2006 – www.gks.ru.; Rosselkhozbank.

Central Federal District the lowest indicator of involvement in the system of crediting is observed in Moscow oblast – only 1.7% of PFs registered there as operating in the course of the recent Agricultural Census obtained credits¹. The situation is similar in Leningrad oblast – only 4% of operating PFs are participating in credit schemes through Rosselkhozbank.

6. Size and specialization of farms. Over 17% of PFs have no land at all. The size of 37% of farms having land is less than 10 hectares². Altogether, 64% of PFs have either no or not more than 20 hectares of land. Meantime, in 20 Russian regions the average size of a land plot that can serve as collateral is over 30 hectares. PFs specialize mainly on crop production: over 80% of them have no or not more than 3 heads of livestock. It's not rational for such farms to buy a separate tractor or to build production premises, i.e. they don't need much capital investments calling for mortgage credits.

7. The structure of land used by PFs. Agricultural land mortgage could be encouraged by a high share of land owned by members of PFs or transferred to PFs as legal bodies³. But according to data of Rosnedvizhimost [Russian real estate agency] only 21% of land assigned to PFs is owned by their members and about 10% – by PFs as legal bodies. The remaining land rests in state ownership (about 41%) or in property of outside owners (28%). This means that less than one third of land used by PFs can serve as loan collateral⁴.

8. Liquidity of land in case of distress. The scarcity of information about demand for agricultural land prevents from assessing its liquidity. Meantime the rate of liquidity determines the attractiveness of collateral for a bank. However, the liquidity of agricultural land can be estimated indirectly by comparing the area of land not demanded by farm producers with the area of land used by PFs in each specific region of the Russian Federation. Non-demanded lands are share-owned land plots whose co-owners failed to transfer their titles and lands of liquidated PFs and corporate farms. The more such lands, the lower liquidity of land plots mortgaged by PFs. Only in 9 regions of the Russian Federation (most of them in the Southern Federal District) the area of non-demanded lands is not big – its ratio to the area of land used by PFs is below 10%. In 15 regions it does not exceed 25%. In the remaining Russian regions the area of non-demanded lands relative to the total PFs' land is rather large implying that the liquidity of a potential collateral – agricultural land – is not high.

9. Collateral value of land plots. In case of no demand for land it usually bases on the cadastral value of a plot. Besides, banks additionally cut it by 30%⁵. Estimates of collateral value of land plots owned by PFs or its members (according to methodology used by Rosselkhozbank) show that in 32 regions of the Russian Federation its average amount is above 200 thousand rubles and exceeds 400 thousand rubles in 16 of them. So, only in these 16 regions an owner can mortgage his plot and get a credit sufficient for buying an ordinary tractor MTZ-82. In all other regions the credit will allow to finance only non-capital expenditures and so in most cases its usage won't be rational. The comparison of an average amount of credits received by PFs in 2008⁶ with the collateral value of their land plots showed that private farmers used other property for mortgage⁷. Only in Rostov oblast land plots can serve as collateral for getting credits since their average collateral value is above the average amount of credits received by PFs in 2008–2009. In two RF regions – Krasnodar kray and Saratov oblast – a land plot can secure up to 75% of the received credit while the rest should be guaranteed by other property items. In all other Russian regions the collateral value of land plots is many – dozens and hundreds – fold below the average amount of credits received by PFs.

So, one can conclude that land can provide individual private farmers with access to capital-purpose credits only in a limited number of cases. For most of them it cannot yet serve as a real loan collateral. ●

1 This can mean that some PFs were recorded as operating although they were created not for the sake of production activities but in order to obtain land plots that could be later sold or used for recreation. The evidences of that are the small size of farms (8.5 hectares – one of the lowest indicators in the country) as compared with land availability in the region and the low average output per farm.

2 All-Russian Agricultural Census of 2006 – www.gks.ru

3 The entitling of PFs as legal bodies with ownership rights is the practice violating Russian legislation. Still, it exists and one should take it into account.

4 Land fund of the Russian Federation as of January 1, 2008. Rosnedvizhimost, 2008.

5 According to Rosselkhozbank's regulations the collateral value is usually assessed to be 30% below the cadastral one.

6 Data of Rosselkhozbank.

7 The collateral value of land plots was estimated on the basis of their cadastral value with coefficient 0.7 according to Rosselkhozbank's methodology.

THE RUSSIAN DEFENSE SECTOR: RADICAL REFORMS ARE URGENTLY NEEDED

V.Zatsepin

In the past two months, the RF authorities have taken a number of important decisions in the sphere of management of the Russian defense sector that should determine its development in the long-term perspective. However, many such decisions were also frequently made in the past, and then invariably proved to be totally inefficient. The recent political decision to the effect that Russia should purchase foreign-made weaponry has become yet another proof of the necessity to modernize the management of her defense sector so as to increase the transparency of defense programs, defense purchases and defense-related budget expenditures.

On 1 March 2010, President Dmitry Medvedev approved “The Fundamental Principles of the State Policy of the Russian Federation on the Development of the Defense – Industrial Complex for the Period Until 2020 and Beyond” drawn up by the RF Ministry of Industry and Trade with participation of other relevant agencies – the *Rosatom* state corporation and the apparatus of the RF Security Council.

On 19 March, there was a meeting between the President and Vice Prime Minister Sergei Ivanov¹ that was devoted to the plans of developing Russia’s defense-industrial complex. Sergei Ivanov informed the President that the Government had determined, *as a percentage of GDP*, the volume of funds necessary for financing the new state program of armaments for the next ten years, and that the RF Ministry of Finance had received an application for the funding, in the amount of approximately 100 bn Rb per year, of the new federal target program for reforming the defense-industrial complex for the period until 2020. It can be assumed that, as far as the armament program is concerned, the authorities have indeed taken into consideration their recent experience of operating under crisis conditions, because in 2007 the volume of financing earmarked for the current state program of armaments had been nominally set at 4.9 trillion Rb.

The current Federal Target Program ‘*The Development of the Defense – Industrial Complex for the 2007 – 2010 Period and for the Period Until 2015*’ that was adopted in October 2006 for some mysterious reasons has been made classified, which makes it impossible to put forth any judgments as to the extent to which ‘the appetites’ of the defense – industrial complex have recently grown. A similar program – the Federal Target Program ‘*The Reform and Development of the Defense – Industrial Complex (2002 – 2006)*’², which was entirely non-classified, cost the federal budget only 11.2 bn Rb, i.e., 2.2 bn Rb per annum on average. Even after adjusting for inflation, the exponential growth in defense spending is clearly alarming. It should be understood that this sum of 100 billion rubles so desperately needed by the defense–industrial complex includes a hidden surcharge, for customers, on weapons and equipment. Naturally, the bill for all this is to be footed by taxpayers.

Equally revealing are Sergei Ivanov’s words that the afore-mentioned plans will be implemented with participation of 1,729 enterprises included on the official register of the defense – industrial complex. They indicate that, after having been reformed time and again, the Russian defense-industrial complex has made a full circle and so effectively returned to its former status as of June 1998, when the federal target program of defense industry restructuring and conversion for the years 1998 – 2000 was adopted. At that time, the defense – industrial complex officially included 1,749 enterprises and organizations, and in accordance with the said program³ it was planned that their numbers should be reduced almost threefold – to a mere 667. However, this

1 President utverdil Osnovy politiki Rossii v oblasti razvitiia OPK do 2020 goda i dal’neishuiu perspektivu: Stenogramma vstrechi D. Medvedeva s vitse-prem’erom S. Ivanovym. [The President has approved The Fundamental Principles of the State Policy of the Russian Federation in the Field of Development of the Defense-Industrial Complex for the Period Until 2020 and Beyond: Transcript of the meeting between D. Medvedev and Vice Premier S. Ivanov. Gorki, 19 March 2010. See <http://kremlin.ru/transcripts/7146>.

2 See <http://fcp.vpk.ru/cgi-bin/cis/fcp.cgi/Fcp/ViewFcp/View/2006/125/>.

3 Confirmed by Decree of the Government of the Russian Federation, of 24 June 1998, No 625.

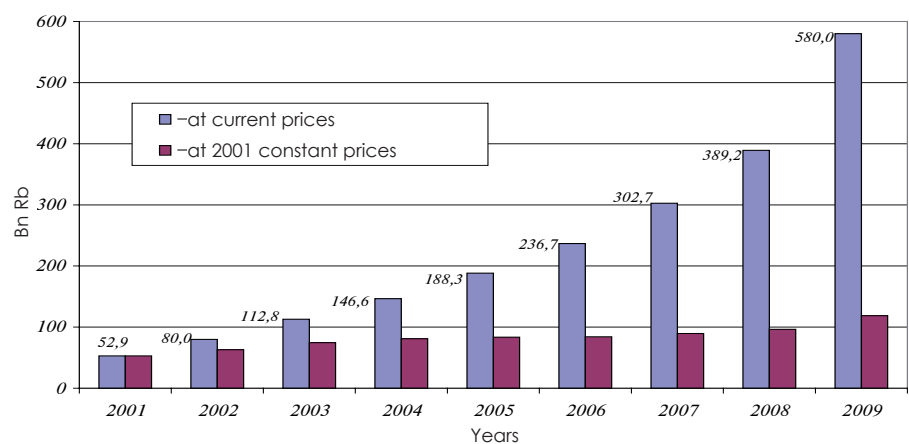
objective was never achieved. The same is true of other goals – such as the creation of modern and efficient mechanisms of management and control, the achievement of an internal consolidation of the defense industry and an elimination of its redundant structures, and the improvement of the efficiency and effectiveness of the use of state property.

In 2001, two more documents were developed for the purpose of dealing with these issues, as well as for providing solutions to a number of other problems: The Fundamental Principles of the State Policy of the Russian Federation on Development of the Defense – Industrial Complex for the Period Until 2010 and Beyond and the new Federal Target Program The Reform and Development of the Defense – Industrial Complex (2002 – 2006). The latter had, in fact, a better chance of being implemented than its predecessor – a three-year program – because of its longer duration (5 years). In these two documents it was envisaged that the number of defense enterprises and organizations should be reduced from 1,770 to 1,300. It was planned that the remaining enterprises would then be integrated into 50 to 60 holding companies specializing in production of war materiel and armaments. The holding companies were to be created with due regard for either their historically established cooperation links with other enterprises or the various geographic factors. As a result, by early 2006, the Combined Register of defense-industrial complex enterprises had been reduced to 1,265 enterprises and organizations. By the end of 2006, the RF Ministry of Industry and Energy had managed to create 27 integrated structures and 19 out of the 20 planned treasury-owned enterprises. However, as had been the case with the previous programs, the aims and objectives of this federal target program could not be achieved in full.

The results of implementing the current classified federal target program are far from trivial: the Russian defense – industrial complex has restored the numerical strength that it had more than ten years ago. Although the specific reasons for and the mechanisms of this achievement clearly merit a special investigation, one can already point to the increased availability of federal budget funds for financing both the ever growing state defense order (*Figure 1*) and the numerous overlapping federal target programs oriented to state support of the defense – industrial complex.

The robust growth in defense spending accompanied by the non-transparency of state finances has significantly increased in the past five years, while the twenty-five percent profit rate officially guaranteed for the ‘unique’ domestic producers, the relaxing of state financial control over the defense sector (in 2009 the RF Audit Chamber carried out only 3 inspections in the defense sector vs. 18 inspections in 1999) and the increased *politicization* of this sector have created exceptionally favorable conditions for rent extraction and so have considerably undermined the effectiveness of budget processes.

In this connection, the approval, in March 2010, of The Fundamental Principles of the State Policy of the Russian Federation on the Development of the Defense – Industrial Complex for the Period of 2020 and Beyond, the forthcoming approval of the State Program of Armaments for 2011 – 2020 which is planned to be signed by the RF President in June, and the adoption of the next federal target program of defense-industrial complex reform for 2011 – 2020 is clearly a continuation of traditional bad practice with roots in Soviet times. This practice owes its existence to the ineffectiveness of the institutions responsible for drawing up the program of armaments, the institution of the state defense order, and paradoxically tight state secrecy. As regards



Source: Data published in mass media; Rosstat (the GDP deflator for government final consumption expenditure).

Figure 1. The State Defense Order of the RF Ministry of Defense in 2001-2009

these phenomena, their origin can be easily traced back to the principle of ‘security through obscurity’.

In February¹ the RF Government announced its plan that, by 2015, modern weapons should account for no less than 30 percent of all military equipment of the RF Armed Forces, and that by 2020 this figure should rise to 70 percent. Many people were evidently deeply surprised by the statement made by RF Deputy Defense Minister and head of armaments for the Russian armed forces Vladimir Popovkin at a round table conducted by the Russian News Agency *Novosti* on 7 April². He said that the development of redundant and morally obsolescent weapon systems (many of which had been represented at military parades in Moscow as an example of the Russian defense- industrial complex’s achievements) had been discontinued, and that it was possible that Russia would purchase from France a Mistral-class amphibious assault ship³. But the news did not come as a surprise for specialists – as early as December 1997, Rachik Faramazian (the Institute of World Economy and International Relations, Russian Academy of Sciences) had warned that, unless Russia put an end to the existing trend, ‘we ... will be forced to import the newest weapon systems’⁴. ●

1 Ibid.

2 Nuzno li Rossii zakupat’ oruzhie za rubezhom? Moskva, 7 apreliia 2010. [Should Russia purchase weapons abroad? Moscow, 7 April 2010. See: http://www.rian.ru/press_video/20100407/219089968.html.

3 Politicheskoe reshenie o zakupke uzhe priniato. [The political decision on the purchase has already been made]. See: Vremia Novostei [Time of News], 22 April 2010 (No 69).

4 Finansovo-ekonomicheskie problemy voennogo stroitel’sтва i puti ikh resheniia (materialy nauchno-prakticheskoi konferentsii) [The financial and economic issues of military capability development (Materials of a scientific – practical conference)]: Nauchnye trudy [Scientific Works]. No 6p. IEPP [IET]. 1998. P. 102. See: http://www.iet.ru/files/text/working_papers/06.zip.

WORLD TRADE WITH GOODS AND SERVICES IN 2009 AND PROSPECTS OF RUSSIAN FOREIGN TRADE DEVELOPMENT

A.Pakhomov

At the end of March 2010 the World Trade Organization Secretariat published analytical review on the results of international trade development in 2009 and prospects for its development in 2010.¹ The review includes preliminary statistical data on the world trade with goods and services in 2009 as broken by countries. According to these data, among the leading trading countries it is in Russia where the fastest decrease rates of export-import operations were observed.

According to WTO analysts' estimations the global GDP reducing by 2.3% in 2009, the drop of the world trade in real terms made 12.2% (the most dramatic drop over the last 70 years) as compared with the increase of 2.0% in 2008 and 5.5% in 2007. According to the initial WTO forecasts the international trade was expected to decrease up to the level of 10% in 2009, but the estimation of economic situation in the world market by the OECD experts was right predicting the fall of 13%.

In nominal terms the global export of goods reduced by 23% primarily at the expense of the reduction of prices for energy carriers and raw materials and made USD 12.2 trillion. Export of services decreased by 13% and made YSD 3.3 trillion, the deepest drop being observed in the sector of transportation services. As a result real average annual growth rates of world trade with goods in 2005 -2009 made 4% and with services – 7%.

The recession of the world trade in 2009 turned out to be so large-scale also because up to two thirds of physical volume of goods are intermediate ones (35% of import in Russia), which are imported by the countries to create a final product which is exported after that. Not taking into account this factor the drop of the world trade could have been by 1.5-3 times less. If only added value was to be taken into account, trade deficit of the USA in trading with China would be 30% less, and with Japan – 25% more, since many goods that China and other countries import to the USA contain components that they have purchased in Japan².

According to the forecasts of WTO experts the volume of world trade in 2010 could increase by 9.5%, which is accounted for by the world economy overcoming the crisis. The main reason for goods turnover upsurge is the recovery of developing markets: they are to become the main engines of trade. In this connection it is assumed that that export of developing countries will increase by 11%, of the developed ones – only by 7.5%.

For the volumes of the world trade to return to record-breaking level of 2008, in WTO estimations, two years will be needed, but the world economy recovery may cease due to possible activation of protectionism. According to the joint report of the WTO, OECD and UNCTAD despite the deepest recession the trade wars were still avoided. Protectionist measures adopted in G20 countries concerned 0.8% of the world import from October 2008 to October 2009, and only 0.4% from September 2009 to February 2010. All in all, in the G20 aggregated import this share went down from 1.3% to 0.7%.³

At the same time Global Trade Alert (GTA) organization which regards protectionism not only as tariff barriers, but also, for instance, as the toughening of the laws concerning migrants counted that there are 257 newly adopted protectionist measures, 184 of which were adopted by G20 countries that signed anti-crisis agreement according to which no new trade barriers were to be cre-

1 World Trade 2009, Prospects for 2010: Trade to expand by 9.5% in 2010 after a dismal 2009. WTO, Geneva, Press/598, 26 March 2010, 16 p.

2 Thus, according to Sloan Foundation data, out of USD 150 of iPod cost only USD 4 are made in China, other 146 represent the cost of imported components. «The Wall Street Journal», 25 March 2010.

3 Report on G20 Trade and Investment Measures (September 2009 to February 2010), WTO, OECD & UNCTAD, 8 March 2010, pp. 4,8.

ated. It should be noted that not all these measures were obvious at once: in the 1st quarter 2009 the countries introduced not 77 but 111 measures – by 44% more. Over the 4th quarter despite the starting recovery in the majority of economies GTA revealed 63 new protectionist measures. According to GTA data the protectionist measures concerned China most often during this crisis (140 measures being introduced against it) and the USA (more than 100), which is accounted for by their active export expansion¹.

According to WTO data, as a result of 2009 in the field of goods export China (USD 1202 million, 9.6% of the world export) for the first time has hold the leading position in the rating of the largest exporters, leaving behind Germany (USD 1121 million, 9.0%) and the USA (USD 1052 million, 8.5%). In the list of the largest importers the leading position is still occupied by the USA (USD 1.604 million, 12.7% of the world import), the second place is held by China (USD 1.006 million, 8.0%), outstripping Germany (USD 931 million, 7.4%). For more details on the world rating of leading exporters and importers of goods and commercial services in 2009 refer to *tables 1* and *2*.

Table 1

LEADING EXPORTERS AND IMPORTERS IN WORLD TRADE WITH GOODS IN 2009

Place	Exporting countries	Volume (USD billion)	Proportion (%)	Change versus the previous year (%)	Place	Exporting countries	Volume (USD billion)	Proportion (%)	Change versus the previous year (%)
1	China	1202	9.6	-16	1	USA	1604	12.7	-26
2	Germany	1121	9.0	-22	2	China	1006	8.0	-11
3	USA	1057	8.5	-18	3	Germany	931	7.4	-21
4	Japan	581	4.7	-26	4	France	551	4.4	-22
5	Netherlands	499	4.0	-22	5	Japan	551	4.4	-28
6	France	475	3.8	-21	6	Great Britain	480	3.8	-24
7	Italy	405	3.2	-25	7	Netherlands	446	3.5	-23
8	Belgium	370	3.0	-22	8	Italy	410	3.2	-26
9	Republic of Korea	364	2.9	-14	9	Hon Kong. China	353	2.8	-10
						- import for internal consumption ¹	91	0.7	-8
10	Great Britain	351	2.8	-24	10	Belgium	351	2.8	-25
11	Hon Kong, China	330	2.6	-11	11	Canada	330	2.6	-21
	- export for local production ¹	15	0.1	-9					
	- re-export ²	314	2.5	-11					
12	Canada	316	2.5	-31	12	Republic of Korea	323	2.6	-26
13	Russian Federation	304	2.4	-36	13	Spain	290	2.3	-31
14	Singapore	270	2.2	-20	14	Singapore	246	1.9	-23
	- export for local production	138	1.1	-19		- import for internal consumption ²	114	0.9	-28
	- re-export	132	1.1	-19					
15	Mexico	230	1.8	-21	15	India	244	1.9	-24
16	Spain	218	1.7	-23	16	Mexico	242	1.9	-24
17	Chinese Taipei	204	1.6	-20	17	Russian Federation ³	192	1.5	-34

1 Global Trade Alert, Will Stabilization Limit Protectionism? The 4th GTA Report, L., 15.02.2010, p.11.

Table 1, cont'd

Place	Exporting countries	Volume (USD billion)	Proportion (%)	Change ver- sus the pre- vious year (%)	Place	Exporting countries	Volume (USD billion)	Proportion (%)	Change ver- sus the pre- vious year (%)
18	Saudi Arabia ¹	189	1.5	-40	18	Chinese Taipei	175	1.4	-27
19	UAE ¹	175	1.4	-27	19	Australia	165	1.3	-17
20	Switzerland	173	1.4	-14	20	Switzerland	156	1.2	-15
21	Malaysia	157	1.3	-21	21	Poland	147	1.2	-30
22	India	155	1.2	-20	22	Austria	144	1.1	-22
23	Australia	154	1.2	-18	23	Turkey	141	1.1	-30
24	Brazil	153	1.2	-23	24	UAE ¹	140	1.1	-21
25	Thailand	152	1.2	-14	25	Thailand	134	1.1	-25
26	Austria	137	1.1	-24	26	Brazil	134	1.1	-27
27	Poland	134	1.1	-21	27	Malaysia	124	1.0	-21
28	Sweden	131	1.0	-29	28	Sweden	119	0.9	-29
29	Norway	121	1.0	-30	29	Czech Republic	105	0.8	-26
30	Indonesia	120	1.0	-14	30	Saudi Arabia ¹	92	0.7	-20
	Total for 30 countries ⁴	10244	82.2	-		Total for 30 countries ⁴	10323	81.6	-
	Total world export ⁴	12461	100.0	-23		Total world import ⁴	12647	100.0	-23

¹ WTO Secretariat estimation

² Import for internal consumption includes import deduced by re-export

³ Import at FOB price

⁴ Including considerable re-export and import for the purpose of re-export

Source: WTO Secretariat, Press release, PRESS/598, Geneva, March 26, 2009, p.10 (Appendix Table 3 «Merchandise Trade: Leading Exporters and Importers 2009»).

Table 2

LEADING EXPORTERS AND IMPORTERS IN WORLD TRADE WITH COMMERCIAL SERVICES* IN 2009

Place	Exporting countries	Volume (USD billion)	Proportion (%)	Change versus the previous year (%)	Place	Exporting countries	Volume (USD billion)	Proportion (%)	Change versus the previous year (%)
1	USA	470	14,2	-9	1	USA	331	10,6	-9
2	Great Britain	240	7,2	-16	2	Germany	255	8,2	-10
3	Germany	215	6,5	-11	3	Great Britain	160	5,1	-19
4	France	140	4,2	-14	4	China	158	5,1	0
5	China ¹	129	3,9	-12	5	Japan	146	4,7	-11
6	Japan	124	3,8	-15	6	France	124	4,0	-12
7	Spain	122	3,7	-14	7	Italy	114	3,6	-11
8	Italy	101	3,0	-15	8	Ireland	104	3,3	-5
9	Ireland	95	2,9	-7	9	Netherlands	87	2,8	-5
10	Netherlands	92	2,8	-11	10	Spain	87	2,8	-17
11	Hon Kong, China	86	2,6	-6	11	Canada	77	2,5	-11
12	India	86	2,6	-	12	India	74	2,4	-
13	Belgium	75	2,3	-11	13	Republic of Korea	74	2,4	-19

Table 2, cont'd

Place	Exporting countries	Volume (USD billion)	Proportion (%)	Change versus the previous year (%)	Place	Exporting countries	Volume (USD billion)	Proportion (%)	Change versus the previous year (%)
14	Singapore	74	2,2	-11	14	Singapore	74	2,4	-6
15	Switzerland	68	2,1	-11	15	Belgium	72	2,3	-12
16	Sweden	60	1,8	-16	16	Russian Federation	60	1,9	-19
17	Luxembourg	60	1,8	-16	17	Denmark	51	1,6	-19
18	Canada	57	1,7	-12	18	Sweden	47	1,5	-14
19	Republic of Korea	56	1,7	-25	19	Hon Kong, China	44	1,4	-6
20	Denmark	55	1,7	-25	20	Brazil	44	1,4	-1
21	Austria	53	1,6	-13	21	Saudi Arabia	43	1,4	-
22	Russian Federation	42	1,3	-17	22	Australia	41	1,3	-13
23	Australia	41	1,3	-7	23	Thailand	38	1,2	-18
24	Norway	38	1,1	-17	24	Austria	38	1,2	-12
25	Greece	38	1,1	-25	25	Norway	37	1,2	-16
26	Turkey	33	1,0	-6	26	Luxembourg	36	1,2	-13
27	Chinese Taipei еñ	31	0,9	-10	27	UAE ²	36	1,1	-
28	Thailand	31	0,9	-9	28	Switzerland	34	1,1	-6
29	Poland	29	0,9	-19	29	Chinese Taipei	29	0,9	-15
30	Malaysia	28	0,8	-8	30	Malaysia	27	0,8	-12
	Total for 30 countries	2765	83,5	-		Total for 30 countries	2540	81,6	-
	Total world export	3310	100,0	-13		Total world import	3115	100,0	-12

* Foreign trade with commercial services is defined as the following: one country executes paid works (services) for another, which are not directly connected with the production of tangible property. So-called state services rendered within the borders of the country are referred to as non-commercial services.

¹ Preliminary estimations

² Estimations of WTO Secretariat

Note. By the beginning of March 2010 there were preliminary annual data for 50 countries (their proportion in the foreign trade with non-commercial services makes about two thirds). The majority of other estimations by countries were received on the basis of the data for first three quarters of 2009.

Source: WTO Secretariat, Press release, PRESS/598, Geneva, March 26, 2009, p.12 (Appendix Table 5 «Leading Exporters and Importers in world trade in commercial services»).

According to WTO data in the elapsed year the biggest rates of export and import operations drop among the leading trading countries were observed for Russia, which was reflected in its positions in the rating of leading exporters and importers of goods and commercial services. Out of 30 countries, which account for more than 80% of the world trade, Russia's indices fell to the deepest extent: import in value terms has reduced by 34% (the second place is occupied by Poland and Turkey with 30%), export – by 36% (only Saudi Arabia with 40% has highest figures).

As a result (according to the preliminary data) in 2009 Russia lost 4 positions and took the 13th place in the rating of export value volumes with USD 304 billion. At the same time the annual growth nominal rates have dropped by 36%. The proportion of Russia in the world export made 2.4% (2.9% in 2008). As to the import value (USD 192 billion, drop of 34%) the Russian Federation sank to the 17th place and its share in the aggregated import has reduced to 1.5% (16th place and 1.8%, correspondingly, in 2008). Not taking into account intraregional trade between the EU countries Russia took the 8th position in the rating of goods export and 11th position in the goods import rating (the 5th and the 0th places, correspondingly, in 2008). In the rating of countries exporting commercial goods in 2009 (USD 42 billion, drop of 17%) the Russian Federation remained on the

22nd place and its share remained the same – 1.3%. In the sphere of commercial services import (USD 60 billion, reduction of 19%) Russia maintained the 16th place in the world, its proportion reducing to 1.9% as compared with 2.2% in 2008.¹

Table 3

DYNAMICS OF RUSSIA'S POSITIONS IN WTO RATING AND ITS SHARE IN WORLD TRADE WITH GOODS AND COMMERCIAL SERVICES IN 2000-2009

	2000	2005	2006	2007	2008	2009
Goods export	17/1.7	13/2.4	13/2.5	12/2.5	9/2.9	13/2.4
Goods import	29/0.7	19/1.2	18/1.3	16/1.6	16/1.8	17/1.5
Services export	31/0.7	26/1.1	25/1.1	25/1.2	22/1.3	22/1.3
Services import	22/1.2	17/1.6	18/1.7	16/1.9	16/2.2	16/1.9

* The first figure refers to the place in the rating, the second – to the share as percentage

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

As it can be seen from the presented WTO data (*table 3*) the most obvious negative changes in 2009 took place in the field of the Russian goods export. It is typical that the comparable dynamics was observed in the world rating of the countries by the GDP volume, which the IMF calculates in nominal terms. Whereas in 2008 the Russian Federation took the 89th place (GDP volume of USD 1.677 billion) in the world, in 2009 according to IMF estimation it sank to the 12th position (USD 1.229 billion) and the proportion of the country in the global GDP reduced from 2.7% to 2.1%, correspondingly². The indicated direct correlation once again demonstrates the dependence of the economic growth in Russia from export volumes and primarily the export of energy commodities.

Table 4

MAIN INDICES OF FOREIGN TRADE IN RUSSIA IN 2009

According to the data of	2009, USD billion				As percentage to 2008		
	turnover	export	import	balance	turnover	export	import
Federal Customs Service of the RF	469.0	301.6	167.4	134.2	-36.2	-35.5	-37.3
Central Bank of the RF and the Federal State Statistics Service*	495.9	304.0	191.9	112.1	-35.1	-35.5	-34.2
Ministry of Economic Development of the RF*	496.0	303.3	192.7	110.6	-35.0	-35.7	-34.0

* according to the 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, in 2009 Russia's foreign trade turnover, calculated on the basis of balance-of-payments methodology, made USD 495.9 billion, which is 35.5% below the figure of 2008 (*table 4*). The positive foreign trade balance reduced by 35.1% and reached USD 112.1 billion. It should be noted that export decreased by 36.2% versus the corresponding period of 2008 and made USD 304.0 billion, and import – by 37.3%, making USD 191.9 billion³. Export and import value volumes in Russia in the previous year are practically equal to the corresponding figures of 2006.

According to the data of the Federal Customs Service of the Russian Federation the goods turnover with non-CIS countries, which account for more than 85% of Russia's foreign trade, reduced by 36.2% in 2009 to USD 400.5 billion, that with the EU countries (their proportion being 50.3%) – by

1 World Trade 2009, Prospects for 2010: Trade to expand by 9,5% in 2010 after a dismal 2009. WTO, Geneva, Press/598, 26 March 2010, pp. 9–12.

2 International Monetary Fund, World Economic Outlook Database, April 2010: Nominal GDP list of countries. Data for the year 2009.

3 Foreign Trade of the Russian Federation with goods in 2009 (according to the balance-of-payments methodology). Bank of Russia site www.cb.ru, 9April 2010

38.3% down to USD 236.1 billion. Foreign trade turnover with CIS countries reduced by 35.5% and reached USD 68.5 billion.¹

As a result of recalculation of foreign trade indices by the Central Bank of the Russian Federation in 2009 goods export exceeded the data of the Federal Customs Service by 0.8% (0.9% in 2008), which is quite an acceptable norm. However, for the goods import the discrepancy makes 14.6% (8.5% in 2008), which corresponds to the level of 2005 and testifies the trend for “grey” import expansion (shuttle trade, smuggling etc.).

Indices (conditions) of the foreign trade of the Russian Federation in 2009 as compared with the previous year were characterized by diversified trends. Whereas for the export average prices index made 66.5%, physical volumes index – 97.0%, for import such indices are equal to 99.1% and 63.3%, correspondingly.

The specified forecast of the Ministry for Economic Development of the Russian Federation prepared at the end of 2009 envisaged three variants of socio-economic development of the country up to 2012. The oil prices serve as the basis of the scenarios mentioned. Parameters of forecast variants for export and import are presented in *table 5*².

Variant 1a – conservative – envisages maintenance of low dynamics of oil prices in 2010-2012 at the level of USD 58–60 per barrel in concordance with parameters built into the budget reference points. In 2010-2012 the GDP is forecast to grow by 5.3%, which will not enable full compensation for the recession of 2009.

Variant 2 is considered to be the most plausible variant of the forecast taking into account favorable foreign economy situation. In 2010 the oil prices are expected to stabilize at the level of USD 65 per barrel and then to grow up to USD 70-71 per barrel in 2011-2012. The forecast GDP growth over three years will make 11.1%, which will allow exceeding the pre-crisis level in 2012.

Variant 2b – moderately optimistic – reflects the development of the Russian economy in the environment of maintaining high prices for oil – up to USD 69 per barrel in 2010, USD 74 per barrel in 2011 and up to USD 81 per barrel in 2012. According to these calculations in 2012 the GDP will exceed the pre-crisis level by 2.7%.

Table 3

FORECAST FOR RUSSIAN FEDERATION FOREIGN TRADE DEVELOPMENT IN 2010-2012
(AS USD BILLION)

	2009 estimation	2010	2011	2012
Export				
Variant 2	305.0	350.0	380.2	401.4
Variant 2b, moderately optimistic	305.0	363.3	396.7	441.0
Variant 1a, conservative	305.0	316.6	326.2	339.1
Import				
Variant 2	195.1	226.4	253.0	283.4
Variant 2b, moderately optimistic	195.1	231.7	262.3	302.8
Variant 1a, conservative	195.1	212.0	222.4	240.9

Source: main parameters of specified forecast for socio-economic development in 2010 and in the planning period of 2011 and 2012, the Ministry of Economic Development of the Russian Federation, December 30, 2009, p. 14

In 2010-2012 the volumes of export will increase mainly due to the expected growth of prices for oil and raw materials. As a result of the expansion of the external demand the physical volumes of foodstuffs, machinery, equipment and transport vehicles export are forecast to grow. However according to both the first and the second variants the total sum of export in 2012 will be below the pre-crisis maximum by 28% and 15%, correspondingly.

1 Russia's export-import of the most important goods in 2009, www.customs.ru, site of the Federal Customs Service of the Russian Federation, 08.02.2010

2 Specification of the main macroeconomic parameters of the forecast was made taking into the account the trends of the world economy development and foreign economic situation, as well as the results of Russian economy and foreign trade development in January-November 2009

As a result of ruble exchange rate strengthening, and faster recovery of investments and consumption (in the second variant) the forecast for the import dynamics will be raised. However, according to all the variants its share in 2012 will not exceed pre-crisis maximum of USD 292 billion. It is also expected that the change in population and enterprises' preferences towards the domestic production as well as slower recovery of the investment demand¹.

At the beginning of 2010 the country's foreign trade started to return to pre-crisis figures. According to the estimation of the Central Bank of the Russian Federation, in the first quarter of the current year trade turnover made USD 136.6 billion or 142.5% versus the corresponding period of 2009. A considerable positive balance reaching USD 45.3 billion (USD 112.1 billion over the whole 2009) was provided by the increase of export volume by 1.6 times up to USD 91.3 billion, while the import over the same period went up by 17.7% up to USD 45.3 billion². The growth of export is accounted for by the effect of low bade as well as by the increase of world prices for oil and a number of other raw materials. At the same time by the end of the year the growth of import rates may accelerate by two times, which will affect the reduction of positive balance.

Summarizing brief analysis of the Russian foreign trade in 2009 and prospects for its development, the following should be noted. At the end of the present decade the Russian economy faced long-term challenges reflecting both global trends and internal barriers for the development, which have become much more serious during the global crisis. The negative dynamics of the foreign trade with goods and services in 2009 once again demonstrates that Russia faces system problems which require serious analysis and elaboration of new strategic approaches to the development of the foreign economic sphere on the whole. ●

1 Main parameters of the specified forecast for socio-economic development in 2010 and in the planning period of 2011 and 2012, Ministry of Economic Development of the Russian Federation, December 30, 2009, p. 4

2 Central Bank of the Russian Federation www.cb.ru, 2 April 2010

REVIEW OF ECONOMIC LEGISLATION

I. Tolmacheva

In April the following changes were made to the legislation: socially oriented non-commercial organizations were defined; the rules for making immediate compensation to the veterans in connection with the 65th anniversary of Victory in the Great Patriotic War were established; the coefficient correcting the severance tax rate towards oil in March 2010 was approved.

I. Federal Laws of the Russian Federation

1. “ON MAKING CHANGES TO SOME LEGISLATIVE ACTS OF THE RUSSIAN FEDERATION CONCERNING THE ISSUES OF SUPPORT FOR SOCIALLY ORIENTED NON-COMMERCIAL ORGANIZATIONS” from 05.04.2010 No 40-FZ.

Socially oriented non-commercial organizations will be entitled for the priority state support.

In concordance with the changes introduced in the Federal Law “On non-commercial organizations” and some other legislative acts an approximate list of kinds of activities for the non-commercial organizations fulfilling them to be recognized as socially-oriented. For instance, it is social support and protection of citizens, preparation of the population for overcoming of aftermaths of natural disasters, ecological, anthropogenic and other catastrophes, prevention of accidents; assistance to the victims of natural disasters, ecological, anthropogenic and other catastrophes, social, national, religious conflicts, to refugees and internally displaced persons; protection of environment and wildlife; protection of objects and territories of historic, cultural, religious and ecological significance; rendering of legal aid free of charge or under privileged conditions for citizens and non-commercial organization, activity on protection of human rights and freedoms; charity and activity aimed at promotion of charity and voluntary work; activity in the field of education, enlightenment, culture, science, arts, health care, illnesses prevention and health protection of citizens; promotion of healthy way of life, improvement of moral and psychological state of citizens, physical education and sport and assistance to such activities, as well as assistance of spiritual development of a person belong to such kinds of activities.

Support to socially-oriented non-commercial organization can be rendered in the forms of financial, property, informational, consulting support, support in staff and volunteers training, granting privileges for taxes and fees, order placement for supplies of goods, execution of works, services rendering for state and municipal needs at socially-oriented non-commercial organizations. The privileges for taxes and fees payment can be also granted to legal entities giving material support to socially-oriented non-commercial organizations.

II. Decrees of the Government of the Russian Federation

1. “ON ESTABLISHING THE REGULATIONS FOR MAKING IMMEDIATE COMPENSATION TO SOME CATEGORIES OF RUSSIAN FEDERATION CITIZENS IN CONNECTION WITH THE 65TH ANNIVERSARY OF VICTORY IN THE GREAT PATRIOTIC WAR OF 1941–1945” from 12.04.2010 No 221.

Flat payment to veterans in connection with the 65th anniversary of victory in the Great Patriotic War will be made in April 2010.

The regulations establishing the procedure for making immediate compensations were approved. The veterans and disabled veterans of the Great Patriotic War (listed in subparagraphs 1-3 paragraph 1 article 2 Law “On veterans”), former underage prisoners of concentration camps and some other categories of veterans a flat payment of RUR 5000 was established; for veterans belonging to those listed in subparagraph 4 paragraph 1 article 2 of the Law mentioned (including persons that worked on home front, and those awarded with USSR orders and medals for selfless work during the Great Patriotic War) the flat payment of RUR 1000 is established. Payments are made by the territorial bodies of the RF Pension Funds or other bodies setting and paying corresponding pen-

sions (lifelong support) to veterans. Citizens that have a right to receive flat payment due to several reasons the payment is made so as to the rate to be maximal.

III. Orders, Letters, Instructions

1. Letter of the Federal Tax Service of the Russian Federation “ON DATA NECESSARY TO CALCULATE SEVERANCE TAX ON OIL OVER MARCH 2010” from 19.04.2010 No ShS-37-3/5@

Coefficient correcting the severance tax rate concerning oil over March 2010 was defined to be 6.9666. The value of coefficient in February 2010 was lower and made 6.6693. The increase of this coefficient is accounted for by the changes in the indices on which basis it is calculated. ●

REVIEW OF RF GOVERNMENT MEETINGS IN APRIL 2010 M. Goldin

In April at the meeting of the Presidium of the RF Government the following questions were considered: the bill “On ratification of the agreement between the Government of the Russian Federation and the Government of the Republic of Cuba on avoiding of the double taxation and prevention of evasion from incomes and capital taxes”; the bill giving Rosfinnadzor and taxation bodies the right to access banking secret.

On April 12, at the meeting of the Government of the Russian Federation the bill “On ratification of the agreement between the Government of the Russian Federation and the Government of the Republic of Cuba on avoiding of the double taxation and prevention of evasion from incomes and capital taxes” (further referred to as the Agreement) was discussed. The project was submitted by the Ministry of Foreign Affairs of the Russian Federation and the Ministry of Finance of the Russian Federation.

The bill envisages the ratification of the Agreement signed in Havana on December 14, 2000. In concordance with subparagraph a paragraph 1 article 15 of the Federal Law from July 15, 1995 No 101-FZ “On international agreements of the Russian Federation” the Agreement is subject to ratification since it contains regulations other than those envisaged by the Russian legislation. The Agreement is aimed at elimination of double taxation of taxpayers’ (legal entities and natural persons of countries participating in the Agreement) incomes and capital. The Agreement guarantees non-admission of tax discrimination, regulates the procedure for taxpayers’ appeals and applications consideration and disputes setting, as well as the issues of information exchange between the authorized bodies of negotiating countries, defines the methods to eliminate double taxation.

The Agreement is based on the typical Agreement on avoiding double taxation of incomes and property as well as typical models recommended by the Organization for Economic Cooperation and Development (OECD) and the United Nations (UN).

The Agreement also applies to incomes and capital taxation of persons having the place of residence, host, management, registration in the Russian Federation or in the Republic of Cuba.

The Agreement envisages that in case an organization that is a resident of one of the countries participating in the Agreement receives the income (profit) from entrepreneurial activity in another country participating in the agreement through the permanent representative in it, such incomes (profit) is levied with tax in the country of its permanent representative. As to construction and installation works and supervising activity connected with it, it is established that the profit received from such activity will be levied with the tax if the duration of such works exceeds 12 months. As to services, including managing and consulting services, this activity will be levied with taxes if the duration of works exceeds 6 months.

Capital in the form of movable property which is a part of the permanent representative property, which the enterprise of one state owns in another state, or in the form of movable property belonging to the permanent base managed by the resident of one state in another state for the purposes of rendering independent private services can be levied with taxes in another state.

Capital in the form of sea vessel or airplane exploited in international transportation by the enterprise of one country or in the form of movable property connected with exploitation of such sea vessels or airplanes is to be levied with taxes only in this country.

The incomes from immovable property can be levied with taxes in the country in which this property in fact is located.

The profit received by the enterprise of contracting state from the exploitation of sea vessels or aircrafts in the international transportation is to be levied with taxes only in this state.

The dividends paid by the company that is a resident of one country to the resident of another country can be levied with taxes in any of the states. If the recipient is a person that has a real right for dividends the collected tax should not exceed 15% (5% in some cases).

Royalties, evolving in one country and paid to the resident of another country, can be levied with taxes in any of the countries, however if the recipient is a person that has a real right for royalty should not exceed 5% of the total sum of royalty.

The Agreement established the classical principle of residence when taxing personal incomes. As a rule, a natural person pays taxes from his income in the country, in which he stays for more than 183 days during the corresponding 12-month period. However, for crews of transport vehicles, actors, sportsmen, state employees, pensioners, students, trainees and teachers the exceptions from this rule are made.

The Agreement comes into effect on the date of the last notification of the completion of intra-state procedures by the contracting states necessary for it to enter into force. The statements of the Agreement will be applied starting with January 1st of the year following its entry into force. The Agreement is in effect up to the moment when one of the contracting states ceases its effect, sending written notification through the diplomatic channels on its cancellation at least 6 months before the year end after five years from the date of the Agreement coming into effect elapse.

The Government of the Russian Federation has ratified the bill “On ratification of the agreement between the Government of the Russian Federation and the Government of the Republic of Cuba on avoiding of the double taxation and prevention of evasion from incomes and capital taxes” and decided to submit it to the State Duma for consideration according to the established procedure.

On April, 22 at the meeting of the RF Government the bill “On making changes to some legislative acts of the Russian Federation concerning the regulation of documents and information exchange between the bodies of currency control and currency control agents” was discussed. The bill was submitted by the Ministry of Finance of the Russian Federation.

The bill envisages making changes to Federal Laws “on banks and banking activity” and “On currency regulation and currency control”. The authors of the bill motivate the necessity of amendment adoption by the fact that in the majority cases credit organizations (authorized banks) refuse Rosfinnadzor (its regional bodies) with provision of necessary information connected with carrying out foreign currency operations, opening and managing accounts, referring to the fact that the requested information contains the data that comprise the bank secret in concordance with article 26 of the federal Law “On banks and banking activity”. According to this article Rosfinnadzor and taxation bodies are not included in the list of federal executive bodies that have a right to receive such information.

According to the existing practice magistrates dismiss cases connected with non-execution of Rosfinnadzor and taxation bodies’ rulings concerning the requests for the information from crediting organizations (authorized banks).

It should be noted that according to article 86 of the Tax Code of the Russian Federation the taxation bodies have a right to get some kinds of documents (information on clients’ accounts and operation statements) at the moment. The authors of the bill insist that such authority is not sufficient for taxation bodies despite the fact that in reality the majority of banks are willing to assist taxation bodies and submit them with the requested documents comprising bank secret. The ruling of the Presidium of the Supreme Arbitrary Court of the Russian Federation from 31.03.2009 No 16896/08 on case No A33-17492/2007 confirms the right of taxation bodies to request the information comprising bank secret within the limits necessary to implement tax control.

Nevertheless, in order to avoid collisions with the existing legislation Rosfinnadzor (its regional bodies) as a body of currency control authorized by the Government as well as taxation and customs bodies of currency control receive a right to get documents and information containing the data of bank secret from crediting organizations. At the same time the submission of the documents and information connected with foreign currency operations, accounts opening and managing, by crediting organizations is to take place only in cases, according to procedures and to necessary volumes envisaged by the Federal Law “On currency regulation and currency control”.

The bill also envisages the possibility of granting the authorized banks and state corporation “Bank of development and foreign economic activity (Vnesheconombank)” with the functions of agents of currency control for the applications of the information from RF Federal Customs Service and RF Federal Tax Service, and sets the deadlines for execution of inquiries of authorized banks from the Federal Customs Service and Federal Tax Service and defines that the information exchange between them is carried out in electronic form according to the procedures, established by the Federal Customs Service and Federal Tax Service, correspondingly. ●

REVIEW OF LEGISLATIVE DOCUMENTS CONCERNING TAXATION OVER MARCH–APRIL 2010

L.Anisimova

1. Letter from March 22, 2010 No 03-03-06/1/161 presents the position of the RF Ministry of Finance concerning the period of limitation of actions regarding unclaimed deposited wages for these sums to be written off to the organizations' profits that are to be levied with profit taxes.

According to article 195 of the RF Civil Code the notion of the period of limitation of actions is defined, which is regarded as a period for protection of the right following the legal actions by the person whose rights have been infringed. Article 196 establishes the general period of 3 years. Article 197 of the RF Civil Code states the possibility to apply special period of limitation of action, established by the Law, to some kinds of complaints. The RF Ministry of Finance regards the three-month period for an employee to appeal to the court with the demand for his wages to be paid, established by the RF Labor Code as such special period.

In the experts' opinion, three-month period mentioned in article 392 of the RF Labor Code is established for an employee's appeal to the court concerning individual employment dispute and does not belong to special periods of limitation of actions regulated by the RF Civil Code. In case the wages were deposited, there are no grounds for employment dispute, i.e. the wages accrued has already been recognized as a liability by the employer to the employee. The wages that were accrued but were not paid to the employee on time due to his (employee's) absence or refusal to receive it are recognized as deposited. Thus, only the wages not received by the employee because of his fault is regarded as deposit.

As to the definition of the period of limitation of actions concerning unclaimed deposited wages, the opinions of the RF Ministry of Finance and experts coincide at the moment – in this case the general period of limitation of actions is in effect, which was established by the RF Civil Code. This period expires in exactly three years after the wages were accrued, and the sums of unclaimed deposits are written off to organizations' profits on the last day of the accounting period in which the period of limitation of action expires.

Some ambiguity in the position of the RF Ministry of Finance remains in case the employer refuses to pay the wages deposited earlier. In the experts' opinion in this case article 392 of the RF Labor Code is applied only to define the period of employee's appeal to the court. The court can adopt the decision for the benefit of the employee in case the period of the limitation of actions established by the RF Civil Code – 3 years – had not expired before the appeal to the court (the legislation does not regulate the period in which the employee has to turn to the employer with the claim to pay the wages that is why the suit can evolve at any time within three years from the moment of wages accrual).

The position of the RF Ministry of Finance on this situation has not been commented on.

2. Letters of the RF Ministry of Finance from April 2, 2010 No 03-03-06/1/220, from April 8, 2010 No 03-03-06/1/244, from March 22, 2010 No 03-03-06/1/158, from April 02, 2010 No 03-03-06/1/217 distinctly reveal technical complications that the organizations face at the moment which are due to replacement of the single social tax with a number of insurance contributions.

One of the problems can be characterized as a discrepancy between the bases for calculation of insurance contributions to the state social funds and expenses for labor remuneration taken into account when defining profit tax base and payments for civil legal contracts with natural persons. The emerging discrepancy results in problems with profit taxation because of accounting insurance contributions to the state social funds that were accrued and paid from the sums not recognized as expenses by the RF Tax Code.

Due to the changes in the RF Tax Code and invalidation of chapter 24 “Single Social Tax”, the basis for insurance contributions calculations to state off-budget funds now does not correspond to expenditures for labor remuneration taken into account when calculating profit tax base. For instance, the RF Ministry of Finance draws attention to the fact that starting with 2010 the insurance contributions are paid from payments and other remunerations for the benefit of employees regardless whether such payments are accounted when decreasing the taxable profit.

Article 270 of the RF Tax Code does not contain statements which prohibit accounting insurance contributions not recognized as expenses in chapter 25 of the Tax Code, and so, in the opinion of the RF Ministry of Finance, starting with January 1, 2010 the expenses in the form of insurance contributions to the RF Pension Fund, RF Social Insurance Fund, RF Compulsory Health Care Fund can be accounted among other expenses on the basis of subparagraph 49 paragraph 1 article 264 of the RF Tax Code. However the legality of such position of the RF Ministry of Finance that recognized accruals for the expenses as decreasing taxation base, though these expenses themselves do not decrease it according to the Tax Code of the Russian Federation, requires further legal expertise from our point of view. The position of the RF Ministry of Finance is focused on the potential decrease of incomes, which can result in regional budgets requiring compensation for evolving losses at the expense of the federal budget.

3. According to the Letter of the RF Ministry of Finance from March 24, 2010 No 03-03-06/4/32 it is clarified that in concordance with the Basis of the Russian Federation Legislation on culture from 09.10.1992 No 3612-1 the right of the cultural organization to receive gratuitous donations (contributions, subsidies) from Russian and foreign legal entities and natural person is not restricted by some limitations.

Since the donations in concordance with the RF Tax Code are recognized as special-purpose receipts the contributions received by the Russian cultural organizations upon meeting of the conditions listed in paragraph 2 article 251 of the RF Tax Code are regarded as directed receipts and are not subject to taxation with profit tax.

4. According to the Letter of the RF Ministry of Finance from March 25, 2010 No 03-03-06/1/173 the issue on the procedure for tax accounting of expenses for modernization of fixed assets of less than RUR 20 thousand for the purposes of profit taxation is clarified, and according to the Letter of the RF Ministry of Finance from March 29, 2010 No 03-03-06/1/202 the procedure for write-off of expenses for modernization of fixed assets the initial cost of which was more than RUR 20 thousand.

1) In concordance with subparagraph 3 paragraph article 254 of the RF Tax Code the expenses on the purchase of fixed assets of less than RUR 20 000 initial value are included in the list of material expenses to the full extent with the start of its exploitation.

The expenses for completion, provision with additional equipment, technical renovation should increase the cost of fixed assets. In this connection the expenses for modernization of fixed assets of initial value less than RUR 20 thousand, which cost was written off for the purposes of taxation at a time in the list of material expenses, are to be included in the current expenses of taxation (accounting) period in the list of other expenses connected with production and sale.

2) For the fixed assets of initial value of more than RUR 20 thousand, the taxpayer (according to paragraph 1 article 258 of the RF Tax Code), has a right to prolong the period of its useful exploitation after the date of exploitation start in case such an object was reconstructed, modernize or technically reequipped. If the period of exploitation of fixed assets was not prolonged, as the RF Ministry of Finance explained, the calculation of object’s amortization should be continued using the previous mechanism of amortization calculation up to the total repayment of the changed initial value.

5. According to the Letter of the RF Ministry of Finance from March 25, 2010 No 03-03-06/1/174 with the reference to paragraph 3 article 256 of the RF Tax Code the question on the exclusion of the property transferred (received) for gratuitous use. For instance, the property transferred for permanent use without counter obligations belong to such property.

6. Letter of the RF Ministry of Finance from April 1, 2010 No 03-03-06/1/204 supports with the references to the RF Tax Code the conclusion on the fact that when forming the profit tax base using the method of accruals the interests for all kinds of loans are regarded as a part of outstanding expenses made evenly throughout the whole period of the loan (regardless the date of real payment of interests) by the end of each month of the use of borrowed monetary funds.

7. According to the Letter of the RF Ministry of Finance from April 1, 2010 No 03-03-06/1/205 the issue on the necessity for VAT recovery for the residue of the material valuables and for the residual value of the fixed assets when the organization transfers from the general regime of taxation to the simplified taxation system is clarified. In concordance with subparagraph 2 paragraph 3 article 170 of the RF Tax Code VAT sums that earlier (under general regime) were adopted for deduction for goods, including fixed assets, are to be recovered in case they are later used for operations not levied with VAT.

According to paragraph 2 article 346.11 chapter 26.2 “Simplified Taxation System” of the RF Tax Code organizations applying simplified taxation system do not pay VAT, and, consequently, the operations they carry out are not levied with VAT. That is why earlier (before the transfer to the simplified taxation system) the VAT sums adopted for deduction for material stocks not written off to production by the date of transfer are to be recovered when transferring to the simplified taxation system and paid to the budget. The calculation of VAT sum that is to be recovered for the amortized property is made taken into account the residual value of this property formed on the basis of accounting data. At the same time on the basis of the RF Tax Code the recovered VAT sum is to be taken into account in the organization’s other expenses connected with production and sale when defining profit tax base of the organization for the preceding taxation period.

8. According to the Letter of the RF Ministry of Finance from April 2, 2010 No 03-03-06/1/224 it is clarified that in chapter 25 (“Organizations’ profit tax”) of the RF Tax Code the mechanism for the definition of the material gain upon receipt of the interest-free loan is absent. It should be added that this question requires additional examination since it can be regarded as a channel for evasion from taxes in foreign economic deals, since in fact the tax-free transfer of the right for income from one person to another takes place. During operations between residents of the Russian Federation no losses for the budget arise.

9. According to the federal law of the Russian Federation from April 5, 2010 No 41-FZ the RF Tax Code is supplemented with a number of changes and additions.

For instance, the text of a number of chapters of the RF Tax Code now includes in the incomes the sums received for assistance of self-employment of the unemployed citizens and stimulation of the creation of additional workplaces for the unemployed citizens by the unemployed that have set up their own business at the expense of budgets of the Russian Federation in concordance with programs approved by the corresponding government bodies. These sums are taken into account in the list of incomes for three taxation periods with the simultaneous reflection of the corresponding sums in the expenses list. It should be noted that the expenses of no more than the sums of really made expenses in each taxation period are accepted for deduction. There being no violations, not tax liabilities will arise, in case the conditions of the sums receipt are not met, the taxation base in the form of difference between the sums reflected in incomes and sums recognized as expenses arises by the recipient.

The tax privilege concerning interests for state securities was spread to the securities of the countries that participate in Union State.

Changes were made to the rate and scheme of the state duties, for instance the list of state duties connected with the state registration of medicines was sufficiently broadened. ●

CHANGES IN REGULATORY BASIS FOR BUDGET PROCESS

M. Goldin

In April 2010 the following events took place in the regulatory base of budget process: "Procedure for distribution and granting of subsidies to the budgets of subjects of the Russian Federation to provide support for the measures of budget balance of the subjects of the Russian Federation in 2010" was approved; according to the Decree of the RF Government "On the state support for the development of innovation infrastructure in the federal educational institutions of higher professional education" the decision to allocate RUR 3 billion in 2010 for the support of the innovative infrastructure development in higher educational institutions was adopted.

According to the Decree of the RF Government from 13.04.2010 No 231 the "Procedure for distribution and granting of subsidies to the budgets of subjects of the Russian Federation to provide support for the measures of budget balance of the subjects of the Russian Federation in 2010" was approved.

It was established that subsidies to the budgets of RF subjects to support the measures on their balancing are given in case the own incomes of RF subjects consolidated budgets are insufficient to provide for the execution of expenditure liabilities. At the same time the distribution of subsidies for the purposes mentioned will be made in concordance with the guidelines that are to be approved by the Governmental decree.

Besides, in 2010 the subsidies will be given on the basis of separate commissions of the President and the Chairman of the RF Government. The granting of such subsidies to the budgets of RF subjects will be made according to the agreement signed by the federal executive body and the RF Ministry of Finance.

It should be remembered that according to the Federal Law from 02.12.2009 No 308-FZ "On the federal budget for 2010 and for the planning period of 2011 and 2012" RUR 89 963 160.7 thousand was allocated for interbudget transfers to support the measures of budgets balancing.

According to the Decree of the RF Government from 09.04.2010 No 219 "On the state support for the development of innovation infrastructure in the federal educational institutions of higher professional education" the decision to allocate RUR 3 billion in 2010 for the support of the innovative infrastructure development in higher educational institutions was adopted. In 2011 and 2012 it is planned to allocate RUR 2 billion and RUR 3 billion for the same purposes.

The RF Government Decree was adopted on the basis of part 5 article 24 of the Federal Law from 02.12.2009 No 308-FZ "On the federal budget for 2010 and for the planning period of 2011 and 2012", according to which the RF Government receives the right to make decisions on allocation of federal budget funds at the rate of up to RUR 195 billion in 2010 for the different purposes of socio-economic development.

The state support of the development of the innovative infrastructure rendered in concordance with the Decree of the RF Government from 09.04.2010 No 219 is carried out for the purposes of creating the innovative environment and the development of the interaction between the educational institutions and industrial enterprises.

Budget allotments for the state support of innovative infrastructure development in educational institutions are allocated to finance the following kinds of expenditures:

a) the development of the innovative infrastructure objects in educational institutions (business incubators, technological parks, technological parks zones, innovative and technological centers, engineering centers, certification centers, technology transfer centers, centers of common use, centers of scientific and technological information, centers for innovative consulting and other objects of innovative infrastructure) and their modern equipment, including technical exploitation, and computer software necessary to implement the results of scientific and technological and intellectual activity, exclusive rights for which belong to educational institutions;

b) the legal protection of the results of the intellectual activity of educational institution and estimation of the intellectual activity results, exclusive rights for which belong to educational institutions;

c) the fulfillment and development of target programs for training and improvement of qualification of the staff in the field of small-scale innovative business, including those for students, postgraduate students and young scientists, as well as the development of methodological and scientific basis for the subjects of small- and medium-scale entrepreneurship;

d) training and professional development of the staff in the educational institutions in the sphere of innovative entrepreneurship and technology transfer in foreign universities that have effective innovation infrastructure;

e) consulting services of foreign and Russian experts in the field of technology transfer, creation and development of small innovative companies, including attraction of professors and tutors to scientific and methodological as well as practical provision for creation of such companies.

Budget allotments will be provided on the basis of contest among the programs for innovative infrastructure development, including support of small innovative entrepreneurship. It is the educational institutions executing fundamental and applied research in the priority fields of science, technology and engineering development in the Russian Federation that can participate in the contest.

The selection is made on the basis of analysis of scientific, educational and innovative potential of educational institutions over the past 3 years and the submitted programs for their development. ●