



## RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES 04'2011

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## RUSSIAN ECONOMY IN APRIL 2011: TENTATIVE DATA AND MAIN TRENDS

### **Socio-Political Climate: Exterior and Interior**

*President D. Medvedev and Chairman of the Government of Russia V. Putin continue to keep silence about who is going to run for president in the upcoming presidential elections in Russia. The key feature of the intrigue is uncertainty in public sphere whereas the decision is likely to be made in public, as both of them previously stated. Escalation of the intrigue at the current stage gives rise to a dispute between groups of supporters of the two potential candidates, thus arising sensation of competition.*

*The report made by Chairman of the Government of Russia V. Putin at the State Duma showed that his team has no new ideas about the Russian economy. Neither do they offer any new “growth model” which was the subject of discussion among experts and economists after the crisis in 2008–2009. Furthermore, V. Putin’s statement that Russia needs a decade of undisturbed development can be regarded as a manifest of forthcoming stagnation as inertia scenario for the economic policy amidst ultrahigh oil prices. Moreover, “modernization” which remains the logo of the incumbent president’s team, has not yet been converted into a realistic and consistent program of action.*

*Amidst decreased inflation in March – April 2011, deteriorated socio-political climate, as described at our previous review, began to stabilize. This was another evidence of the key importance of inflation for social well-being and political stability. This is why it is important to focus on what Putin said at the State Duma about the need to lower the inflation rate, which is very likely to become a priority trend for the Russian Government, even at the expense of economic growth.*

*In the meantime, the benzene crisis at the last week in April 2011 showed limited capacity of the administrative-oligarchic model of economic management. Let’s recall that the Russian Government made efforts to compensate for the lack of government measures on demonopolization of the domestic market by delivering administrative pressure on suppliers to make them limit benzene prices, which eventually resulted in shortage of fuel in many regions and subsequent fast growth in prices.*

*The President’s initiative to replace government representatives in the **boards** of state-owned joint-stock companies looks very ambiguous. One should be wary of the initiative, because of immaturity of the institution of independent directors, lack of economic and financial transparency of such companies, monopolistic position of most of the companies in the market. This measure is insufficient in the absence of a holistic and well-defined government strategy with regard to the national economy. Under the circumstances, replacement of government representatives with “independent directors” would make the federal government less responsible for the performance of the said companies and decisions made by their board. The most disturbing fact is that the initiative is being implemented against announced plans of privatization of a large state-held interest in such companies.*

*The conflict around Bank of Moscow entered its final phase in April 2011. Bank of Moscow was taken over by VTB, a state-owned bank, alongside the flavor of notorious traditions of “enforced entrepreneurship” – a criminal proceeding was initiated and the person involved in the proceeding ran away to London. Furthermore, it is political motives, not economic expediency, that were behind the take-over, because Bank of Moscow is considered a resource of the elite group which is disloyal to the incumbent Government. This fact explains why VTB has transferred no money to the Moscow government to date. According to Vice-Mayor of Moscow A. Sharonov, the money will be credited to the Moscow budget “within a year”, which also proves non-market nature of the transaction.*

### **Macroeconomics and Finances: Oil Curse Paradoxes**

*Macroeconomic climate in April 2011 was governed by steady growth in oil prices. The price of Brent oil overcame a physiologically relevant level of USD 120 per barrel on April 4, 2011 and maintained above this level. Steady growth in oil prices has a significant effect on macroeconomic*

situation in Russia – inflow of petrodollars strengthened the national currency from 28,52 RUB/USD on April 1 to 27,50 RUB/USD on April 29, 2011, i.e. RUB gained 3.6% against USD whereas only 1.04% against EUR (from 40,39 RUB/EUR on April 1 to 40,81 RUB/EUR on April 29, 2011). RUB strengthened in spite of significant efforts by the Bank of Russia to prevent growth of the national currency. According to Deputy Chairman of the Central Bank of Russia A. Ulyukayev, the Bank of Russia purchased more than USD 20 bln since February 4, 2001, which resulted in considerable growth in the international reserves which totaled USD 517,9 bln as of April 22, 2011. The current growth in the international reserves began at the beginning of the year: a growth of 8.5% since January 14, 2011 (including a 2.75% growth in the period between March 25 and April 22, 2011) to account, as of April 22, 2011, for 87% of the pre-recession upper peak.

According to the estimates by Rosstat, the consumer price index accounted for 100.4% in the period between April 1 and 25, 2011, by 104.2% since the beginning of the year (against 2010, when prices increased by 0.3% between April 1 and 25 and by 103.5% since the beginning of the year). Inflation slowed down due to the end of the period of growth in monopolies' tariffs, exhaustion of a global food inflation wave, the efforts made the federal government to stabilize prices in the grain market, and, maybe, strengthening of the national currency which improves profitability of imports. In spite of the slow-down, inflation still accounts for 9.6% on an annual basis, which gives rise to stringency in the consumer market and reduces the real personal disposable income and saving incentives. The monetary authorities are seriously concerned about this problem, which is proved by the Bank of Russia's decision to increase the refinancing rate up to 8.25% since May 1, 2011. The Central Bank of Russia left unchanged only rates on lombard loans and fixed rate REPO, as well as mandatory provision requirements.

Strengthening of the national currency creates conditions for changes in the dynamics of capital inflow/outflow. According to the preliminary estimates of the Bank of Russia, capital outflow totaled USD 2 bln in March 2011 and USD 21,3 bln at the end of Q1 2011. It should be noted that the top management of the Bank of Russia expected capital inflow at the end of Q1 2011, and as early as mid-March Deputy Chairman of the Bank of Russia Aleksei Ulyukayev forecasted no capital outflow at the month-end. Though every time such forecasts were found to be too optimistic, dramatic slow-down of capital outflow in March 2011 made it maximum possible for the trend to change in April 2011. However, the Bank of Russia previously estimated a total of USD 17 bln capital outflow in January – February; therefore, a value in March may be found to be higher in the future. In any way, it is already obvious that no decrease in capital outflow was reported in Q1 2011 – against Q4 2010 (USD 21,5 bln), contrary to all expectations and in spite of steady growth in oil prices and strengthening of the national currency.

High oil prices and strengthening of the national currency create conditions for considerable, positive trade balance regardless of faster growth in imports. According to preliminary customs statistical data, imports from non-CIS countries amounted to 147.6% in March 2011 against March 2010, hence imports growth rates continued to develop (a growth of 43.4% for non-CIS countries in February, 45.4% in January); outrunning growth in import of machine-building products resulted in further enlargement of its share in the structure of imports (from 44.8% in February to 46.4% in March 2011).

Dynamics of the Russian stock markets was nontrivial against steady growth in oil prices in April 2011. After a growth within the first week of the month, stock market indices began to slump to lower peaks on April 18, 2011 (a decline of nearly 8%) and then returned back to values close to those which were reported at the beginning of the month: the MICEX index showed 1.742 points on April 29, 2011 against 1.788 points on March 29, 2011, the RTS index showed 2,026 points against 2,019 points on March 29, 2011. It should be noted that mismatch between dynamics of oil prices and the Russian stock market indices is very typical of a new upsurge in oil prices, which may testify to the fact that markets view this growth as opportunistic and unstable.

### **Real Sector: Slow-Down Before Reaching a Peak**

The following trends should be considered most important in the real sector: steady decrease in capital investments and real personal income due to the inflation wave late in 2010 – at the beginning of 2011. Capital investments in Q1 2011 accounted for 98.5% y-o-y and 79.7% of the pre-

*recession maximum which was reported in Q1 2008. Real personal disposable income decreased in Q1 by 2.9% y-o-y.*

*According to the preliminary estimates of the Ministry of Economic Development and Trade of Russia, in Q1 2011 GDP increased by 4.5% y-o-y, but was by 2.1% less than the value reported in Q1 2008. The industrial production index accounted for 105.9% in Q1 2011 against Q1 2010 and 98.0% against Q1 2008. Economic recovery rates were slower early in 2011 against Q1 2010. In the period between February and March, a series of industries showed further slow-down in growth rates ( such as chemical, textile and garment industries as well as food industry ) which were found to be negative in the woodworking industry and electrical equipment manufacturing. The growth became even slower as it reached pre-recession values, and neither investments, nor the demand supported the growth.*

*Market surveys at companies also showed that sales stopped to grow in March 2011. Demand growth rates slowed down throughout the entire period in Q1 2011, the balance lost 9 points and turned from positive into zero over the period. Negative dynamics of sales had an effect on demand forecasts: following the most optimistic expectations over the post-recession period, which were registered in December 2010, by the end of Q1 2011 the balance of forecasts lost 7 points to reach the minimum over the recent eight months. In March 2011, only 58% of companies reported similar changes in sales and output (65% in January, 62% in February), and output exceeded the demand at 35% of companies (at 14% of companies in January 2011, at 28% of the companies in February 2011 ). The Russian industry have seen no lower values of the former and higher values of the latter Over the three recent years ( since April 2008 ). Perhaps, in the short-term companies would have to decrease their output due to the expected demand. However, stagnation in the demand leads to lower prices in the manufacturing industry: by March 2011 actual growth rate in prices decreased by 2 times from 47 to 23 points after the rise in January 2011. ●*



## THE POLITICAL AND ECONOMIC RESULTS OF APRIL 2011

S.Zhavoronkov

*In April 2011, President D. Medvedev of Russia has somewhat escalated the situation in the country having declared that the decision on his participation (or non-participation) in the 2012 presidential elections he may take “in the short-term prospect”. However, the President did not take any serious actions as regards the personnel and legislation in order to win over the state apparatus to his side, nor did he receive support of the key figures of the Russian elite, while G. Pavlovsky, a political technologist who publicly supported President D. Medvedev was dismissed from the Administration of President D. Medvedev by his formal chief S. Naryshkin. It seems that Premier V. Putin is going to make his decision public at the end of the year on the eve of the elections, while now he has called on the ruling party and the elite “to stop worrying” and “do their work”. President D. Medvedev obligated the government to find resources in order to reduce citizens’ social insurance payments; a principal decision on an increase of such payments came into effect this year. However, the government is not much in a hurry to fulfill that decision. In April, a large scandal around the partially state-run Bank of Moscow whose top management (which used to extend loans to itself) was put on a wanted list had a continuation. At the same time, it has become known that the money paid for the purchase of that bank by the VTB, another state-run bank has not been received by the Moscow budget so far; the above fact is another evidence of the extent to which a large state-run asset is inefficient in Russia.*

In April, rhetorical exercises as regards probable nomination of the candidature of a new President of Russia continued and even cost some officials (not high-ranking ones) their jobs as they were too active in their speculations on that subject. The events unfolded as follows: on April 7 in his interview to a Chinese TV channel on the eve of his visit to China President D. Medvedev made a number of major declarations which were commented on by Premier V. Putin on the next day. Those comments were later elaborated on by Premier V. Putin in his lengthy report to the State Duma and alternated with few and far between remarks by activists of the United Russia whom Premier V. Putin individually asked later to stop worrying: “As regards the presidential election campaign, I would like to ask you not to speak about it, nor heat up about it. It will take place next year. Everybody should work at their places. As regards the election campaign to the Duma, it has actually begun”.

President D. Medvedev said nothing new as compared to his previous statements, except for one thing – a promise to take a decision in the near future: “I do not exclude the prospect of running for the next Presidential term. The decision will be taken in the short-term prospect because as you said it correctly there is less than a year left” (for instance, in his address to the Davos Economic Forum in January which address was left practically unnoticed President Dmitri Medvedev promised to “see how things are developing ...and take the decision this year” – such remarks can be regarded as a renunciation of ambitions considering the fact that under the effective law a nomination of presidential candidates is to take place this year). President D. Medvedev’s other remarks do not differ much from those he made in the past three years: «...Before taking such a decision, one has to consider one’s chances and avoid acting mechanically, but act with full comprehension of the situation. I expect such a comprehension to be formed in the near future and I will tell about it... My line is the modernization of the economy and modernization of the political life ... We should not give up all the good things we have done in the past twenty years and, particularly, in the past ten years, but we should look forward ... However, we should change the legislation when it is necessary and we should create straightforward and up-to-date forms of implementation of the democracy in this country... We should be open to criticism which is voiced ... One cannot fence it off and say: well, we know it pretty well and will sort it out ourselves. Otherwise, backwardness, unwillingness to reform, standstill, stagnation and a breakup of the foundations of the state will eventually follow”.

On the next day, in a brief interview Premier V. Putin confirmed as usual that he did not exclude his participation in the presidential elections. In less than a week, he delivered a more lengthy speech. A part of his address had little to do with the reality, but was purely a kind of an election campaign. In particular, it was promised that Russia would become the world's 5<sup>th</sup> largest economy as regards the absolute size of the GDP and by the year 2020 the labor efficiency would increase *“at least 100%, while in the key sectors of the Russian economy, by 150%-200%”*, and the level of the birth rate would grow by one-third by the year 2015. Conceptual and political subtleties of Premier V. Putin's speech boiled down to a few points: first, Vladimir Putin complained as usual that foreigners were willing to meddle with Russia's affairs, second, he remembered P. Stolypin's words about twenty years without wars and revolutions and third, he gave his definition of modernization: *«...Modernization, in other words, is a progressive and quality development. In our view, it is primarily investment in human beings, their abilities and talents and creation of relevant conditions for self-realization and initiative and better quality of life. I am confident it is the basis that will ensure high growth rates and a real technological breakthrough. The country needs a decade of sustained and peaceful development without swings from one way to the other and reckless experiments based sometimes on unjustified liberalism or social demagoguery»*.

Thus, as usual, neither President Dmitri Medvedev, nor Premier Vladimir Putin has promised anything specific in the institutional sphere and the difference between their statements consists in the fact that the former speaks about some changes in a good-natured manner, while the latter, in a more cautious way. If President Dmitri Medvedev is actually going to declare about his participation in the elections and not to support the lukewarm intrigue as he has been doing for the past three years the sheer declaration is not worth much without readiness to use constitutional powers to replace the disloyal part of the state apparatus. Without doing that, candidate Dmitri Medvedev will be neither nominated by anybody to the next presidential term, nor will he keep his office: the constitutional majority in the Parliament and the Supreme Court of the Russian Federation is sufficient enough to execute legislatively his resignation.

In this connection, it is quite interesting that in April renowned political technologist and TV propagandist G. Pavlovsky who held the office of the advisor to the Presidential Chief of Staff for more than a decade (now the Presidential Chief of Staff is S. Naryshkin, while before that it was Dmitri Medvedev) was removed from that office after he had made a statement that *“...If nothing extraordinary happens to the country Medvedev will run for the second term, while Putin supports him ... It is a baseline scenario”*. After his dismissal G. Pavlovsky said that *“he is a supporter of the President's team and now it is more difficult to be such”* which statement is another evidence of the existing informal Putin-oriented mode of running business – the Presidential Chief of Staff who, one would think, by virtue of his position should uphold the interests of President D. Medvedev dismisses G. Pavlovsky for his statement in support of President D. Medvedev.

In April, at the Congress of the Just Russia party – one of the four parliamentary parties – S. Mironov, Head of the Council of the Federation gave up unexpectedly the office of the Chairman of the Party which he had held since 2006 and took the office of the Head of the Council of the Chamber of Deputies of the Party. N. Levichev, a close associate of S. Mironov was elected the party chairman, and S. Mironov confirmed that he would head the party list at the parliamentary elections. The success of the Just Russia party which has had no anti-rating, including the recent regional elections, has long been an irritation to the United Russia party, while the status of S. Mironov who formally is the third important person in the state has permitted him to do fundraising without any problems. However, S. Mironov's old acquaintance with Premier Vladimir Putin has prevented the United Russia party which has a formal majority in the Council of the Federation to remove him from office. It seems S. Mironov has found an exquisite way out of that situation: having sacrificed an insignificant position<sup>1</sup>, he has preserved the key offices, both a public one and a party one (the status of the head of the party list).

In April, President Dmitri Medvedev made a few important (but not decisive) initiatives. Firstly, he declared that he had ordered both removal of all the profile ministers and vice-premiers from the boards of directors of state-run companies which operated in the competitive environment and replacement of them by independent directors. It means, in particular, that I. Sechin has to leave

1 V. Putin is not officially a member of the United Russia party.

the office of the Head of the Board of Directors of Rosneft, while A. Kudrin, the VTB and S. Shmatko, Transneft and etc. Also, other ministers, deputy ministers and heads of departments of ministries will have to give up their offices in the boards of directors. A number of analysts have assessed that situation as a reduction of influence by the above ministers on state-run companies.

However, it is difficult to agree with the above. A minister – the head of the board of directors – who does not receive a pay for it, nor is often present at the meetings of the board of directors, in most cases, acts as a mute unless he has got special instructions to “look after” the company. But one does not necessarily need the status of the head of the board of directors to look after the company if he is instructed to do that by Premier Vladimir Putin. For instance, nobody has ever believed that V. Zubkov, First Vice-Premier and the present formal Head of the Board of Directors of Gazprom has influence on the company’s policy unlike members of Gazprom’s Board and managers of the company’s numerous subsidiaries who are authorized to manage the company’s financial resources.

However, President D. Medvedev’s another order to the government to reduce again from the year 2012 insurance contributions to the level close to 26% and submit proposals to that effect to the President of the Russian Federation by June 1 is more important. It means that with the baseline parameters of the expenditure preserved (there can be no talk about a reduction thereof in the election year) the lost income needs to be compensated for. As an option, A. Dvorkovich, Presidential Aide proposed that the severance tax and the excises on tobacco and alcohol be increased as well as the threshold of taxable wages and salaries (Alexei Kudrin, Minister of Finance of the Russian Federation specified as an option the parameters of the expansion of the threshold of taxable wages and salaries from the existing RUR 463,000 a year to RUR 1.5 million to 2 million with a return of regression for wages and salaries which exceed the above level). Also, he proposed privatization and reduction of costs on the government procurement, however those two issues are highly political ones and cannot be regarded seriously as reserve options).

President D. Medvedev’s decision has actually canceled Premier V. Putin’s decision of 2008–2009 on raising of the rates of the social tax which is particularly unpleasant to the middle class and workers of the innovation sector where the wages and salaries account for a larger portion of the expenditures. It was declared then that the decision on raising of the rates of the social tax was taken in the interests of the pensioners, the health-care and the police. Incidentally, the above declarations, at least, in respect to pensioners and the police corresponded to the reality (their pensions and pay have been raised repeatedly of late in advance of the inflation rate and it was evidently done not without respect to the elections where a majority of pensioners vote and the police ensures implementation of the results of their voting into life). In this situation, President D. Medvedev’s seemingly innocent idea appears as a kind of a “trip”, however, in the short-term prospect the government may overcome any difficulties, for instance, simply by way of borrowing. Not surprisingly, Premier V. Putin commented on those initiatives in a reserved and negative manner. «...*The funds from the increase of contributions have already been allocated to social and defense programs ... We cannot lift that burden from the business and shift it to ordinary people. A direct, non-recurrent sharp raising of the excises on alcohol and tobacco will result in soaring growth in prices on those products. ... Please do not formulate simple and linear proposals*». It seems Premier V. Putin’s strategy will consist simply in delaying a solution until the current budget is executed, however, in the autumn the certainty around the election may save him the need to comply with those formalities.

Continued in April was a large-scale corporate conflict around the Bank of Moscow, whose founders were initially structures of the government of Moscow which retained 46% of the Bank’s interest which (with S. Sobyenin, new Mayor of Moscow already in office) was sold to VTB Bank whose controlling interest is owned by the state. It was believed that such structures related to A. Borodin, President of the Bank and protégé of Y. Luzhkov as controlled at least one-third of the Bank’s equities would sell them one way or another to the VTB Bank. However, the VTB Bank refused to buy them at the price paid for the main package of equities and got law-enforcement agencies involved in that business. The latter made an inquiry into various deals made by the Bank’s top management, particularly, RUR 13 billion worth of loans extended to Y. Baturina, wife of Y. Luzhkov. Shortly after, a criminal case was initiated and a little later both A. Borodin and

his partner D. Akulinin were put on a wanted list (by that time they had already moved to Britain). A portion of their interest (19%) was eventually bought by V. Yusufov, son of I. Yusufov, former Minister and Special Representative of the President. Interestingly, the loan for the purchase of the above interest against a highly doubtful collateral<sup>1</sup> was granted him by A. Borodin himself when he was the President of the Bank of Moscow. Late in April, M. Kuzovlev, VTB candidate was elected almost unanimously as the Bank's new President at the extraordinary meeting of the Bank's shareholders. However, the issue of how many assets had been withdrawn from the partially state-run Bank by its former top management remains as much open as that of the revealed surprising lending potential of state-run banks to grant loans to their chief executives and relatives of their founders. In connection with the story around the Bank of Moscow which became public due to a change of its top managers a question arises: what is the point of transferring one quasi public asset to another one? However, the answer to that question is given in the information of A. Sharonov, Vice-Mayor of Moscow which says that the funds from the sale of the Bank of Moscow in the amount of RUR 103 billion which the VTB Bank was to pay will be received by the Moscow budget "within a year".

In April, it became known about criminalization of another old conflict. The Tverskoi Court of Moscow made a ruling on an arrest in absentia of Y. Kachmazov, main owner and Chairman of the Board of Directors of the SOK group of Privolzhie and his partners who were accused of intentional bankruptcy of the IzhAvto plant (the scheme consisted in the sale of the controlling interest of the bankrupt plant to the plant itself in return for RUR 5 billion worth of cars; as a result the plant's debts to the budget and the Savings Bank of Russia became unsecured). At the same time, the above court decision should be viewed in the context of the general struggle around the automotive industry of Privolzhie for which the delivery of parts is controlled to a great extent by the SOK Group. ●

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<sup>1</sup> The Nordic Yards, the German shipyards were bought less than a year ago for USD 290 million. It is to be noted that the above shipyards were in the state of bankruptcy, while the value of the interest of the Bank of Moscow is estimated at, at least, USD1 billion.



## THE INFLATION RATE AND MONETARY POLICY

N.Luksha

*In March, the consumer price index (CPI) amounted to 0.6% (against 0.8% in February 2011). In 18 days of April, prices rose by 0.3% to amount to the value of the same index last year. So, from the beginning of the year till April 18 the growth rates of consumer prices amounted to 4.1%. Despite some slowing down of the growth in prices, it is believed that attainment of the government forecast as regards the CPI of 7% this year is unrealistic. In March, the outflow of capital from Russia continued: in the 1st quarter of this year the capital outflow amounted to USD 21.3 billion which is 50% higher than that in the 1<sup>st</sup> quarter of 2010.*

In March, the inflation rate kept slowing down; the consumer price index fell from 0.8% to 0.6% amounting to the value of the similar index of last year (see *Fig. 1*). A drop in the inflation growth rates contributed to slowing down of the growth in prices on paid services and food products.

In March, prices on paid services to households were growing at a slower rate than in February (0.3% as against 0.8%). The above fact can be explained by a fivefold reduction of growth rates of prices on public and housing utilities (0.2%). At the same time, with sightseeing trips to Europe becoming more expensive due to worsening of the situation at popular resorts of Tunisia and Egypt the prices on tourist trips abroad in general have gone up (+0.1%).

In March, growth rates of consumer prices decreased by 0.3 percentage points as compared to those in February. Sugar became cheaper by 2.2%. The growth rates of prices on fruit and vegetable products and sunflower oil decreased by nearly 50%, that is, +1.4% and 0.6%, respectively. At the same time, after a considerable drop in prices in February (−4.1%) prices on eggs sharply rose in March (+4.1%).

In March, the growth rates of prices on non-food products increased globally not very much (0.5% against 0.3% in February). In March, the growth rates of prices on tobacco products were still the highest (+2.8%). With growth in demand in the in-between-season garment and footwear, prices on clothes and footwear increased by nearly 100%, that is, +0.9% and +0.5, respectively. At the same time, prices on petroleum kept falling (−0.8%).

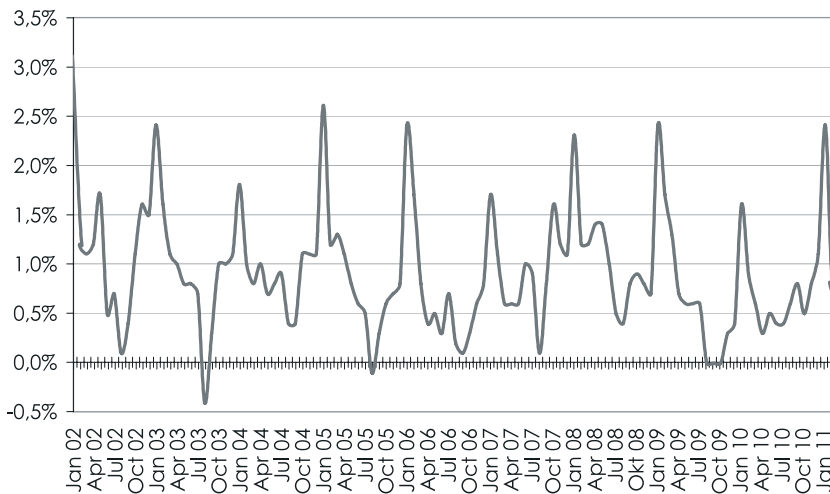
In March 2011, the reference consumer price index<sup>1</sup> amounted to 0.7%, while in a similar period last year, to 0.5%.

As in the same period last year, in eighteen days of April the consumer price index amounted to 0.3%. Also, prices on a number of food products (sunflower oil, chickens, milk, flour, sugar and potatoes) went down, as well as those on some paid services. In April, growth in prices on millet and, particularly, eggs before the Easter holiday made the largest contribution to the growth in prices. However, since the beginning of the year the inflation rate has amounted to 4.1% which is 0.7% higher than that in 2010.

In May, by all appearances, the trend towards slowing down of the inflation rate will prevail. Due to both the ban on export of grain and two-month long grain interventions, the prices on grain have stabilized. As a result, in the beginning of April the Ministry of Agriculture declared that grain interventions would be stopped. In addition to the above, a seasonal drop in prices on milk and eggs is expected. With a reduction of import duties on raw sugar from May 1, 2011, sugar prices are expected to go down. Also, further appreciation of the ruble will have a restraining effect on price rises. Apart from domestic factors, a somewhat decrease in global food prices will contribute to further slow down of growth rates of prices.

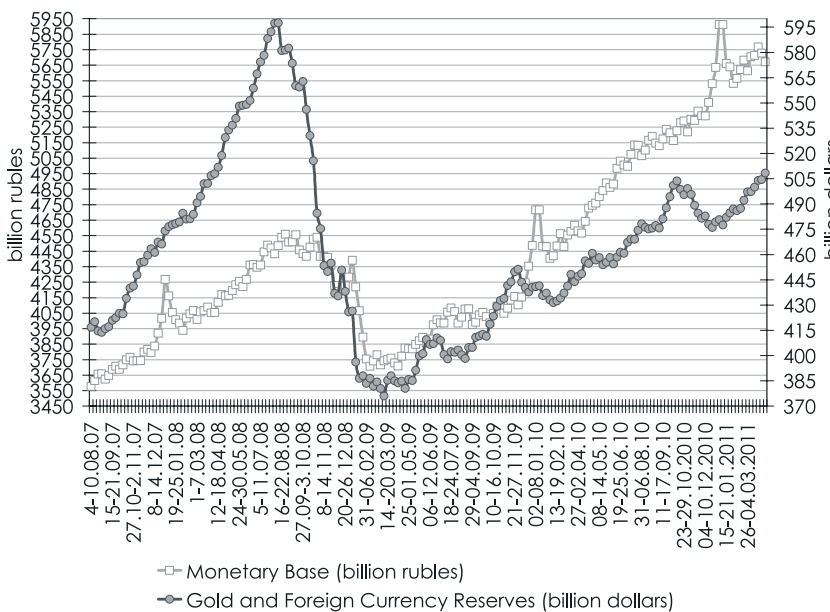
At the same time, it is to be noted that in April after a two-month long decline of petroleum prices the wholesale petroleum prices started to grow again. Such a growth in petroleum prices

<sup>1</sup> The reference consumer price index shows the level of the inflation rate on the consumer market with exclusion of the seasonal factor (prices on fruit and vegetable products) and administrative product (tariffs on regulated types of services and other). The above index is calculated by the Statistical Service of the Russian Federation, as well.



The source: Rosstat.  
 Fig. 1. The growth rates of the consumer price index in the 2002–2011 period (% a month)

In March, after a two-month long reduction the wide monetary base rose by 1.1% to RUR 7514.2 billion. Widening of the monetary base took place as a result of both a 50% increase in deposits by credit institutions with the Bank of Russia and a 25% increase in mandatory reserves. The inflow of foreign exchange to the Russian Federation continued as high global oil prices kept prevailing, while the remaining high risks in the economy prompted banks to deposit the available funds with the Central Bank of Russia. Last month, excessive reserves of commercial banks<sup>1</sup> started to grow for the first time since the beginning of the year and amounted to RUR 1787.3 billion. (+1.8%).



The source: The Central Bank of Russia  
 Fig.2. Dynamics of the monetary base (in a narrow definition) and international (gold-exchange) reserves of the Russian Federation in the 2007–2011 period.

can be explained, on the one hand, by a seasonal factor (the field work has started in the South of Russia) and, on the other hand, by the fact that a number of large oil refineries have closed down for overhaul. A more considerable growth in petroleum prices is expected by May when with a time lag growth in the wholesale prices is to be followed by that in retail ones.

The Central Bank’s official forecast as regards the inflation rate has remained unchanged and amounted to 6% to 7%; the government expects price rises within the range of 6.5% to 7.5%. Our forecast of the inflation rate in 2011 still remains at the level of 8.1% to 8.9%.

In March, the value of the cash money in circulation with cash balances of credit institutions taken into account remained virtually unchanged (+0.1% to RUR 5482.7 billion), while banks’ correspondent account balances with the Central bank of Russia somewhat decreased (–5.7% to RUR 597.2 billion). Also, the value of the Central Bank’s bonds with credit institutions dropped by more than one-third (–33% to RUR 403.4 billion).

In March, both growth of 0.1% in cash money in circulation and that of 25.1% in compulsory provisions resulted in widening of the monetary base in a narrow definition (cash, plus compulsory provisions)<sup>2</sup> by 0.9% to RUR 5726.8 billion (see Fig. 2).

1 Excessive reserves of commercial banks with the Central Bank of Russia (CBR) are the amount of commercial banks’ correspondent account balances and deposits with the Central bank of Russia, as well as CBR bonds held by commercial banks.

2 It is to be reminded that in a broad definition a wide monetary base is not a monetary aggregate, but defines liabilities of the Central Bank of Russia in the national currency. In a narrow definition, the monetary base is a monetary aggregate (a measure of the volume of the money supply) which is under complete control of the CBR.

In March and in the first half of April, international reserves of the Bank of Russia kept growing and amounted to USD 512.8 billion by mid-April.

In March the outflow of capital from the Russian Federation continued though it was lower than in the previous four months. In the 1<sup>st</sup> quarter of 2011, the capital outflow amounted to USD 21.3 billion and almost attained the extent of the 4<sup>th</sup> quarter of 2010 (USD 21.5 billion). It is to be reminded that in January the capital outflow amounted to RUR 11 billion, while in February, to USD 6 billion. It is to be noted that the capital flight from Russia has been observed for three quarters running. The main factor behind the above trend is, by all appearances, the prevailing unfavorable investment climate in the Russian Federation.

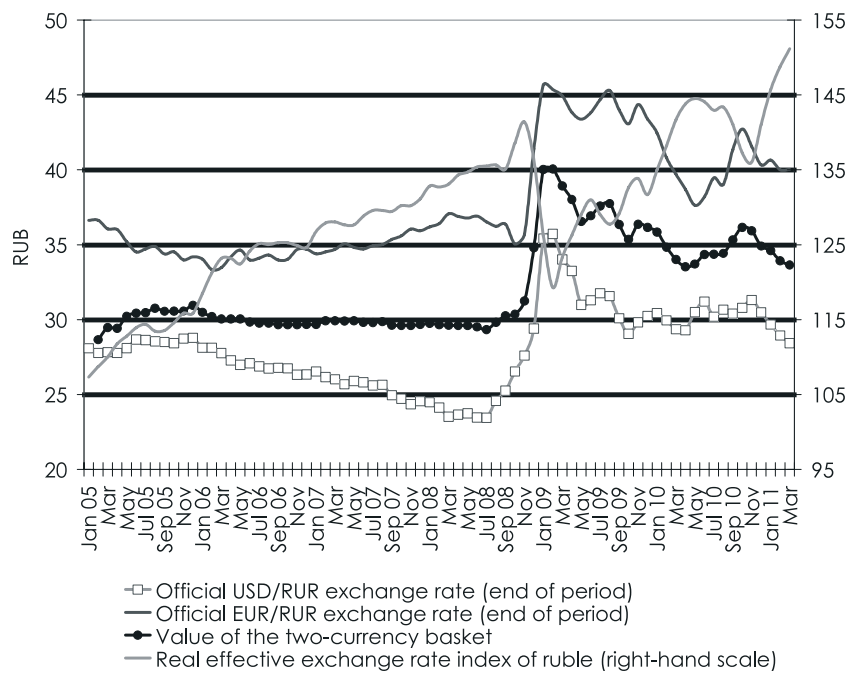
In March, the real effective RUR exchange rate kept appreciating and increased by 1.6%. Accordingly, the index of the real effective exchange rate rose to 151.15<sup>1</sup> (See Fig. 3<sup>2</sup>).

In April, the RUR kept appreciating against the USD; in the three weeks of the month the Russian currency gained 1.3%. On April 12, for the first time since December 2008 the RUR gained the level of RUR 28 per a USD. The trend towards appreciation of the RUR against the USD has been observed since the beginning of this year. By now, the RUR has appreciated by 7.2%.

On the contrary, in the first three weeks of April the RUR depreciated against the Euro (-0.4%). Since the beginning of the year, the dynamics of the RUR/Euro exchange rate has been very volatile and repeatedly changed its trend to the opposite one. Generally, from the beginning of 2011 till April 21, the RUR/Euro exchange rate remained virtually unchanged falling by the mere 0.1%.

In April, both the oil prices and the Euro/USD exchange rate dynamics on the global financial markets still had the main effect on the RUR/USD exchange rate dynamics. The RUR is appreciating against the USD in the situation of growing global oil prices which vary in the range of USD 120 to USD 126 a barrel. In the FOREX market, the Euro has appreciated against the USD due to the following factors: in the beginning of April the Euro appreciated after the European Central Bank raised the interest rates while in the third week of April it strengthened due to the favorable news on the growth in industrial prices in Germany and expectations of further tightening of the monetary policy by the European Central Bank. In April, an important development which had an effect on the RUR exchange rate dynamics was the downgrading by S&P of the US credit rating forecast from “stable” to “negative”. As a result, in a situation where a drop in oil prices was expected the RUR depreciated sharply. However, the decision of the above international rating agency did not have a long-range effect, and a few days later the RUR regained the lost grounds.

In April, the cost of the dual currency basket increased and on April 21 it amounted to RUR 33.73 (+0.2%). In our view, despite high prices on oil a considerable flight of capital from Russia will prevent the cost of the dual currency basket from falling below the level of RUR32–RUR33 in 2011. ●



The source: The Central Bank of Russia and the author's calculations.  
 Fig.3. The indices of the RUR exchange rate in the period of from January 2005 to March 2011.

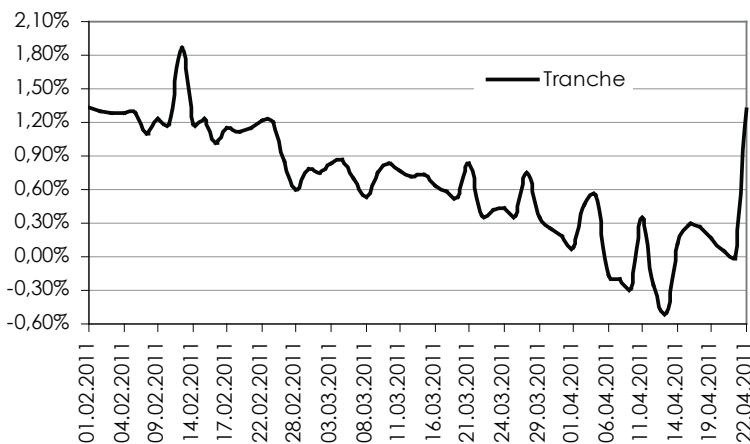
1 The level of January 2002 is taken for 100.  
 2 The level of January 2002 is taken for 100.

## FINANCIAL MARKETS<sup>1</sup>

N.Burkova, E.Khudko

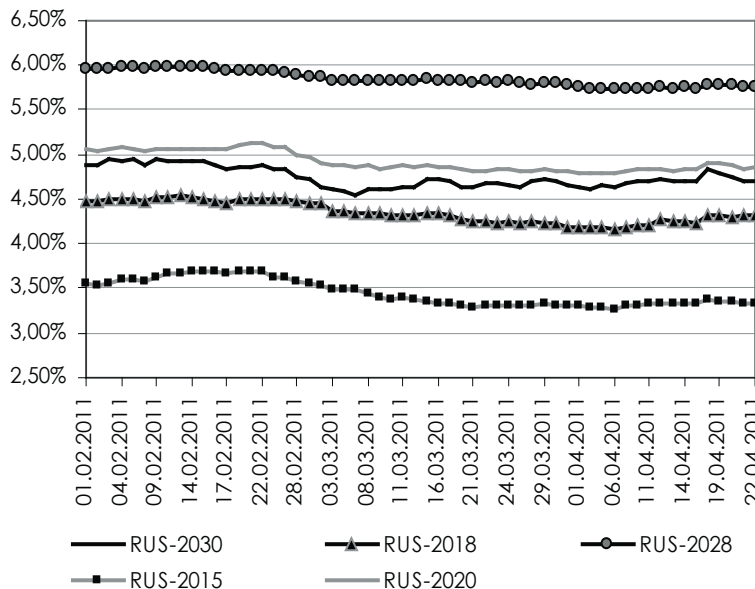
Growth in quotations in global oil markets was conditioned mostly by the catastrophe in Japan and politically unstable situation in the Middle East and Africa in April 2011. Subsequent rates of recovery of the global economy remained in the focus of attention of investors in the financial markets in April 2011. In addition, global markets responded very negatively to the Standard & Poor's forecast which downgraded (from «stable» to «negative») the US sovereign credit rating. These factors along with growth in inflation and foreign debt owed by the Russian Federation resulted

in a generally downward trend in the Russian stock market in April 2011, in spite of growth in global oil prices. The corporate bond market saw new peaks of the key indicators such as corporate bond market's volume and index, investors' activity in the primary and secondary markets. Some issuers failed to redeem their bonds in April 2011, which had an adverse effect on the market as well.



Data Source : based on the data published by Finmarket agency.

Fig. 1. Minfin bonds' yields to maturity in February – April 2011



Data Source : based on the data published by Finmarket agency.

Fig. 2. Yields to maturity of the Russian Eurobonds with maturity due in 2010, 2015, 2018, 2020, 2028 and 2030, in February – April 2011

### Government Securities Market

Such factors as multidirectional fluctuations of oil prices, in spite of a generally pronounced upward trend, strengthening of the national currency against the US dollar, unchanged rate of refinancing, and increase in the size of mandatory provisions from April 1, 2011 deteriorated substantially the demand in the Russian government securities market and increased the yield of such bonds in April 2011. In addition, Standard & Poor's downgraded the US sovereign credit rating, inflation in Russia increased to reach 3.8% between January and March 2011, foreign debt owed by Russia increased by 3.2% in Q1 2011, and net capital outflow from the Russian Federation (negative investment) increased by 44.9% to USD 21,3 bln in Q1 2011 (against Q1 2010), which also had an effect on quotations and demand in the market.

According to the data as of April 24, 2011, yields to maturity of the Russian Eurobonds increased insignificantly against March 24, 2011, save for RUS-28 which decreased by 1.22% p.a. The

<sup>1</sup> The review is based on the data and analytical materials published by the MICEX and RTS Exchanges, and the Central Bank of Russia, as well as posted on official websites of Russian corporate issuers.



7<sup>th</sup>-tranche Minfin bonds' yields fluctuated considerably to eventually triple at the month-end (from March 24 till April 24, 2011) (Fig. 1–2). The increase was associated with the upcoming annual coupon payment due on May 14, 2011.

In the period between March 25 and April 24, 2011, the turnover in the secondary federal loan bond market totaled nearly RUB 210,88 bln, with an average daily turnover being at a level of RUB 10,04 bln (nearly RUB 530,63 bln, with an average daily turnover being at a level of RUB 26,53 bln in March 2011), which means that the average daily turnover decreased by 2.6 times.

Five OFZ (government bonds) auctions were held in the primary market in the period between March 25 and April 24 (against four auctions in the previous month) (see Table 1). A total actual volume of floating accounted for 89% of the planned volume. No OFZ auctions were held in the secondary market.

Table 1

## OFZ AUCTIONS IN THE PRIMARY MARKET

Auction date	Issue	Issue volume, RUB mln	Volume at par value, RUB mln	Average weighted yield
30.03.2011	OFZ-25075-PD	10,000.00	9,596.01	7.21
30.03.2011	OFZ-26203-PD	10,000.00	9,719.17	7.55
06.04.2011	OFZ-26204-PD	20,000.00	18,947.99	7.61
13.04.2011	OFZ-26205-PD	20,000.00	17,213.25	7.99
20.04.2011	OFZ-25076-PD	20,000.00	15,573.90	6.44
Total:		80,000.00	71,050.33	

Data Source : published by the Ministry of Finance of Russia.

## Stock Market

### Stock Market Situation

The following factors had a positive effect on the stock market in April, 2011: oil prices kept growing, the US GDP increased by 3.1% in terms of annual growth against the previous quarter in Q4 2010, US unemployment declined by 0.1 p.p. down to 8.8% in March 2011, the Organization for Economic Cooperation and Development upgraded its forecast up to 3% for the leading global economics in H1 2011, the World Bank upgraded its forecast from 4.2 to 4.4% for GDP in Russia in 2011, as well as a series of the largest Russian companies (including OAO Mosenergo, Sberbank of Russia, Aeroflot) strengthened their international reserves and published positive financial statements. On the other hand, growth rates of Russian securities were slowed down in April 2011 due to high rates of inflation in the Russian Federation, negative external environment deteriorated by the situation in Africa and the Middles East, the effects of the catastrophe in Japan, downgraded sovereign credit ratings (by Standard & Poor's) for the United States at a level of Aaa from «stable» to «negative» and Portugal, Greece and Ireland, downgraded credit rating (by Fitch and Moody's Investors

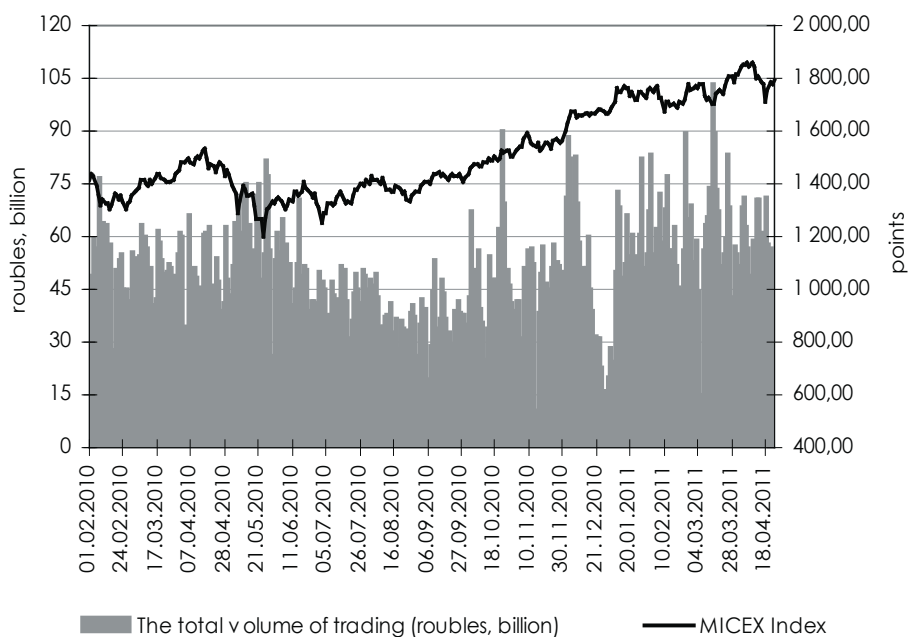


Fig. 3. Dynamics of the MICEX Index and trading volume

Service) for Portugal, a 0.25 p.p. increase (up to 1.25% p.a.) in the basic rate of refinancing by the European Central Bank. In addition, the Standard & Poor's downgrade forecast (on April 18, 2011) for the US sovereign credit rating at a level of Aaa from 'stable' to 'negative' resulted in fall of quotations in the global markets. Nevertheless, the Russian stock market won back the fall within 5-6 days.

The MICEX Index reached its monthly upper peak value of 1,859.99 points on April 6, 2011 (against 1 795,4 points in the previous month) and monthly lower peak value of 1714,07 points on April 18, 2011 (against 1,700.54 points in the previous month) (*Fig. 3*).

In general, the MICEX Index declined by 0.08%, which is equal to 1.44 points in absolute terms (the MICEX Index increased by 22.24% in the period between April 25, 2010 and April 24, 2011), and trading turnover of the MICEX Index stocks reached RUB 1,256.22 bln in the period between March 25 and April 24, 2011. Hence the average daily level of activity of investors in the stock market declined by 11.5% in April, 2011 against the previous period.

Rosneft's and Mosenergo's stocks were hit most by the decline of the Russian Blue Chips and devaluated by 6.08 and 5.76%, respectively, over the analyzed period. Gazprom's stocks were leading in growth and increased by 6.32% (*Fig. 4*).

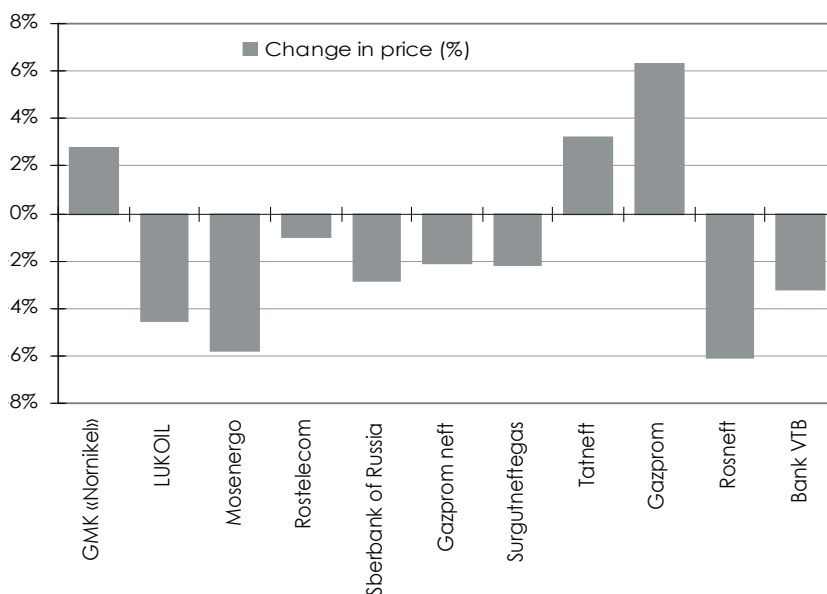
According to the MICEX's data, the top-5 leaders in terms of capitalization included Gazprom (RUB 5,596.42 bln), Rosneft (RUB 2,660.25 bln), Sberbank of Russia (RUB 2,237.06 bln), LUKOIL (RUB 1,667.1 bln) and GMK Nornikel (RUB 1,466.31 bln) as of April 24.

### Derivatives Market

In April 2011, the average daily trading volume in the MICEX derivatives market declined by 29% against the previous month. The biggest trading volume in April 2011 was reported for securities futures (RUB 79,01 bln) (324,27 thousand deals), like in the previous month. Delivery futures contracts with the stocks of Nornikel, Gazprom, Sberbank and LUKOIL were ranked number two in terms of trading volumes after non-deliverable MICEX Index futures contracts in this section of the MICEX derivatives market. It should be noted that the value of MICEX index (the price of closed deals) ranged between 1 700 and 1 770 points as of June 2011, i.e. a 1.3 – 5.2% decrease in the index is expected against April 24, 2011. Currency futures deals were ranked number two in terms of trading volume (RUB 27,67 bln) in April 2001. EUR/USD non-deliverable futures contracts and US dollar and EUR futures contracts were ranked number one and two, respectively, in terms of trading volumes in this section of the MICEX derivatives market. In April 2011, prices of closed RUB/USD futures contracts in the MICEX derivatives market with a settlement date due in June 2011 ranged within an average of RUB/USD 28,1 to 28,7, i.e.

the RUB is expected to weaken by 0.6 – 2.7% against April 24, 2011 (RUB/USD 27,9396).

The same trends were observed in the RTS FORTS derivatives market, where in April 2011 the average daily activity of investors also decreased by 11% against the previous month. RTS Index futures contracts were ranked number one in terms of futures trading volumes, leaving far behind futures contracts on RUB/USD exchange rate, EUR/USD exchange rate, and Sberbank and Gazprom ordinary shares which were ranked number two in trading volumes. In the RTS FORTS derivatives market prices of the recent deals closed on RUB/USD futures contracts with the



*Fig. 4. Dynamics of the Russian Blue Chips in the period between March 25 and April 24, 2011*

settlement date due on June 15, 2011 ranged between RUB/USD 28,0 and 28,7, i.e. RUB is expected to weaken by 0.2 – 2.7% against April 24, 2011, like it was estimated in the MICEX derivatives market. The value of RTS Index futures contract (based on the prices of recently closed deals) with the settlement date due on June 15, 2011 averaged between 1.900 and 2.070 points, i.e. the index is expected to decline by 1.02 – 7.3% against April 24, 2011. Options were less popular. Trading volume on options totaled nearly RUB 343,88 bln (367,31 thousand deals).

### ***External Factors Which Had an Effect on the Dynamics of the Russian Stock Market***

The global oil market was one of the main factors which supported the Russian stock market in April 2011. The global oil market showed growth in quotations due to unstable political situation in Libia and the Middle East, one of the largest oil exporters (see *Table 2 and Fig. 5*). Furthermore, investors were governed by the Japanese government's decision on April 12, 2011 to maximize the hazard level at the Fukusima nuclear power plant under 7-grade scale (similar to the Chernobyl disaster), as well as the announcement made by the International Monetary Fund to downgrade the forecast US economic growth from 3 to 2.8% in 2011. In addition, on April 18, 2001 Standard & Poor's downgraded its forecast for the US sovereign credit rating at a level of Aaa from 'stable' to 'negative', which crashed global stock exchanges, but they managed to recover within a few days.

The German DAX-30 stock exchange index (5.22%) showed the fastest growth among the developed countries. On the other hand, emerging markets showed both growth by 1 – 8% and decline by 0.1 – 0.7% during the month (see *Table 2 and Fig. 5*).

*Table 2*

DYNAMICS OF GLOBAL STOCK MARKET INDICES (DATA AS OF APRIL 24, 2011)

Indexc	Code	Value	Monthly change (%)*	Changes since the beginning of the year (%)
MICEX ( Russia )	MICEXINDEXCF	1,793.96	-0.08	6.28
RTS ( Russia )	RTSI	2,049.03	1.04	15.75
Dow Jones Industrial Average ( USA )	DJI	12,505.99	2.76	8.02
NASDAQ Composite ( USA )	NASD	2,820.16	3.06	6.31
S&P 500 ( USA )	SPX	1,337.38	2.12	6.34
FTSE 100 ( Great Britain )	FTSE	6,018.30	2.34	2.01
DAX-30 ( Germany )	DAX	7,295.49	5.22	5.51
CAC-40 ( France )	CAC	4,021.88	1.34	5.71
Swiss Market ( Switzerland )	SSMI	6,457.16	2.18	0.33
Nikkei-225 ( Japan )	NIKKEI	9,682.21	2.62	-5.34
Bovespa ( Brazil )	BUSP	67,058.02	-0.70	-3.24
IPC ( Mexico )	IPC	36,816.31	-0.15	-4.50
IPSA ( Chile )	IPSA	4,738.67	3.09	-3.83
Straits Times ( Singapore )	STI	3,194.73	4.99	0.15
Seoul Composite ( South Korea )	KS11	2,197.82	7.91	7.16
ISE National-100 ( Turkey )	XU100	68,691.77	6.74	4.07
BSE 30 ( India )	BSE	19,602.23	6.82	-4.42
Shanghai Composite ( China )	SSEC	3,010.52	2.17	7.21
Morgan Stanley Emerging&Frontier Markets Index	EFM	952.27	6.14	4.45

\* – against the values of the indices as of March 24, 2011

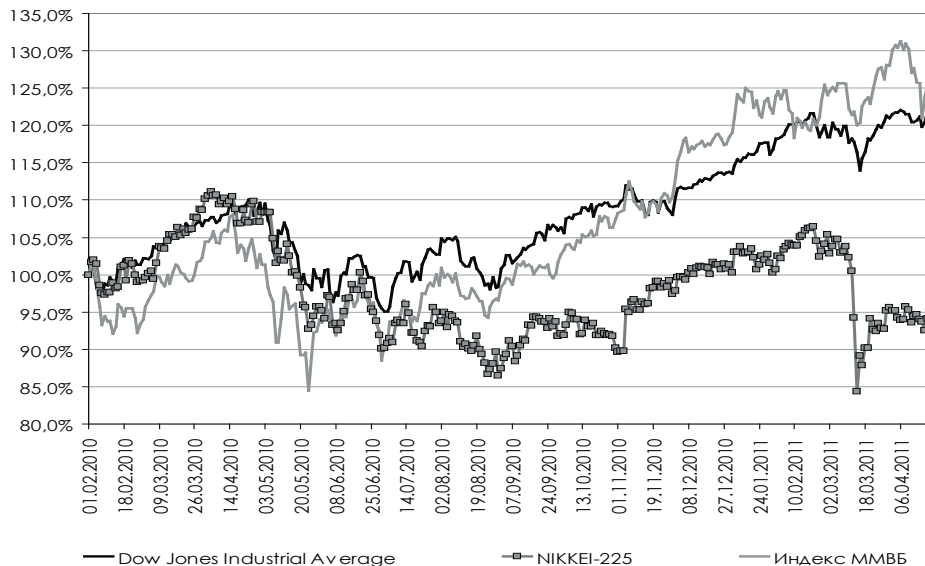


Fig. 5. Dynamics of the main USA, Japanese and Russian stock indexes (as % of the stock indices as of February 1, 2010)

In summary, one may say that in the absence of negative news the Russian market may continue consolidating within gained levels due to currently unavailable preconditions for fast growth. Furthermore, downward correction may continue in the Russian stock market in the short term. Upward trend is likely to take place in the Russian equity market in the midterm. Within a few months to come, the Russian market will continue to be effected by US macroeconomic statistics, political situation in the Middle East and Africa which has a direct effect on the dynamics of global oil prices, as well as economic status of the European countries which were hit hard by the financial crisis (in particular, Portugal, Greece and Spain) .

### Corporate Bond Market

The volume of the domestic corporate bond market in Russia (at the nominal value of securities outstanding and denominated in the national currency) continued to grow in April 2011 to reach RUB 3,024.8 bln at the end of the month, and gained 1.1% against late in March 2011<sup>1</sup>. As a result, the volume of the bond market gained a new historical maximum. On the other hand, there was a reduction in the number of issuers in the bond segment of the securities market (348 issuers against 355 in the previous month) and issues registered in the national currency (692 issues against 722 at the end of March 2011). Such a multidirectional dynamics of values means gradual growth in nominal volume of each bond issue. There are two outstanding bond issues, a USD denominated issue and a JPY denominated issue.

The corporate bond turnover value reached new historical maximum over at least the recent three years in the stock market. For example, the volume of deals in the MICEX Stock Exchange totaled RUB 196,9 bln in the period between March 25 and April 22, 2011 (to compare, the volume of deals totaled RUB 149,3 bln in the period between February 24 and March 24). The number of deals remained at a high level – 29,8 thousand deals (against 27,4 thousand deals in the previous period)<sup>2</sup>.

The Russian corporate bonds IFX-Cbonds market index continued to grow steadily (2.8 points or 0.9% in the past month). As a result, the index overpassed 300 points for the first time since its introduction. Over the analyzed period, following a short growth in March, the average weighted effective yield decreased from 7.32% late in March to 7.13% late in April, 2011, but remained within a range of 7.0 to 7.6% since June of the last year (Fig. 6). Hence, an upward change in the rate of refinancing, which took place almost two months ago, had no serious effect on corporate bonds' yield. Corporate bond portfolio duration resumed its trend to shorten which was broken in March,

1 based on the data published by Rusbonds.

2 based on the data published by Finmarket Information Agency.



and became 573 days late in April, which was 24 days less than the previous value, i.e. a share of long-term liabilities slightly decreased in the corporate segment.

The most liquid bond issues showed downward dynamics, but no acute fluctuations of interest rates was observed, and yield declined by 1 p.p. or less in most cases in the period under review.

The biggest number of state registration of corporate bond issues were reported in April 2011 over the recent few months. For example, 43 bond issues, a total value of RUB 220,3 bln, were registered the period between March 25 and April 22, 2011. However, such a nominal of corporate bonds was provided by no more than ten issuers. A similar situation was observed in the previous month, when seven large issuers placed 25 issues of a total nominal value of RUB 106,0 bln.

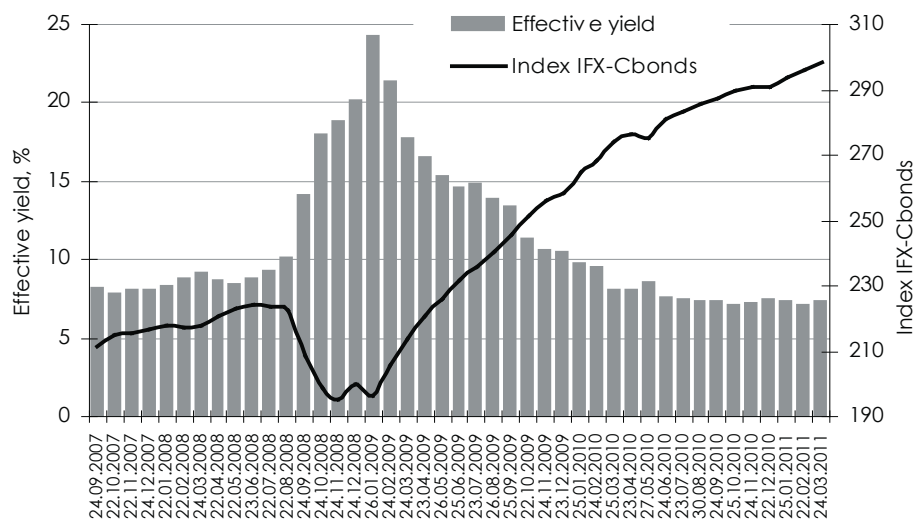
The old-time issuers in the stock market most often register bond issues under a simplified scheme, this is why the 43 issues included 36 issues of stock exchange bonds.

The primary bond market's values were very high as well in the period between March 25 and

April 22, 2011: outstanding issues totaled RUB 153,0 bln ( against RUB 110,9 bln in the period between February 24 and March 24, 2011), issues reached the highest number (78) over the recent years (15 issues were placed in the previous period) (Fig. 7). However, such a large number of issues was related to the reorganization of OAO Rostelecom, under which a series of regional communication companies were affiliated with the company.

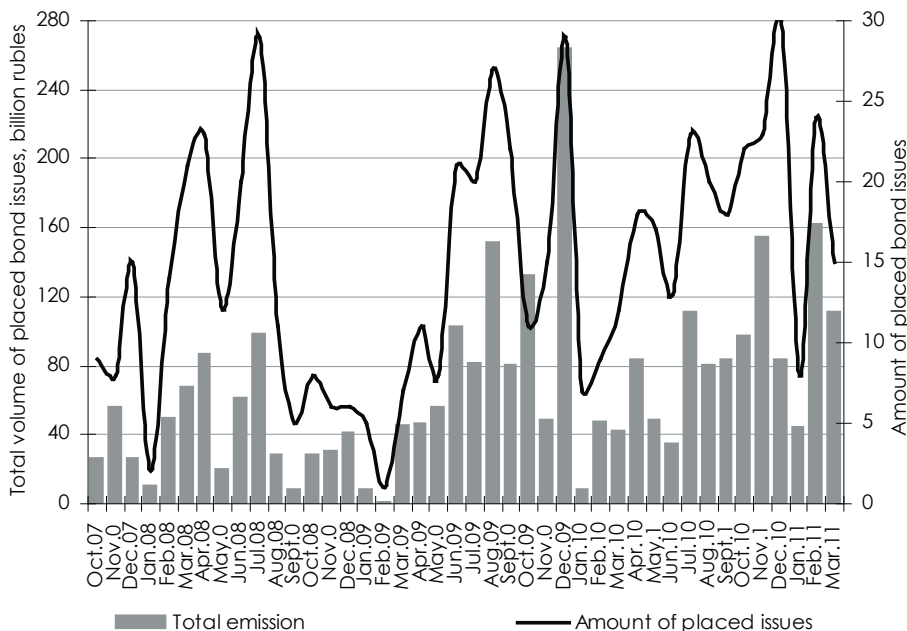
In the period between March 25 and April 22, 2011, the Federal Financial Markets Service of Russia held invalid and cancelled state registration of three bond issues due to non-placement (two initial bond issues were cancelled in the period between from February 24 and March 24, 2011)<sup>1</sup>.

Twenty issuers were to redeem a total of RUB 82,2 bln bond loans, of which 26 issues of a total value of RUB 7 bln were redeemed by Uralsviyazinform, in the period between March 25 and April 22, 2011. However, four of the 20 issuers failed to discharge their obligations and announced



Data Source : based on the data published by Cbonds.

Fig. 6. Dynamics of the Russian corporate bond market index and average weighted yield



Data Source : based on the data published by Rusbonds.

Fig. 7. Dynamics of initial offer of corporate bonds denominated in the national currency

1 based on the data published by the Federal Financial Markets Service of Russia .

technical default on their bond loans of a total nominal value of RUB 8,7 bln (two issuers failed to discharge their obligations in due time in the previous period). Seventeen issues of corporate bonds, a total value of RUB 27,8 bln<sup>1</sup>, are to be redeemed in May 2011

The situation with failures to discharge obligations still remains serious. In the period between March 25 and April 22, 2011, only three issuers failed to pay coupon yield to bond holders (against six issuers in the period between February 24 and March 24), in the period under review, however, six issuers failed to redeem the nominal of bond issues or discharge their obligations to early redemption of bonds under an offer even as part of technical default (all of the issuers redeemed their bonds without announcing a real default in the previous period)<sup>2</sup>. ●

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1 based on the data published by Rusbonds.

2 based on the data published by Cbonds.

## REAL ECONOMY SECTOR: TRENDS AND FACTORS

O.Izryadnova

According to the preliminary data of the Ministry for Economic Development, in the 1<sup>st</sup> quarter 2011 the GDP went up by 4.5%, industrial production – by 5.9%, minerals extraction increasing by 3.3%, manufacturing production – by 10.6% as compared with the corresponding period of the previous year. This March the situation at the internal market was defined by the acceleration of the retail trade turnover under the influence of anticipating growth rates of non-food market expansion. The increase in retail trade turnover in annual terms made 4.8%, in foodstuffs – 1.0%, in non-food goods – 8.7%. Low business activity in construction still has a negative effect on the internal demand. The trend towards the contraction of investments volume persists (by 1.5% versus the 1<sup>st</sup> quarter 2010).

According to the preliminary estimation of the Ministry for Economic Development, in the 1<sup>st</sup> quarter 2011 the GDP in real terms increased by 4.5% as compared to the corresponding period of the previous year, but still was below the figure of the 1<sup>st</sup> quarter 2008 by 2.1%. At the beginning of 2011 the macroeconomic situation was formed under the influence of internal and external demand expansion, unemployment levels lowering and sustention of low investment activity.

Table 1

MAIN ECONOMIC INDICES GROWTH RATES IN THE 1<sup>ST</sup> QUARTER 2008–2011, AS PERCENTAGE TO THE CORRESPONDING PERIOD OF THE PREVIOUS YEAR

	2008	2009	2010	2011
GDP	109.1	90.5	103.5	104.5
Industry	106.2	84.5	109.5	105.9
Investments I fixed assets	123.6	85.0	95.2	98.5
Retail trade turnover	117.2	101.3	102.2	104.7
Export*	153.6	52.0	161.1	122.1
Import*	140.8	63.6	118.8	140.9
Total number of the unemployed	96.5	134.8	96.3	86.6

\* export, import – as percentage to the corresponding period in real prices, as USD

Source: Federal State Statistics Service

Comparative analysis of the results of the 1<sup>st</sup> quarter 2009–2011 allows finding out specific features of the present situation. The anticipating import versus export growth both by physical and price volumes that has been observed since the 3<sup>rd</sup> quarter 2010, continued to cause the proportion of the net export in the GP. It should be noted that the influence of his factor was partially compensated by the expansion of the consumer market.

In the 1<sup>st</sup> quarter 2011 retail trade turnover went up by 4.7% as compared with the corresponding period of the previous year exceeding by 8.4% the figure of the 1<sup>st</sup> quarter 2008<sup>1</sup>. In March the increase in retail trade turnover in year-to-year terms made 4.8%, including increase of 1.0% in foodstuffs turnover and 8.7% increase in on-food goods turnover.

1 In March 2011 the Federal State Statistics Service corrected the indices of retail trade turnover by months of the current year and results of 2010. In January 2011 the rates of retail trade turnover growth was estimated at the level of 3.3%, in February – 5.8%, in March – 7.8% versus the corresponding periods of the previous year. As a result of 2010 the estimation of the retail trade turnover growth was raised by 6.3% versus 2009, exceeding by 1.9 percentage point the index published earlier. The change in the retail trade turnover dynamics is completely due to re-estimation of the non-food goods market turnover rates. The result of this is the change in the earlier estimations of consumer demand influence on the economic situation in 2010 and the beginning of 2011. In 2010 and in the 1<sup>st</sup> quarter 2011 the situation at the consumer market was defined by the anticipating rates of non-food goods market expansion versus the retail turnover rates of foodstuffs. As a result of 2010 retail trade turnover made 101.9% versus the level of 2008, foodstuffs turnover being 103.1%, non-food goods – 99.0%.

Continuing slow-down of investment activity negatively influences the internal market. In the 1<sup>st</sup> quarter 2011 investments in fixed assets decreased by 1.5% versus the corresponding period of the previous year and made 79.7% of the maximum pre-crisis figure of the 1<sup>st</sup> quarter 2008. The volume of workload in construction went up by 1.6% versus the 1<sup>st</sup> quarter 2010. It should be taken into account that it was the continuous decrease in housing construction rates, lack of the sufficient backlog in construction and focus of the investment activity on less capital intensive directions, for instance on the increase of production capacities load that acted as factors determining low investment activity. Non-government investors' activity being low, implementation of residential housing reduced by 3.7% in the 1<sup>st</sup> quarter 2011 as compared with January-March 2010.

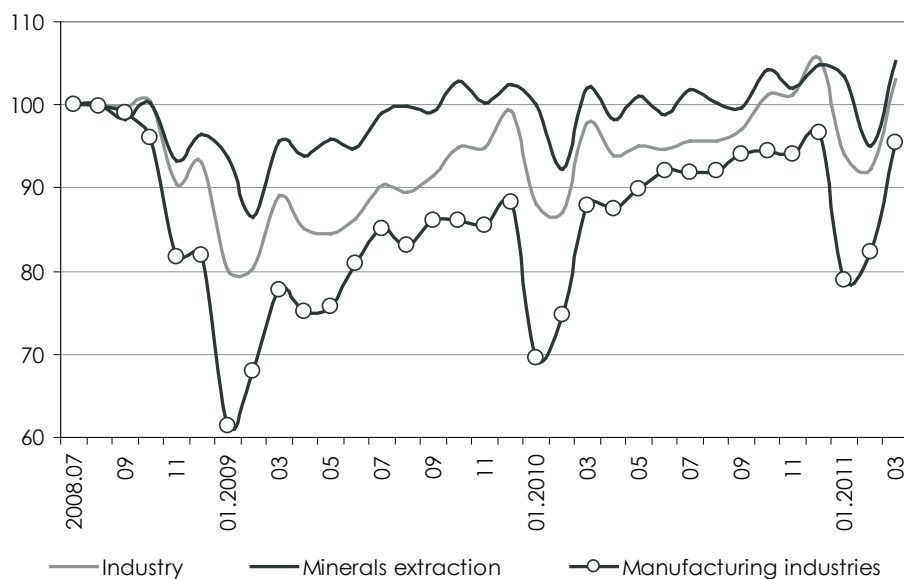
Low investment activity against the background of the interest rates reduction, sustention of high economy revenues from export, increase in banking sector liquidity, expansion of the funds attracted by crediting organizations and scales of capital withdrawal up to USD 21.3 billion versus USD 14.7 billion in the 1<sup>st</sup> quarter 2010 demonstrates that the business does not have long-term strategic plans for the increase in investments in the Russian economy.

It should be noted that the economy of capital investments is accompanied by the expansion of the demand for the work force. As compared with the 1<sup>st</sup> quarter 2009 when the unemployment level registered was at the maximum level (9.4% of the total number of the employed in the economy), the total number of the unemployed decreased by 1.3 million to 5.7 million (7.6% of the total number of the employed in the economy).

As compared with the 1<sup>st</sup> quarter 2010 in the 1<sup>st</sup> quarter 2011 index of industrial production made 105.9% or 98.0% versus the 1<sup>st</sup> quarter 2008. It should be noted that the growth of production was observed for all the consolidated types of economic activity. Index of minerals extraction made 103.3% versus the 1<sup>st</sup> quarter 2010, index of processing production – 110.6%.

The conditions for crisis overcoming and its rates in the 1<sup>st</sup> quarter 2011 minerals extraction made 106.0%, manufacturing industries – 98.8% and electricity, gas and water production – 101.2% versus the level of the 1<sup>st</sup> quarter 2008. It should be noted that the recovery of the production at the level or above the level of the 1<sup>st</sup> quarter 2008 pre-crisis figures is observed in consumer complex (foodstuffs production, textile and sewing industry, leather and footwear production) and in oil and gas complex (coke and oil products production, chemistry industry, rubber and plastic goods production).

In timber processing complex (pulp and paper production, lumber processing and wooden goods production) production makes approximately 85%, in metallurgy complex – about 90% of



Source: Federal State Statistics Service

Fig. 1. Dynamics of Industrial Production, Minerals Extraction and Manufacturing Industries (July 2008 figure made 100)

the figures of the 1<sup>st</sup> quarter 2008. In investment complex production of construction materials is more than 20% below and machinery and equipment – 10% below the figure of the 1<sup>st</sup> quarter 2008.

In machine-building complex the increase in production of transportation vehicles and equipment is notable, which is accounted for by a high level of anti-crisis support for automotive industry in 2009–2010 and execution of the declared liabilities concerning the programs of the market support at the beginning of 2011.



Table 2

PRODUCTION INDICES AS BROKEN BY MAIN TYPES OF MANUFACTURING INDUSTRIES IN THE 1<sup>ST</sup> QUARTER 2007-2011, AS PERCENTAGE TO THE CORRESPONDING PERIOD OF PREVIOUS YEAR

	2007	2008	2009	2010	2011
<b>Industry</b>	107.2	106.2	84.5	109.5	105.9
<b>Minerals extraction</b>	104.0	100.7	96.2	106.7	103.3
Fossil fuels extraction	103.8	102.7	100.4	106.4	100.3
Minerals extraction, fossil fuels extraction excluded	107.9	92.2	96.2	110.9	107.7
<b>Manufacturing industries</b>	114.5	108.7	79.2	112.1	110.6
Foodstuffs production, including tobacco and beverages	113.7	106.4	96.7	103.8	101.7
Textile and sewing industry	110.8	102.6	78.8	110.2	107.7
Leather, leather goods and footwear production	118.7	106.6	83.0	126.3	112.8
Timber processing and wooden goods production	111.0	115.6	70.8	111.1	106.9
Pulp-and-paper industry, editing and publishing	110.8	107.8	82.0	106.7	99.5
Coke and oil products production	106.0	105.0	96.3	104.7	104.6
Chemistry industry	110.6	103.7	77.6	123.8	108.0
Rubber and plastic goods production	124.1	130.4	82.7	122.8	120.6
Other non-metal mineral goods production	125.8	108.6	67.8	104.9	112.7
Metallurgy and finished metal goods production	108.2	108.6	72.3	118.8	109.1
Machinery and equipment production	126.0	116.4	74.3	109.1	111.6
Electric, electronic and optic equipment production	123.7	93.3	56.6	130.4.2	106.3
Transport vehicles and equipment production	116.4	114.4	64.5	113.3	159.6
Other types of industry	112.9	118.6	79.3	130.7	105.0

Source: Federal State Statistics Service

In the Forecast for scenario conditions for socio-economic development in 2012–2014 presented by the Ministry of Economic Development of the Russian Federation, the basic variant of the forecast envisages sustention of the positive trends for the world market recovery.

According to the forecast, it is the manufacturing industries that will continue to lead the economic growth in 2011. The manufacturing industries production growth rates at the level of 107.5% versus the previous year will allow exceeding the pre-crisis level of 2008 by 1.9%.

This year the business activity is forecast to increase and investments in fixed assets growth to grow by 6-7% versus 2010. The positive contribution will be made by the investments of the federal budget in fixed assets of high-tech sector, transportation and social infrastructure, whose nominal growth according to the RF Ministry of Economic Development estimation, may exceed 40%. However according to the forecast dynamics the investments in 2011 will make 95% of 2008 figure, and if the growth rates make 108.8%, they will exceed pre-crisis level by 2.4–3.4%.

*Under such conditions, the growth of the GDP in 2011 will make 104.3% versus the previous year, which will result in the 2008 level recovery. The estimations of the GDP dynamics are in agreement with the forecast of Gaidar Institute.* ●

## RUSSIAN INDUSTRY IN MARCH 2011

S.Tsukhlo

According to the data of Gaidar Institutes Surveys<sup>1</sup>, the Russian industry maintains relatively high output growth rates and optimistic plans for production, demonstrates the increase in employees hiring and intends to continue hiring. However the cease of demand growth, correction of forecast for the demand that has started and decoupling of sales and output dynamics can force the enterprises to lower industry growth rates.

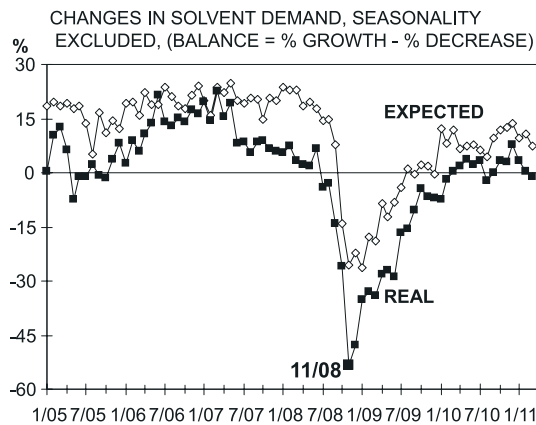


Fig. 1

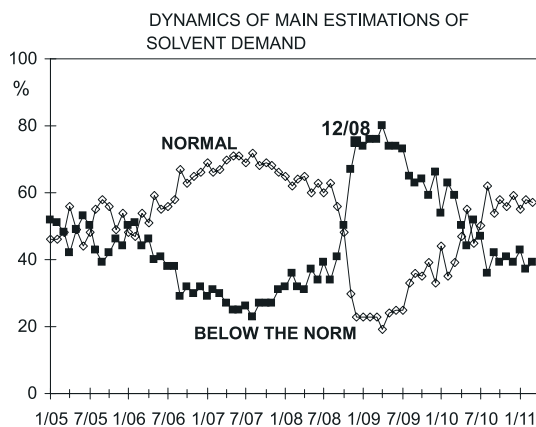


Fig. 2

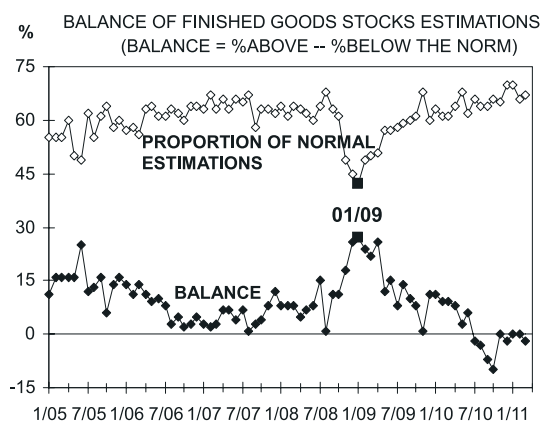


Fig. 3

### Demand for industrial goods

Initial data on demand dynamics demonstrated formal increase in sales growth rates in March up to +9 balance points as compared with +3 points in February. However the exclusion of seasonality has corrected these figures radically: the sales stopped to grow in March. Thus, demand growth rates decreased throughout the 1<sup>st</sup> quarter, balance lost 9 balance points over the period and became zero. Such a slowdown of the recovery was not observed before (fig. 1).

Negative dynamics of sales affected the forecasts. After the most optimistic expectations of post-crisis period which were registered in December 2010 by the end of the 1<sup>st</sup> quarter 2011 the balance of forecasts lost 7 balance points and lowered to the minimum figure of the last 8 months.

However, the satisfaction with the sales still remains at the previous level. Since September 2010 the proportion of normal estimation has been fluctuating in the range 54-59% (fig. 2). The highest satisfaction of the sales in the 1<sup>st</sup> quarter 2011 was registered in ferrous metallurgy (74%), chemistry industry (69%), non-ferrous metallurgy and foodstuffs production (67% each). The other end of the spectrum is occupied by light industry (35%) and industry of construction materials production (37%).

### Finished goods stocks

In the environment of weak demand the industry continues to pursue a very cautious policy of stocks management. For the fifth month in the row the balance of their estimation remains practically zero (fig. 3), which demonstrates that producers are lack confidence in rapid recovery of the steady demand growth.

1 Surveys of industrial enterprises directors have been conducted by Gaidar Institute according to the European harmonized methodology monthly since September 1992 and encompass all the territory of the Russian Federation. Panel size makes about 1100 enterprises, at which more than 15% of the employed in the economy work. The panel is shifted towards large enterprises in each of the sectors allocated. Questionnaires recovery makes 65-70%.

### Production output

Output growth rates (upon exclusion of seasonality) demonstrate slow recovery of the figure after traditional January drop and return to the average level which has been registered for 11 months already (*fig. 4*). As it is demonstrated by calculations, such output dynamics does not correspond to demand dynamics. In March 2011 only 58% of enterprises reported the synchronous change in sales and output (65% in January, 62% in February), at 35% of enterprises output grew at the anticipating rates versus the demand (14% in January, 28% in February). Such a low figure for the former index and such a high figure for the latter had not been registered in the Russian industry for 3 years (since April 2008).

The production plans at the same time demonstrate that industrial enterprises are not ready to coordinate output and demand dynamics. In March the proportion of entrepreneurs that intend to change output anticipating their demand forecast reached 25%, which is the maximum figure for the last 8 months. Moreover, only 68% of enterprises are prepared to change output in concordance with the forecast demand dynamics (minimum over the same 8 months). Such a decoupling between the real and forecast dynamics cannot continue for a long time. It is most likely to result in a radical correction of the output dynamics since the upsurge of demand seems at the moment improbable, and the enterprises are not going to increase the excessive stocks.

### Manufacturers' prices

By March the real prices growth rates lowered by half from 47 to 23 balance points after the ascent in January (*fig. 5*). In the 4<sup>th</sup> quarter 2010 the surveys registered the growth of manufacturers' prices at the rate of 17 balance points, in the 3<sup>rd</sup> quarter – at the rate of 7 balance points.

Slowdown of the real growth of prices was observed in all the sectors of industry in March, excluding chemistry industry and production of construction materials. It is the foodstuffs production that is characterized by the most moderate growth of prices for the second month in the row.

Prices plans were subject to the analogous correction. After a leap in December they have lost 14 balance points and approximated the level of November 2010. The decrease in prices forecast is again observed in all the sectors excluding chemistry industry and production of construction materials.

### Redundancies: Real Dynamics and Plans

In March the intensity of employees hiring increased in the industry up to +17 balance points and reached the maximum of the last four (!) years, i.e. there has not been such a large-scale hiring of employees since 2007 (*fig. 6*). In March 2011 the employees hiring started in all the sectors, excluding the light industry (where, in contrast, the scale of redundancies expanded). The highest growth rates of the number of employees are registered in ferrous metallurgy, chemistry industry and production of construction materials.

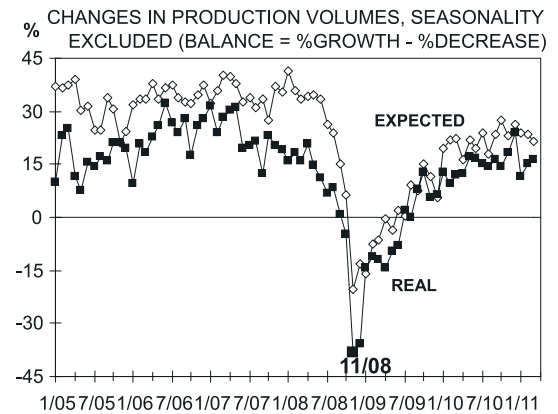


Fig. 4

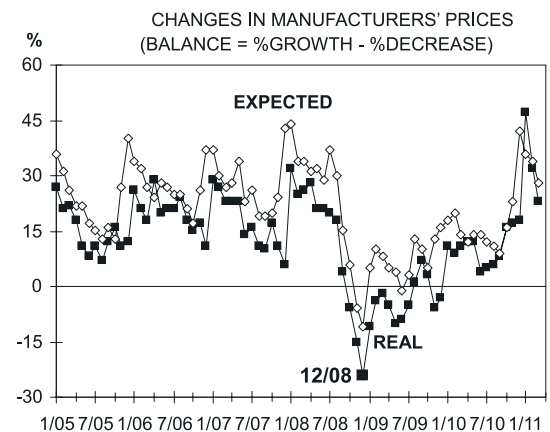


Fig. 5

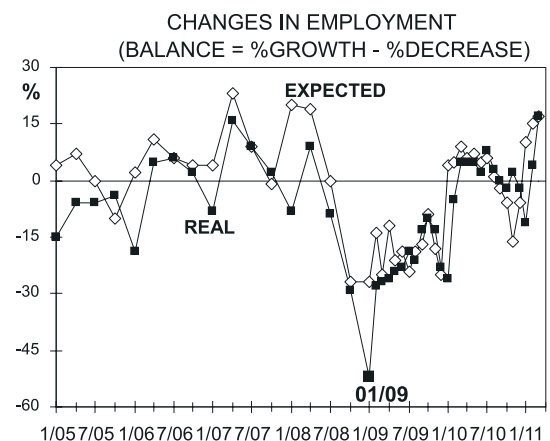


Fig. 6

In February enterprises quite precisely forecast March scale of employees' hiring. Then they reached +15 balance points and reached crisis maximum. At the same time the increase in employees' number was planned in all the sectors of industry. In March the forecasts for hiring did not change, i.e. the industry is most likely to continue hiring.

### Industry Crediting

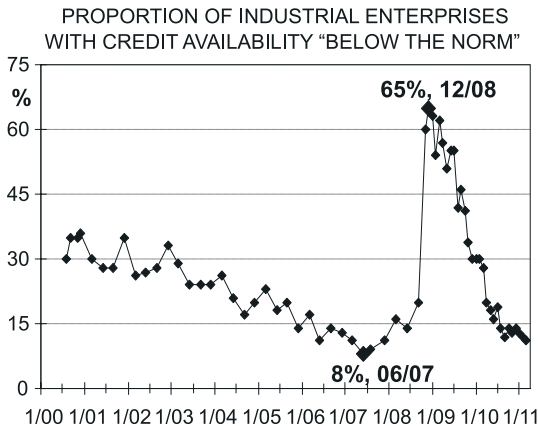


Fig. 7

Availability of credits for the industry has become stable since August 2010. This is testified by the proportion of enterprises that are not satisfied with the access to borrowed funds. This figure remained in the range 11-14% for 8 months (*fig. 7*). In pre-crisis period lower (i.e. better) indices of credits unavailability were registered only in summer 2007. Only 8% of enterprises (the absolute minimum of eleven-year monitoring) were then dissatisfied with the banks' offer. Thus, on the whole throughout the industry banks returned to the pre-crisis crediting conditions and are not willing to soften them anymore. In the 1<sup>st</sup> quarter 2011 ruble credits were offered to enterprises for 12.6% per annum at best (corresponding figure in the 4<sup>th</sup> quarter 2010 - 13.0%). ●



## FOREIGN TRADE

N.Volovik, K.Kharina

The Russian foreign trade performance figures in Q1 2011 exceeded the figures reported in the pre-recession year 2008. A regular round of preparatory negotiations of the Work Group on Russia's accession to the World Trade Organization (WTO) was held in Geneva late in March 2011.

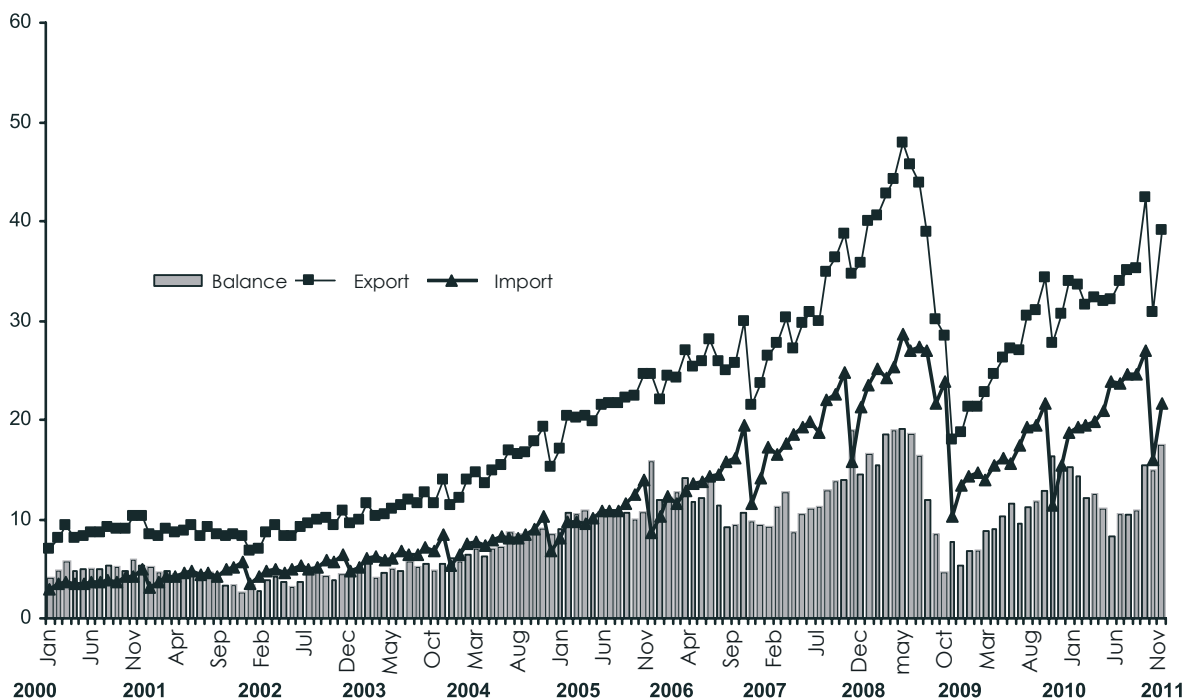
According to the data published by the WTO, a booming recovery of trade operations in 2010 made it possible for global trade volumes to reach the pre-recession upper peak: global volume of exports increased by 14.5% in 2010. This value became the highest since 1950, when calculation of global trade volumes was introduced. In 2009 the global trade dynamics were reported to be the worst over the entire period of monitoring, when recession reached 12% as a result of global financial crisis. Global trade volumes dropped only three times over the last 65 years: by 0.2% in 1965, by 2% in 1982, and % in 1975.

The Russian foreign trade turnover, as assessed by using the foreign balance methodology, amounted to USD 60,6 bln in February 2011, an increase of 31.6% y-o-y. Exports reached USD 39 bln, an increase of 27.7% y-o-y. Exports increased by 26.3% against the previous month.

Exports increased in value again due to growth in prices of global raw material markets. Amidst political tensions in the Arab nations, prices of Brent oil exceeded USD 100 per barrel on January 31, 2011 and remained unchanged since then. On April 9, 2011 the price of Brent oil reached the upper peak of USD 126,9 per barrel since July 2008.

The price of Urals oil reached USD 101,3 per barrel in February 2011, an increase of 39.3% y-o-y, an increase of 8.0% against January 2011.

According to the data provided by monitoring, the average price of Urals oil amounted to USD 114,5 per barrel over the period between March 15, 2011 and April 14, 2011. The Government of the Russian Federation issued Order No. 311 on April 25, 2011 under which the rate of export



Data source : the Central Bank of the Russian Federation.

Fig. 1. Key values of the Russian foreign trade, USD bln

customs duty on crude oil was to be increased from USD 423.7 per ton to USD 453.7 per ton since May 1, 2011. On May 1, 2011, the reduced rate of oil export duty increased to USD 211.7 per ton, against USD 191 per ton in April 2011, for 19 oil fields in the Eastern Siberia and two oil fields in the North Caspian. Since May 1, 2011 Vankorskoye, Verkhnechonskoye and Talakanskoye oil fields in the Eastern Siberia were excluded from the list of oil fields entitled to the reduced rate of export duty on oil. Export duties on light-oil products and dark-oil products increased respectively from USD 283.9 to USD 304 per ton and from USD 197.9 to USD 211.8 per ton, since May 1, 2011.

Table 1

## AVERAGE MONTHLY GLOBAL PRICES IN FEBRUARY IN THE PERIOD BETWEEN 2001 AND 2011

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Oil (Brent), USD per barrel.	27.2	20.3	32.1	30.9	44.8	59.7	58.26	92.66	43.87	73.8	104.1
Natural gas, USD/1 mln BTU	5.642	2.260	6.367	5.407	6.242	6.128	7.606	8.58	4.414	5.35	4.28
Gasoline, USD/gal.	0.882	0.616	1.045	1.045	1.37	1.734	1.662	2.48	1.262	2.16	2.70
Copper, USD per ton	1811.4	1601.5	1705.9	2759.0	3254	4982	5671.1	7887.7	3314.7	6899	9867.6
Aluminum, USD per ton	1602.1	1370.8	1428.04	1685.6	1883	2455	2759.14	2776.9	1330.2	2061	2508.2
Nickel, USD per ton	6544.6	6042.7	8619.64	15178.3	15350	14979	41154.5	27955.5	10409	19141	28252

*Data source* : estimates were made based on the data published by the London Metal Exchange (London, Great Britain), Intercontinental Oil Exchange (London).

According to the data published by the World Bureau of Metal Statistics (WBMS), in the period between January and February, the global aluminum market was characterized by an oversupply of 302 thousand tons against surplus at a level of 247 thousand tons y-o-y. The demand for primary aluminum amounted to 6.46 million tons in January – February 2011, an increase of 103 thousand tons y-o-y. Global aluminum production increased by 158 thousand tons in January – February, following an increase of 3.7 million tons at the 2010 year-end. Since aluminum is much cheaper than copper, the Chinese high voltage electric grids tend to use aluminum instead of copper, which makes aluminum further challenge copper in other sectors as well. The fact that many aluminum smelters are located in the Middle East makes the industry depend upon political situation in the region and prices of energy resources. Late in March 2011, a combination of these factors made the price of aluminum to reach a new 30-month upper peak at a level of USD 2653 per ton (a growth of 7.2% since the beginning of the year).

The global copper market was characterized by в January – February 2010 oversupply at a level of 118 thousand tons against a surplus of 32 thousand tons at the 2010 year-end. Global copper consumption in the first two months of the year was at a level of 2.996 million tons against 19.13 million tons in 2010 (over 12 months). Refined copper output amounted to 1.517 million tons in the period between January and February. On February 14, 2011 the price of copper reached its maximum of USD 10147.5 per ton over the last 30 years. Such a price rise was caused mainly by concern about copper deficit which is likely to take place in anticipation of growth in the demand at developing countries. However, increased oil price and a threat of replacement of copper components with other metals made investors less interested in copper, which forced the prices go down. Nevertheless, in February 2011 the average monthly price increased by 3.3% the January value but then decreased again to that value in March 2011.

According to the data published by the WBMS, the global nickel market was characterized by a moderate shortage in the supply at a level of 3700 tons in the period between January and February 2011. Production of nickel amounted to 273,8 thousand tons (+46.2 thousand tons on an annual basis) in the same period. Global demand for nickel increased by 59 thousand tons against the previous year. In February 2011, output at nickel smelters amounted to 130.7 thousand tons, consumption amounted to 129.8 thousand tons. The price of nickel increased by 10.2% in February 2011 against the previous month, but dropped by 5.1% in March 2011.

In Q1 2011 prices of non-ferrous metals will be supported by a traditional seasonal increase in consumption, and demand is expected to be increased in Japan which will need large volumes of metals to recover its destroyed infrastructure.

According to the data published by the Food and Agriculture Organization (UN FAO), global prices of food products decreased for the first time over the last eight months. For instance, in March 2011 the UN FAO food price index, which is based on the food basket including grain, oil-yielding crop, dairy products, meat and sugar, decreased by 2.7% against February 2011 and reached 230 points. According to the estimates made by the UN FAO, prices of vegetable oil and sugar decreased visibly in March 2011. In addition, the price of grain decreased a bit, and prices of rice dropped under a heavy supply in export countries. On the other hand, prices of dairy products and meat increased insignificantly. The UN FAO price index exceeded by 37% its value in March 2010

Table 2

## DYNAMICS OF AVERAGE GLOBAL PRICES OF SPECIFIC AGRICULTURAL GOODS

	2007	2008	2009	2010	2011		
					I	II	III
Wheat, USD per ton							
Canadian, CWRS	300.4	454.6	300.5	312.4	440.5	474.1	432.5
American, HRW	255.2	326.0	224.1	223.6	326.6	348.1	316.7
American, SRW	238.6	271.5	186.0	229.7	320.4	338.8	303.1
American corn, USD per ton	163.0	223.1	165.5	185.9	264.9	292.9	290.5
Barley, USD per ton	172.0	200,5	128,3	158,4	195,2	196,5	202,6
Soya beans, USD per kilo	384.0	523.0	437.0	450.0	572.0	570.0	553.0
Soya oil, USD per ton	881.0	1258	849.0	1005.0	1374.0	1365.0	1307.0
Thai rice, USD per ton	326.4	650.1	555.0	488.9	516.8	524.0	492.8
Raw sugar, FOB ports of the Caribbean basin, indicator price ISO, 11/kg	22.22	28.21	40.00	46.93	65.28	64.97	57.85

Data source : World Bank.

Import prices began to grow faster in the Russian Federation at the beginning of the year. Annual import prices grew up by 6.5% in February 2011 against 1.2% in January 2011. Export prices increased by 12.7% on an annual basis in January 2011 and 18.2%, in February 2011. The terms of trade were favorable for Russia due to a faster growth in export prices against import prices. The terms of trade index accounted for 111,4 points in January 2011 and 111,0 points in February 2011.

Increase y-o-y in exports in the period between January and February 2011 was reported for all groups of goods of the Russian exports, save for the group of food products and raw materials for food production. Exports of this group of goods decreased by 45.5%, while its share decreased from 2.3 to 1.1% in total exports.

Imports amounted to USD 21.6 bln in February 2011, an increase of 39.3% against the previous year, and 34.9% against January 2011. Imports increased due to strengthening of the RUB exchange rate against foreign currencies.

The Russian positive foreign trade balance increased by 15.67% up to USD 17,4 bln in February 2011 against USD 15 bln in February 2010. To compare, the monthly average positive foreign trade balance amounted to USD 9,3 bln in 2009, USD 14,9 bln in 2008, USD 10,9 bln in 2007.

According to the estimates of the Central Bank of the Russian Federation, the Russian foreign trade turnover amounted to USD 177 bln, including USD 112,6 bln of exports, USD 64,4 bln of imports in Q1 2011. The entire period of monitoring saw no such high values in Q1. In Q1 2008, exports and imports totaled USD 110,1 bln and USD 60,2 bln, respectively. The last year's upward trend towards surplus of imports over exports growth rates remained the same. For example, in Q1 2011 exports and imports increased by 22.1% and 40.9%, respectively, against Q1 2010. Imports grew faster immediately prior to the recession (in the first three quarters of 2008) amidst consumer and investment boom.

Substantial increase in imports depressed seriously the impact of high oil prices on the Russian trade balance. In spite of increase in the oil price and exports, a positive balance in Q1 2011 increased by mere 3.6% y-o-y due to faster growth in imports.

The import pattern shows a steady growth in the demand for engineering products (by 61.3% on an annual basis in March 2011). However, most of the demand was focused on overland transport, whose import increased by 2.1 times, rather than investment goods (deliveries of electrical equipment increased by 51.3%, mechanical equipment by 40.4%, optical tools and devices by 34.5%). The demand for imported knitwear and woven wear, by 1.6 and 1.5 times respectively, and footwear, by 46%, as well as a few types of food products (vegetables – by 1,9 times, grain crops– by 1.7 times) grew steadily. Import sugar deliveries increased by 3,3 times on an annual basis and by 11.7 times against the previous month due to a new rate of seasonal customs duty on raw sugar of USD 50 instead of USD 140 per 1,000 kg, which was established on March 1, 2011.

Normally, high growth rates of import deliveries are conditioned by growth in the domestic demand. However, the domestic consumer demand early in 2011 didn't grow because of negative dynamics of the real household disposable income which decreased by 1.8% in March 2011 against February 2011, and by 3.4% y-o-y, according to the data published by Rosstat. In 2011 the decrease lasted for three months on end against the previous year. As a result, in Q1 2011 the real household disposable income decreased by 2.9% y-o-y.

Therefore, the domestic demand has been increasingly satisfied with imports. There are no reasons to suggest that the situation may improve in favor of domestic manufacturers in the foreseeable future. In case of a heavy crop in Russia in 2011, there is a chance for domestic agricultural producers to return a part of the import-invaded food market.

Indeed, such a high growth rates in imports can't last for long. However, even though imports stabilize at the level of March till the end of the year, the value of imports would reach USD 300 bln (a growth of 20% by 2010) at year-end. The trade balance amounted for about USD 190 bln in 2011 against more than USD 150 bln in the previous year as oil prices and value of exports remained at the level of Q1 (respectively USD 111 per barrel and USD 42 bln in March 2011) till the end of the year.

A regular round of preparatory negotiations of the Work Group on Russia's accession to the WTO was held in Geneva late in March 2011. The Work Group discussed another five sections of the final report: pricing, export duties and three sections dedicated to customs clearing. A series of countries expressed a serious concern about the decision of the Russian Federation to limit the number of points of export of scrap metal through its customs frontier. The Russian party believes that such a change doesn't contradict the WTO's regulations, and the decisions were made for the purpose of ecological expediency. In addition, some of the participants at the meeting focused on the corporate problems which are associated with a new procedure of issuing an alcohol distribution license, but these issues are of "technical nature", according to the Russian party's opinion.

The next round of multilateral preparatory negotiations of the Work Group on Russia's accession to the WTO is scheduled for late in May 2011. The Russian party counted on that this meeting would be the final in terms of approval of the Work Group's report. However, it wouldn't: seven sections of the final report remain to be presented.

The emergence of new problems means that Russia is unlikely to be accessed to the WTO in 2011: changes took place in the Russian regulations, and subjects of discussion at the WTO arise as the current issues are discussed, like in the case of alcohol licenses. Furthermore, the issue on WTO agreements with Georgia still remains to be resolved. Though President of Georgia M. Saakashvili noted that negotiations between the two countries on the WTO issue can be considered as a positive fact, he also explained that Georgia takes a dim view of any "trade-off" agreements with Russia through the intermediary of the United States, which would allow Russia to bypass the issue of territorial integrity of the future partner within the WTO – i.e. the issues associated with the customs frontiers between the Russian Federation and Abkhazia and South Ossetia.

A new progressive scale for calculation of export duty rate was introduced instead of the fixed export duty on nickel in the Russian Federation. On April 25, 2011 the Government of the Russian Federation issued Order No. 312 "On Calculation of the Export Customs Duty Rate on Unalloyed Nickel" under which the rate of export customs duty on unalloyed nickel is to be determined on



the basis of an average price in the London Metal Exchange within the monitoring period and calculated by using special formulas. The monitoring period lasts from 1<sup>st</sup> date of the calendar month of the quarter thru the last date of the calendar month of the quarter.

Provision is made for a correction factor in calculating the customs duty rate. The rate is to equal to zero at a price up to USD 12,000 per ton, a correction factor of 0.05 is to be applied at a price ranging between USD 12,000 and USD 15,000, a correction factor of 0.15 is to be applied at a price ranging between USD 15,000 to USD 20,000, a correction factor of 0.3 is to be applied at a price more than USD 20,000. The Ministry of Economic Development and Trade of Russia of the Russian Federation was assigned to conduct a quarterly monitoring of nickel prices; submit to the Government of the Russian Federation, not later than on the 20<sup>th</sup> date of the calendar month following the end of the monitoring period, quarterly proposals on how to establish the rate of export customs duty on unalloyed nickel to be calculated by using the formulas provided for by the Annex to the Order. The rate of export customs duty on unalloyed nickel is to take effect from the 15<sup>th</sup> date of the calendar month following the end of the monitoring period.

Let us recall that late in 2010 the Government of the Russian Federation increased the export duty on unalloyed nickel from 5 to 10% of the customs value. ●

## NATIONAL BUDGET

E.Fomina

*Preliminary results of the federal budget implementation in Q1 2011 were summed up in April 2011. Owing to a positive external economic environment, there were reasons to suppose that federal budget deficit in 2011 would be less than the parameters set in the law. For example, deficit the federal budget deficit is expected to be 1.5% of GDP of less than 3.6% of GDP approved by the law. In 2011, growth in revenues may outrun by RUB 1440 bln the planned parameters. However, in spite of the forecast growth in budget resources, the degree of “diversification” of tax sources began to decline as early as Q1 2011. Virtually, today, federal budget revenues generate two taxes, namely mineral extraction tax and VAT.*

### Analysis of Main Parameters of the Enlarged Government Budget Implementation in the period between January and- February 2011

According to the Treasury of the Russian Federation, *the enlarged government budget* revenues decreased by 0.3 p.p. of GDP in January – February 2011 against 2010<sup>1</sup>. On the other hand, budget expenditures decreased by 1.8 p.p. of GDP in relative terms and grew by a total of about RUB 404 bln in absolute terms. As a result, the enlarged government budget was implemented with a surplus of 6.2% of GDP, which was by 2.3 p.p. of GDP more than in 2010 ( *Table 1* ).

Table 1

#### IMPLEMENTATION OF BUDGET REVENUES AND EXPENDITURES AT ALL LEVELS OF POWER IN THE PERIOD BETWEEN JANUARY AND FEBRUARY 2010 – 2011

	January -- February 2011		January -- February 2010		Deviation as p.p. of GDP
	RUB bln	as % of GDP	RUB bln	as % of GDP	
<b>Federal budget</b>					
Revenues	1505.6	20.6	1308.3	21.1	-0.5
Expenditures	1427.1	19.5	1477.8	23.9	-4.4
Deficit (-) /Surplus (+)	78.5	+1.1	169.5	-2.7	+3.8
<b>Consolidated budget of the constituent territories of the Russian Federation</b>					
Revenues	737.9	10.1	689.8	11.1	-1.0
Expenditures	652.3	8.9	606.1	9.8	-0.9
Deficit (-) /Surplus (+)	+85.7	+1.2	+83.7	+1.4	-0.2
<b>Enlarged government budget</b>					
Revenues	2.405,0	32.9	2,001.4	33.2	-0,3
Expenditures	1.949,5	26.6	1.757,7	28.4	-1.8
Deficit (-) /Surplus (+)	+455.9	+6.2*	+243.8	+3.9	+2.3
For reference: GDP, bln RUB	7.318,00		6.190,00		

\* A substantial enlarged government budget surplus against the federal budget surplus and surplus of the budget of the constituent territories of the Russian Federation can be explained by amended procedure for crediting money to extrabudgetary funds bypassing the federal budget.

*Data Source* : the Ministry of Finance of Russia, the estimates were made by experts from the Gaidar Institute.

*The consolidated budget of the constituent territories of the Russian Federation* was also implemented with a surplus of 1.2% of GDP in January – February 2011 against 1.4% of GDP in the previous period. A decline in the budget surplus of the constituent territories of the Russian

<sup>1</sup> Analysis of inflow of budget revenues to the budget system should consider investment revenues generated from managing oil & gas funds – RUB 125,9 bln and RUB 47,1 bln in January 2010 and 2011, respectively.

Federation was conditioned by a decline in revenues reallocated through regional budgets. For example, budget revenues decreased by 1 p.p. of GDP in January – February 2011 mainly due to reduction in uncompensated allocations (financial aid) from the federal budget. The Ministry of Finance of Russia is currently pursuing a policy aimed at equalizing subsidies and subventions to the budget of the constituent territories of the Russian Federation.

To optimize flows of intergovernmental support and encourage entrepreneurship at the constituent entities of the Russian Federation, it is planned to establish a promotion fund to support regional investments<sup>1</sup>. In addition, regional road funds are planned to be established following the establishment of the Federal Road Fund of Russia (the Budget Code of the Russian Federation will be amended accordingly). As above suggested, the key source of revenues of the road fund would be excises on petroleum products in full as well as transport tax. According to preliminary estimations, the road funds would accumulated nearly RUB 600 bln by 2013. Money among federal and regional levels of the budget system is supposed to be allocated in the following ratio: RUB 313 at the federal and RUB 293 bln at the regional levels.

In analyzing the enlarged government budget revenues generation structure (*Table 2*), it should be noted that growth in revenues is conditioned by growth in revenues generated from foreign economic operations.

Revenues from *mineral extraction tax and foreign economic operations* increased by 0.2–0,5 p.p. of GDP for each type of the revenues in the period between January and February 2011. The growth in these taxes and dues both in absolute and relative terms was caused by growth in global oil prices y-o-y (USD 103 per barrel against USD 75 per barrel).

*Table 2*

DYNAMICS OF INFLOW OF MAIN TAX REVENUES TO THE ENLARGED GOVERNMENT BUDGET  
OF THE RUSSIAN FEDERATION IN THE PERIOD BETWEEN JANUARY AND FEBRUARY  
IN 2010 – 2011, AS % OF GDP

	January – February 2011	January – February 2010	Deviation as p.p. of GDP
Tax burden level (1+2+3)	30.3	28.9	+1.4
1. Tax revenues, including:	17.3	18.0	–0.7
corporate profit tax	1.7	1.2	+0.5
personal income tax	3.3	3.5	–0.2
VAT	6.1	6.5	–0.4
excises	1.0	1.1	–0.1
mineral extraction tax	4.0	3.8	+0.2
2. Compulsory social insurance premiums	5.6	4.0	+1.6
3. Revenues from foreign economic operations	7.4	6.9	+0.5

*Data Source* : the Ministry of Finance of Russia, Rosstat, the estimates were made by experts from the Gaidar Institute.

Following a substantial growth in oil & gas revenues, non-oil & gas revenues showed an upward trend in nominal terms and multidirectional changes in relative terms (*Table 2*).

Revenues from *corporate profit tax* to the enlarged government budget increased by 0.5 p.p. of GDP in January – February 2011 y-o-y due to growth in the taxable base. For example, in the period between January and February 2011, the real sector obtained a financial result of RUB 1261,5 bln which increased by 40% y-o-y, and a share of profit-making companies increased by 1 p.p. y-o-y to account for nearly 63% of the total number of companies<sup>2</sup>.

Revenues from *personal income tax* to the enlarged government budget accounted for 3.3% of GDP in relative terms, which was less by 0.2 p.p. of GDP y-o-y. Nevertheless, revenues increased by nearly 10% in nominal terms in January – February 2011. Growth in personal income tax was

1 For more details please refer to the article below: “On the Initiative to Establish the Federal Regional Investment Support Fund in the Russian Federation”.

2 По данным Росстата «О финансовых результатах деятельности организаций в январе 2011 года» [Based on the data published by Rosstat: “Financial Performance Results of Companies in January 2011”].

associated in general with enlarged taxable base: dynamics of the monthly average gross payroll shows an increase up to the level of 2010 both in nominal ( 9.9% ) and real ( 2.5% ) terms.<sup>1</sup>

According to the estimates made by the Ministry of Economic Development and Trade of Russia, в 2012 personal income growth may reach 4% against the parameters in 2011<sup>2</sup>. The growth will be governed by increase in salaries in the public sector: military compensation and wages of government employees. On the other hand, growth in wages is expected to slow down in the private sector. This slow-down dynamics in wages in the private sector may result from both growth in insurance premiums payable to extrabudgetary funds and intention to “hide” a part of the taxation base thereby relieving tax burden from businesses.

However, the situation may change if insurance rates resume the previous level of 26–28% beginning with 2012. At present, discussion is underway on how to reduce rates for all businesses. The most probable option is to widen a range of wages, from RUB 463,000 to RUB 1 mln– RUB 1,5 mln, to be charged for contributions<sup>3</sup>. The Ministry of Finance of Russia made a preliminary statement on the possibility to introduce a small insurance rate within 3 to 5% for employers who pay higher wages. No option with zero insurance rates will be considered.

However, there is the risk that this tool will move tax burden on companies which pay higher wages, above all, the oil & gas and financial sectors, rather than relieve it on the economy.

*Excises* to the enlarged government budget slightly decreased (by 0.1 p.p. of GDP) in the period between January and February 2011. Even advanced growth of rates on a series of excisable goods failed to break the dynamics.

Partial reallocation (30%) of petroleum product excises to the federal budget can be noted among innovations in 2011. Previously, 100% of excises were credited to the budget of the constituent territories of the Russian Federation.

In the midterm period, to increase excise revenues to the budget, the Ministry of Finance of Russia suggests to increase excises on tobacco products by 2015 to a level of RUB 3,000 per 1,000 cigarettes from current RUB 270. Tobacco excise rates may grow by 60% in 2012<sup>4</sup>. According to preliminary estimate, this growth will help replenish the treasury by RUB 100 bln.

In general, it should be noted that in the period between January and February 2011 *tax burden* on the economy increased by 1.4 p.p. of GDP y-o-y to reach 30.3% of GDP. The midterm sources of increase of tax burden on the economy can be as follows: increase in excise rates on pure alcohol and tobacco, mineral extraction tax on gas (expected to be doubled), increase in property tax rates, changes in depreciation rates (it was suggested to go back to a rate of 10% instead of currently applicable 30%). In general, additional budget revenues in 2012 – 2014 may total nearly RUB 1,9 t, while most part of such revenues will be generated by increasing the excise on alcohol and mineral extraction tax on gas<sup>5</sup>.

Following the decrease of the enlarged government budget revenues, a relative level of revenues also showed decline: budget expenditures decreased by 1.8 p.p. of GDP ( *Table 3* ).

Table 3

IMPLEMENTATION OF THE ENLARGED GOVERNMENT BUDGET EXPENDITURES IN THE PERIOD BETWEEN JANUARY AND- FEBRUARY IN 2011–2010, AS % OF GDP

	January – February 2011		January – February 2010		Deviation as p.p. of GDP
	RUB bln	as % of GDP	RUB bln	as % of GDP	
Expenditures, total	1949.1	26.6	1757.7	28.4	–1.8
including					
National issues	171.9	2.3	151.9	2.5	–0.2
Including on servicing government and municipal debt	54.8	0.7	43.2	0.7	0.0
National defense	185.4	2.5	128.4	2,1	+0.4

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

2 <http://www.rg.ru/2011/04/12/uskorenie.html>

3 <http://bujet.ru/article/123877.php>

4 <http://www.minfin.ru/ru/press/speech/index.php?id4=12434>

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



Table 3, cont'd

	January – February 2011		January – February 2010		Deviation as p.p. of GDP
	RUB bln	as % of GDP	RUB bln	as % of GDP	
National security and law enforcement	176,2	2.4	172.2	2.8	–0.4
National economy	131.6	1.8	138.3	2.2	–0.4
Housing and utilities infrastructure	80.4	1.1	58.4	0.9	+0.2
Environmental conservation	1.9	0.03	2.2	0.04	–0.01
Education	201.0	2.7	187.5	3.0	–0.3
Culture, cinematography, mass media*	39.1	0.5	31.7	0.5	0.0
Healthcare and sports**	189.1	2.6	167.1	2.7	–0.1
Social security policy	772.2	10.6	719.9	11.6	–1.0

\*, \*\* changes were made to the functional classification of budget expenditures in 2011: “Culture, cinematography and mass media”, as well as “Healthcare” and “Sport” are recognized as separate items of the budget.

Data Source : the Treasury of the Russian Federation, the estimates were made by experts from the Gaidar Institute.

All the items of the enlarged government budget expenditures decreased in relative terms, save for “Housing and utilities infrastructure” which increased by 0.2 p.p. of GDP against 2010, and “National defense” which increased by 0.4 p.p. The decrease in public expenditures was associated mostly with a decrease in financing of “Social security policy” by 1 p.p. of GDP. “National security and law enforcement”, “National economy”, “Education” decreased as well, by 0.3 – 0.4 p.p. of GDP for each item.

### Implementation of the Federal Budget of the Russian Federation in Q1 2011

According to the preliminary assessment made by the Ministry of Finance of Russia, federal budget revenues accounted for 20.7% of GDP in January – March 2011, which is by 0.9 p.p. of GDP more y-o-y (*Table 4*). Federal budget revenues increased up to RUB 440 bln in absolute terms. The revenues generated in 2010 from management of oil & gas assets which totaled RUB 47,1 bln, were credited to the budget in January 2011. Total volume of oil & gas revenues accounted for 9.8% of GDP in January – March 2011, which is by 0.9 p.p. of GDP more than in March 2010. In general, growth in revenues in 2011 may exceed the planned parameters by RUB 1440 bln (RUB 1138 bln – oil & gas, RUB 301 bln – non-oil & gas). It should be noted that the degree of “diversification” of tax sources began to decline as early as Q1 2011. Today, federal budget revenues generate two taxes, namely mineral extraction tax and VAT<sup>1</sup>.

According to the forecasts made by the Gaidar Institute, federal budget revenues may increase up to 18.4% of GDP<sup>2</sup> if oil price averages at least USD 100 per barrel in 2011, which exceeds by 0.8 p.p. the budget value approved by the law.

Table 4

### BASIC PARAMETERS OF THE FEDERAL BUDGET OF THE RUSSIAN FEDERATION IN THE PERIOD BETWEEN JANUARY AND MARCH IN 2010 – 2011

	January – March 2011		January – March 2010		Implementation as % of the budget annual breakdown for 2011	Deviation	
	RUB bln	as % of GDP	RUB bln	as % of GDP		RUB bln	as p.p. of GDP
Revenues, including:	2391.3	20.7	1954.9	19.8	27.0	+436.4	+0.9
Oil & gas revenues	1134.1	9.8	877.6	8.9	27.7	+256.5	+0.9
Contributions to the Reserve Fund and National Wealth Fund (Stabilization Fund)	0.0	0.0	26.5	0.4	–	–26.5	–0.4

1 <http://www.kommersant.ru/doc/1621547?isSearch=True>

2 the estimates were made by experts from the Gaidar Institute as of 25.04.2011 .

Table 4, cont'd

	January – March 2011		January – March 2010		Implementation as % of the budget annual breakdown for 2011	Deviation	
	RUB bln	as % of GDP	RUB bln	as % of GDP		RUB bln	as p.p. of GDP
Expenditures, including:	2270.0	19.7	2199.5	22.3	21.3	+70.5	-2.6
interest costs	83.0	0.7	71.2	0.7	21.3	+11.8	0.0
non-interest costs	2187.0	19.0	2128.3	21.6	21.3	+58.7	-2.6
Federal budget surplus (deficit)	+121.3	+1.1	-244.6	-2.5	6.7	+365.9	+3.6
Non-oil & gas deficit	-1012.8	-8.8	-1122.2	-11.4	17.2	+109.4	+2.6
GDP assessment	11,541.0		9,873.3				

*Data Source* : the Ministry of Finance of Russia (tentative assessment), the estimates were made by experts from the Gaidar Institute.

Preliminary assessments of implementation of federal budget expenditures in January – March 2011 show a substantial decline of the same by 2.6 p.p. of GDP against Q1 2010.

A visible decline in expenditures was conditioned by slow rates of absorption of budget funds. The key factor of low dynamics of budget funds utilization were delays in approval of regulations at the government level as well as uncertainty with the CCBF (chief controller of budget funds) related to the ongoing reform of state-financed entities<sup>1</sup>.

In April 2011 it transpired that the annual budget breakdown would be amended to increase federal budget expenditures by a total of RUB 300 bln. The money will be allocated to finance wages of school teachers, additional indexation of pensions, provide support to the agricultural sector, small businesses, to prevent or suppress forest fires<sup>2</sup>.

Ineffective expenditures in terms of contribution to economic growth keep prevailing in the current expenditure pattern of the Russian budget system: high level of social and administrative costs, investment costs in support to enterprises of different industries (state subsidies), as well as high level of national defense and security expenditures against a relatively low level of expenditures on the development of the human capital asset (education, healthcare, culture, sports). In our opinion, this budget expenditure pattern is inadequate to the government course of modernization of the Russian economy and should be adjusted in the midterm period.

According to the preliminary data on January – March 2011, the federal budget was implemented with a surplus of 1.1% of GDP against a deficit of 2.5% of GDP in 2010; non-oil & gas deficit decreased considerably by 2.6 p.p. of GDP against the previous year and totaled 8.8% of GDP. In general, federal budget deficit at a level of 3.6% of GDP (USD 75 per barrel) was set in the budget law for the entire year. *According to the estimates made by experts from the Gaidar Institute, deficit may be reduced to 2.4% of GDP if annual average oil price is USD 100 per barrel.*<sup>3</sup>

The federal budget deficit will be financed from the following sources in 2011: the Reserve Fund, revenues generated from privatization of federal property, and public borrowings.

As of April 1, 2011, the Reserve Fund totaled RUB 748,5 bln (against RUB 775,2 bln as of January 1, 2011); the National Wealth Fund decreased to RUB 2609,7 bln (against RUB 2695,5 bln as of January 1, 2011).

Favorable foreign economic situation allows funds to be accumulated in the Reserve Fund thereby facilitating mitigation of inflation risks. In addition, going back to accumulation of an “airbag” implies growth in additional expenditure obligations, which is typical of any pre-election period.

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

2 <http://www.minfin.ru/ru/press/speech/index.php?id4=12434>

3 the estimates were made by experts from the Gaidar Institute as of 25.04.2011.

## RUSSIAN BANKING SECTOR

S.Borisov

February 2011 saw a string of notable developments in Russia's banking sector, including credit institutions growing increasingly keen to invest in government bonds against the backdrop of a moderate increase in lending to the real sector, a continuous increase in the volume of the portfolio of home mortgages, and a record-breaking level of balances of the populace's deposits.

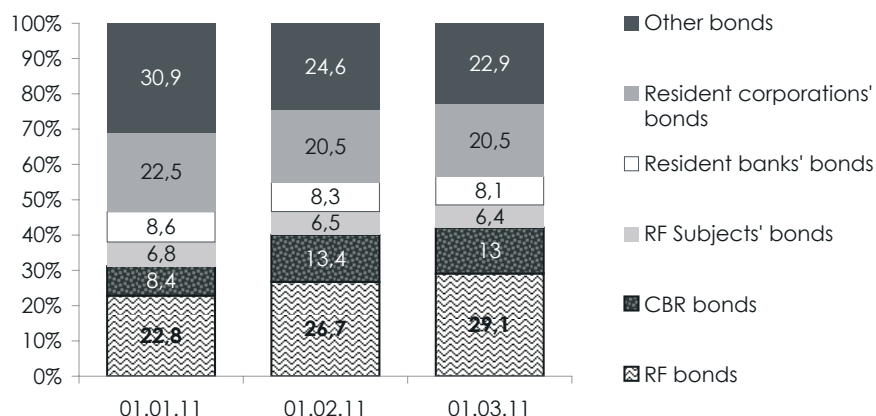
Table 1

MAIN INDICATORS OF RUSSIAN BANKING SYSTEM, AS RUB BLN.

	As of 01.03.2010	As of 01.01.2011	As of 01.03.2011		
			Face- value	Increase rate from the beginning of the year, %	Increase rate on a year-on- year basis, %
Assets	29 082.2	33 804.6	33 857.8	0.2	16.4
Loans to non-financial organizations	12 421.6	14 062.9	14 186.4	0.9	14.2
Loans to private individuals	3 525.8	4 084.8	4 103.0	0.4	16.4
Loans to banks	2 993.1	2 921.1	3 200.7	9.6	6.9
Investments in bonds	3 611.9	4 419.9	4 579.7	3.6	26.8
CBR Deposits	927.2	325.7	316.0	-3%	-65.9
Banks' deposits	3 077.0	3 754.9	3 734.7	-0.5	21.4
Deposits of legal entities	5 001.9	6 035.6	5 568.3	-7.7	11.3
Populace's deposits	7 671.7	9 818.0	9 920.7	1.0	29.3
Bank loan loss provisions	2 149.3	2 192.0	2 211.5	0.9	2.9
Profit (current year)	65.9	573.4	138.3		109.9

Source: the Bank of Russia

The second month of 2011 saw renewal of lending and the amount of the banking system's assets bounce back to its late-2010 level. According to CBR data, the national banking system's assets added 2% over the month (against a 1.8% drop in January 2011). It was banks' investments in securities and a substantially soaring volume of interbank lending that secured the greatest contribution to the balance-sheet total. The pace of increase in lending to the real sector and the populace alike proved to be substantially lower than the average figures reported over the prior 3 months. Banks were most keen to invest in RF bonds, with the respective portfolio posting a RUB 122.4 bln. – worth growth over the month, while the proportion of these papers in the security portfolio has added 6.3 p.p. since the beginning of the year. The most significant alternative to the federal bonds remained resident non-financial organizations' bonds; however, their proportion in the banking system's securities portfolio slid by 2 p.p. by results of the two months 2011 (Graph 1).



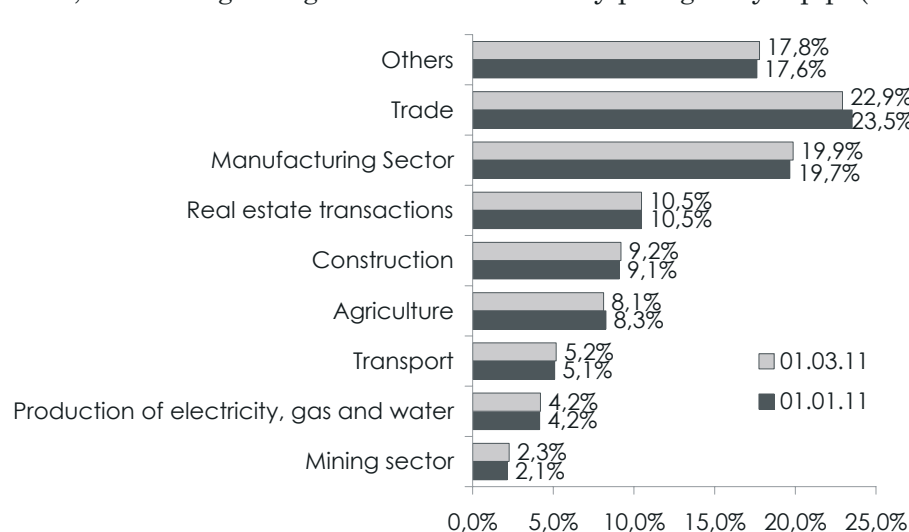
Source: the Bank of Russia

Graph 1. Structure of Banks' Investments in Debt Securities

The portfolio of loans to non-financial organizations grew by RUB 50 bln. over the month, or by 0.4% relative to January 2011. The sectoral structure of the corporate credit portfolio, which had emerged by late 2010, basically remained stable, while there began unfolding a string of quantitative changes therein, nonetheless.

Specifically, as far as the RUB-denominated part of the corporate credit portfolio is concerned, the proportion of loans to wholesale and retail trade organizations continued shrinking: as of 1 March 2011, the specific weight of this particular group of borrowers in the aggregate portfolio of RUB-denominated loans accounted for 22.9%, down by 0.6 p.p. over the month. Loans to wholesalers and retailers, as a rule, are denominated in RUB and used to finance their liquidity for the term of up to one year, with the credit risk being higher than average. According to the official data, the share of delinquencies in the portfolio in question shrank from 10 to 9.7% in the first two months of the year. In terms of specific weight in the banking system's corporate RUB-denominated portfolio, the second biggest category of borrowers is formed by manufacturing enterprises, with their aggregate share making up 19.7% as of 1 March 2011. Key consumers of banking products in this sector are food producers (25% of the aggregate credit portfolio as of 1 March 2011) and metallurgical corporations (15%), with the share of the latter being down insignificantly in February, while food makers, on the contrary, boosted their proportion in the portfolio in question by 0.1 p.p. An increase of the share of construction companies in the credit portfolio is worth a particular notice: between January and February 2011, the volume of lending to this sector soared by RUB 34 bln., while the sector's share in the aggregate portfolio posted a 0.1 p.p. increase. The detailed sectoral structure of the portfolio of RUB-denominated loans extended to non-financial organizations is displayed in *Graph 2*.

The retail credit portfolio extended by RUB 22.4 bln. in February, with the increase ascribed chiefly to growth in the volume of RUB-denominated loans to resident private individuals. Meanwhile, the forex-denominated part of the portfolio of retail loans to the populace continued to shrink. Product-wise, a particularly important indicator of a diminishing level of credit risk is growth in the volume of the home loans portfolio. While the statistics on the volume of home mortgages are traditionally delayed, however, with the January data at hand, it is possible to conclude the trend to increase in the portfolio in question is still there. Specifically, during the first month of the year (which is far from being a most favorable one from the perspective of lending activity), the volume of home loans added 2.22%, or RUB 25 bln., and stood at the level of RUB 1,127 bln. As of 1 February, the proportion of home loans in the Russian banking system's retail credit portfolio was 27.6%, thus having advanced by 0.9 p.p. over the past 6 months. The terms of lending continued to improve concurrently with the increase in the volume of home loans. In January, the average weighted interest rate on RUB-denominated mortgages lost 0.4 p.p. So, between 1 July 2010 and 1 February 2011, the average weighted rate has already plunged by 1 p.p. (*Graph 3*).



Source: the Bank of Russia

Graph 2. Structure of the Portfolio of RUB-Denominated Loans to Non-Financial Organizations, as %

The February resource base of the banking system saw the most substantial increase in regard to the volume of the populace's deposits attracted across all the categories of deposits. According to CBR, the monthly increase accounted for 2%, or RUB 191 bln., with the Top-30 banks combined attracting 131 bln. out of the said amount. Such statistics is yet another proof of a high degree of the biggest banks' oversaturation with liquidity. More specifically, banks with an extensive



and well developed retail business, such as Sberbank, VTB24, the Bank of Moscow, to name a few, have announced lower interest rates on private RUB and forex-denominated deposits. It is small-and medium-sized banks that continued to most vigorously boost their resource bases. In February alone, they boasted of a 2.4% increase (up by RUB 58 bln.) in the private clients' deposits. So, by results of February 2011 the volume of attracted private deposits in the national banking system hit its peak value over the last year under review. Meanwhile, the volume of funds attracted from legal entities grew by RUB 132 bln.



Source: the Bank of Russia

Graph 3. Dynamic of the Portfolio of Housing Loans and the Average Weighted RUB.- Denominated Interest on Housing Loans

In February, the national banking sector posted a RUB 61.5 bln. increase in profits, which have already hit RUB 138.3 bln. since the start of the year, or up by 110% on a year-on-year basis. CBR is to publish an enlarged report on the banking system's losses and gains by results of Q1 2011; however, it is already clear that it was extension of the banks' interest margin in tandem with slashed costs of formation of bank loan loss provisions that emerged as major drivers of rising profits.

The most noteworthy developments in Russia's banking sector in April were as follows:

- Since 1 April, the Bank of Russia has raised the rate of allowances for provisions. The rate was raised by one percentage point (from 4.5 to 5.5%) by banks' obligations before legal entities and from 3.5 to 4% - by all other obligations;

- The Bank of Russia plans to shift to October 2011 the date of entry into force of requirements to banks to employ increased capital-assets ratio while calculating their capital adequacy ratio. Initially, the Bank of Russia was going to tighten its requirements to banks that purchased non-core assets in significant volumes since 1 July 2011. The regulator estimates the current volume of such assets at the level of some RUB 700 bln.;

- In the frame of termination of the anti-crisis measures, the Bank of Russia gradually, between 1 April and 1 July, tightens its ranking requirements under refinancing banks against papers and non-market assets. Since 1 April, minimal ratings of securities included in the CBR's Lombard list and organizations included in the CBR's list have been raised by one step – from B-/B3 to B/B2 by Standard& Poor's, Fitch Ratings and Moody's Investors Service's classifications;

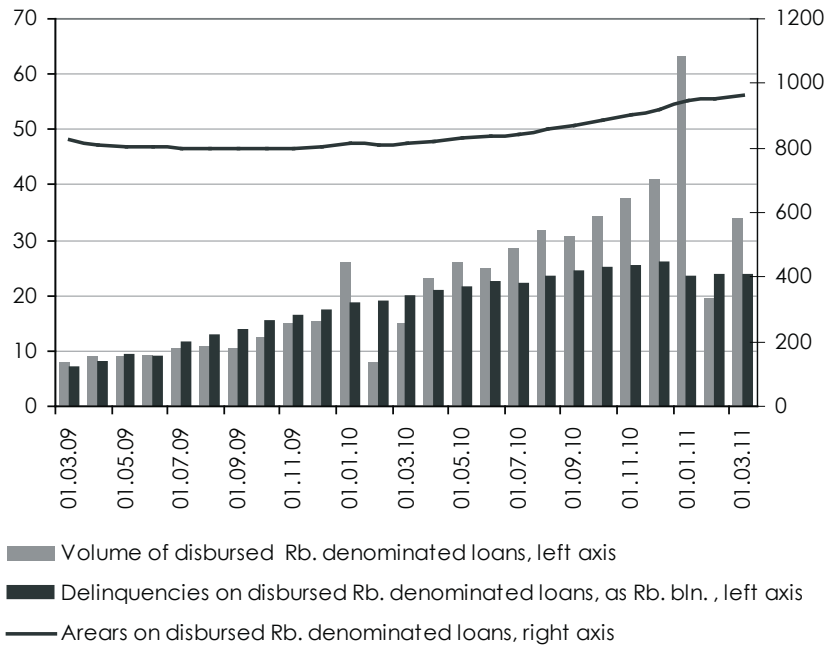
- In April, Russian banks placed their Eurobonds worth a total of USD 2 bln., which became a record-breaking volume over the past 7 months. Two banks enjoyed largest placements in their history to date: Alfa-bank managed to attract USD 1 bln. for the term of 10 years, while Promsvyazbank – USD 0.5 bln. for the term of 3 years;

- CBR loosen requirements to reservation of mortgages with the 10% initial contribution on condition of the borrower's insured responsibility, thus trying to give a boost to advancement of the insurance program of the public corporation HMFA, which was launched last year;

- On 15 April 2011, joint-stock bank ROSBANK convened an extraordinary shareholders meeting. At the meeting, the shareholders ruled to reorganize the bank (which is an open-end joint-stock company) in the form of its takeover of the Commercial joint-stock bank Societe Generale Vostok (closed-end joint-stock company). ●

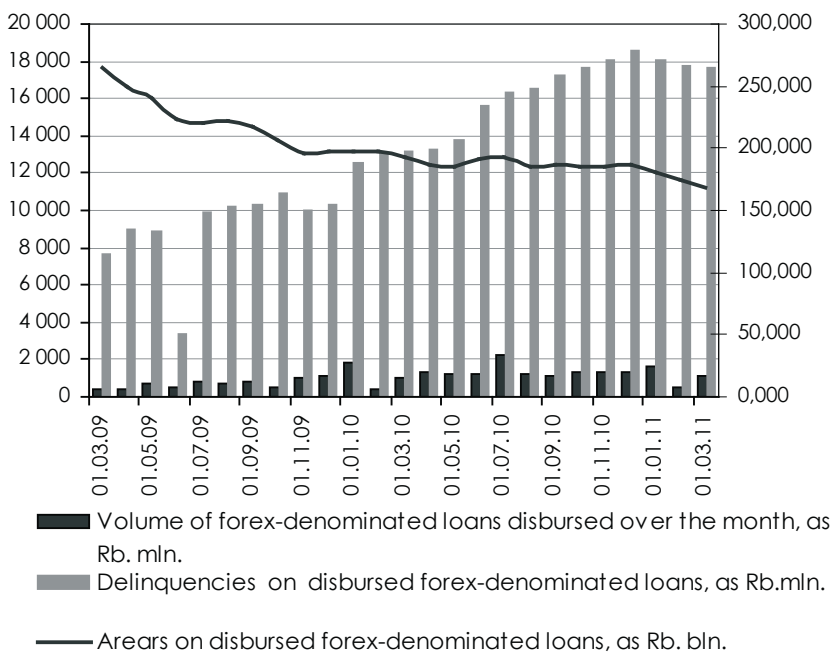
## MORTGAGE IN RF

G.Zadonsky



Source: CBR

Graph 1. Dynamic of Disbursement of Mortgage Loans, as Rb. bln.



Source: CBR

Graph 2. Dynamic of Disbursement of Forex-Denominated Home Mortgage Loans

In February 2011, the volume of disbursed mortgage loans increased 2.17 times vis-a-vis February 2010. Delinquencies on Rb. denominated mortgage loans accounted for Rb. 23,814 bln. as of 1 March 2011, which is a figure lower than in February 2010. The volume of arrears by defaulted housing mortgages and the proportion of the arrears in the aggregate volume of debt have been in decline. According to JSC HMFA's projections for 2011, the volume of mortgages on the primary housing market may hit Rb. 65 bln., while unmortgaged lending at the stage of construction may reach Rb. 96 bln.

According to CBR, in February 2011, the volume of housing loans extended to private individuals accounted for 31,932 units worth a total of Rb. 39,772 bln., including 25,281 units of home mortgages worth a total of Rb. 35,127 bln. The volume of housing loans extended in February 2011 was 2.06 times greater than a year before, while the volume of mortgages posted a 2.17 times growth on a year-on-year basis. As of 1 March 2011, housing loan delinquencies accounted for Rb. 1,292,642 bln., including those on mortgages – Rb. 1,130,960 bln., thus being at 1.5% greater than the ones reported as of 1 January 2011 (Graph 1). By contrast, debts on forex-denominated mortgages as of 1 March 2011 (Rb. 167,822 bln.) plummeted by 6.8% vis-a-vis the respective figure of 1 January 2011 (Graph 2)

Defaulted debts on housing loans as of 1 March 2011 accounted for Rb. 46,842 bln., including Rb.

41.456-worth ones on mortgages. Delinquencies on Rb.-denominated mortgages as of the same date stood at Rb. 23.814 bln., which is somewhat smaller a figure (*Graph 1*) than the one reported as of 1 February 2011 (2.868 bln.).

Defaulted debts on forex-denominated mortgages have been in decline since December 2010 (*Graph 2*) and accounted for Rb. 17.642 as of 1 March 2011. That said, their proportion in forex-denominated remaining mortgage balances (10.5% as of 1 March) kept rising due to the diminishment of the residual debt per se.

According to the CBR data, the volume of arrears by defaulted home mortgages (with outstanding payments over 180 days) and the proportion of such arrears in the aggregate volume of the mortgage debt kept declining (*Table 1*) As of 1 March 2011, the volume of defaulted arrears accounted for Rb. 52.363 bln., or 4.63% of the aggregate home mortgage debt.

Table 1

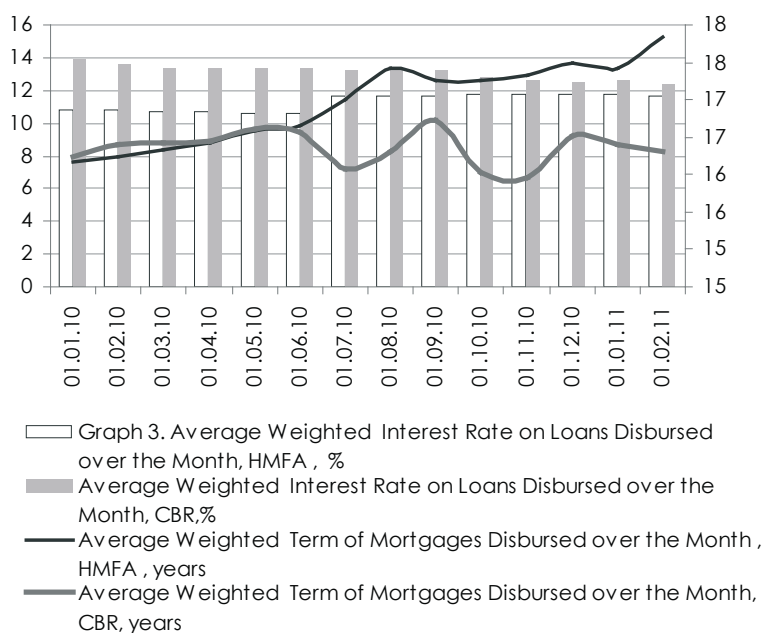
## CLASSIFICATION OF HOME MORTGAGE DELINQUENCIES BY LEAD TIME BEFORE PAYMENT

	Aggregate mortgage arrears	including							
		No outstanding payments		Outstanding payments between 1 and 90 days		Outstanding payments between 91 and 180 days		Outstanding payments over 180 days	
		As Rb. Mln.	as % to the aggregate mortgage arrears	As Rb. Mln.	as % to the aggregate mortgage arrears	As Rb. Mln.	as % to the aggregate mortgage arrears	As Rb. Mln.	as % to the aggregate mortgage arrears
2011 r.									
01 Jan	1 129 373	991 928	87.83	66 859	5.92	12 875	1.14	57 711	5.11
01 Feb.	1 127 529	977 116	86.66	84 565	7.50	12 290	1.09	53 558	4.75
01 Mar	1 130 960	980 204	86.67	86 518	7.65	11 875	1.05	52 363	4.63

Source: the CBR data

According to the CBR and JSC Housing Mortgage Finance Agency (HMFA) data, the average weighted interest rates on Rb.-denominated home mortgages disbursed over the month have been demonstrating a steady trend to convergence through 2010 and in early 2011 (*Graph 3*). The minimum value of the average weighted rate by refinanced by HMFA loans falls on May 2010 (10.60%), while the peak one – on December 2010 (11.80%) (*Graph 3*). In February 2011, the average weighted rate on refinanced by JSC HMFA loans slid further to 11.69%, while the CBR's figure was 12.4%.

By contrast to interest rates, the dynamic of average weighted terms by Rb.-denominated home mortgages extended over the month diverged from that of loans HMFA refinanced over the



Source: CBR  
Graph 3. Average Weighted Terms and Interest Rates on Rb.-Denominated Home Mortgages Extended over the Month

month (Graph 3): according to CBR, the former shrank to 16.3 years, while the latter extended to 17.8 years.

Table 2

CLASSIFICATION OF REGIONS BY THE NUMBER OF HOME MORTGAGES EXTENDED  
OVER THE YEAR

2011				2010			
Ranking		The number of loans of per 1,000 residents	The average amount of loan, as Rb. Mln.	Ranking		The number of loans of per 1,000 residents	The average amount of loan, as Rb. Mln.
1	Altay Republic	8.926	0.424	1	Nenetsky AO	5.354	1.676
2	Yamal-Nenetsky AO	7.154	1.707	2	Yamal-Nenetsky AO	2.812	1.473
3	Khanty-Mansy AO	7.071	1.705	3	Khanty-Mansy AO	2.642	1.408
4	Nenetsky AO	6.573	1.673	4	Tyumen oblast	2.483	1.218
5	Tyumen oblast	6.164	1.599	5	Chuvashya	2.048	0.694
6	Tatarstan	4.989	0.604	6	Komi Republic	1.947	0.801
7	Ural federal district	3.664	1.292	7	Altay krai	1.913	0.655
8	Novosibirsk oblast	3.626	1.131	8	Republic of Udmurtiya.	1.710	0.766
9	Chelyabinsk oblast	3.531	0.864	9	Perm krai	1.707	0.782
10	Chuvashya	3.393	0.788	15	Ural federal district	1.379	1.062
22	Sibir federal district	2.835	1.050	23	Sibir federal district	1.210	0.843
28	Volga federal district	2.630	0.884	32	Volga federal district	1.047	0.746
40	Far-Eastern federal district	2.158	1.336	38	North-West federal district	0.944	1.118
42	Russian Federation	2.099	1.221	41	Russian Federation	0.902	0.967
52	North-Western federal district	1.793	1.396	43	Far-Eastern federal district	0.879	1.070
65	Central federal district	1.481	1.750	59	Central federal district	0.686	1.281
66	Moscow oblast	1.457	2.327	61	St. Petersburg	0.666	2.039
68	St. Petersburg	1.423	2.136	62	City of Moscow	0.660	2.260
69	Southern federal district	1.358	1.195	65	Southern federal district	0.648	0.895
77	City of Moscow	1.165	3.049	81	Moscow oblast	0.465	2.225
86	North Caucasian federal district	0.715	1.016	86	North Caucasian federal district	0.339	0.839

Source: by the CBR and Rostat data

A top the 2011 list of regions in terms of disbursed home mortgages was Altay Republic (in 2009, it ranked 54<sup>th</sup>) (Table 2). As to such leading regions in terms of financial volumes of disbursed home mortgages as the Central federal district, Moscow oblast, St. Petersburg and the city of Moscow, they held 65<sup>th</sup>, 66<sup>th</sup>, 68<sup>th</sup> and 77<sup>th</sup> positions in the rating, respectively (Table 2).

The 2011 volume of refinancing of home mortgages by JSC HMFA so far has fallen behind the respective 2010 figures. In March 2011, the Rb. 2.32 bln.-worth increase in arrears on refinanced mortgages accounted for 63.8% of the respective figure in March 2010, while the increase in the number of refinanced mortgages made up 60.5% (Graph 4). The average amount of the loan by mortgages refinanced over the month oscillates in the region of Rb. 1 mln. a month, and in March 2011 it accounted for Rb. 1.037 mln. (Graph 4).

According to the JSC HMFA's forecast for 2011 (Table 3), the volume of mortgage lending on the primary housing market may hit Rb. 65 bln., and on the secondary market – Rb. 575 bln.



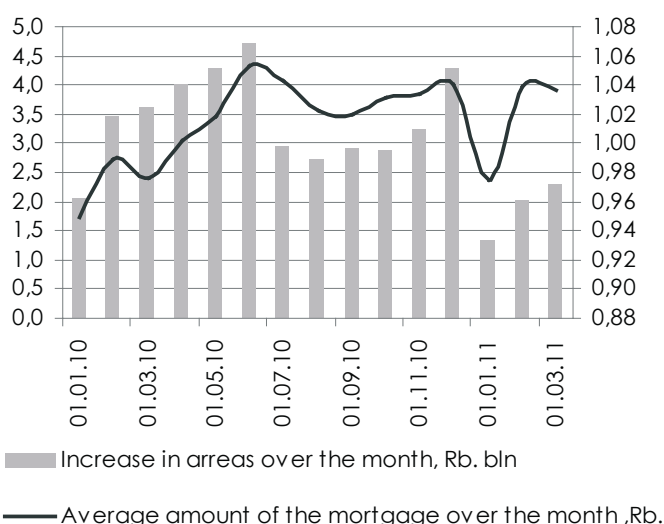
Meanwhile, the volume of unmortgaged lending on the stage of housing construction may account for Rb. 96 bln.

In early April 2011, JSC HMFA placed its sovereign-backed bonds series A18 with face-value of Rb. 7bln. and the coupon rate of 8% annualized. The total volume of demand made up 7 times the face-value and accounted for Rb. 49.4 bln. The same month, JSC HMFA also successfully completed a public offering at MICEX of its sovereign-backed bonds series A19 due 2024 worth a total of Rb. 6 bln. The ultimate overall demand for the issue was Rb. 16.5 bln.

In the frame of the program on encouragement of disbursement of credits (loans) on construction and purchase of housing “Stimul”, HMFA set differentiated rates on unmortgaged loans. The lower margin of the rate was set at the level of 7% annualized, while the upper one – at 8.75%.

In July 2010, the respective rate was cut from 11 to 8% due to Vensheconombank slashing the rate on its subordinated loan to HMFA from 9 to 6.5% annualized.

Following the JSC HMFA’s decision, special terms on disbursement and redemption of mortgages to WWII veterans take into account a subsidy to a veteran as an initial contribution, regardless of the moment of its actual granting (prior to or after provision of the loan). The special conditions also apply to loans with a fixed rate: “Standard mortgage”, “Floating rate”, “New housing development” and “Low-rise housing”.



Source: by data of JSC HMFA

Graph 4. Dynamic of Refinancing of Home Mortgages by JSC HMFA

STATISTICS AND FORECAST ON HOME MORTGAGES (2008–2011)

Table 3

	2008	2009	2010	The 2011 forecast
Mortgage loans on purchasing housing on the secondary market, as Rb. bln.*	534.9	136.9	340.7	521–575
As Thos. units	285.1	116.7	270.2	373–413
As mln. sq.m.	13.5	3.7	8.1	11–12
Mortgage loans on purchasing housing on the primary market, as Rb. bln.*	120.9	15.6	38.8	59–65
As Thos. units	64.4	13.3	30.8	42–47
As mln. sq.m.	3.3	0.5	1.2	1.7–1.8
Uncollateralized housing loans, including the ones at the stage of construction, as. Rb. bln.**	101.0	29.7	77.0	80–96
As Thos. units	157.8	48.4	94.7	125–160
As mln. sq.m.	4.3	1.4	2.8	3.6–4.5

Source: HMFA. (\*) – by RBK and Rusipoteka data; (\*\*) – by CBR data.

## PRIVATIZATION PROCESS AND THE STATE OF PROPERTY RELATIONS

A.Radygin, G.Malginov

*After some break caused by the global financial crisis in the first place, the privatization process notably revived in 2010. According to the RF Ministry of Economic Development, the amount of revenues generated by sales of privatized federal property in 2010 not just proved to be many times in excess of the respective 2008 volume but for the first time in recent years ensured over-fulfillment of the planned figures. A central development in the government's property policy has recently become the decision to replace government representatives, deputy prime ministers and ministers, with independent directors on boards of 17 largest corporations. Effects from the measure seem equivocal.*

The last year's progress in processes in the said sphere took the same path as the national economy as a whole did – that is, under the sign of overcoming consequences of the financial economic crisis. From the purely quantitative perspective, however, let alone the renewal of the privatization process, last year saw quite a number of important developments that affect the privatization policy in the medium term.

First, it is worth noting adoption of a huge package of amendments to the effective privatization law between the spring and summer 2010<sup>1</sup>. Most of them should be conceived of as unambiguously positive ones, as they champion competition, strive to secure a due level of transparency and to simplify privatization of small objects. To a less extent this can be attributed to such novelties as granting the government the right to make decisions on privatization of public property beyond the framework of “standard” procedures defined by the Act on privatization, simplification of employment of such a privatization mechanism as contribution with the government assets to JSCs' authorized capital.

Second, radical cuts were made in the List of backbone corporations and joint-stock companies which can be included in the prognostic privatization plan (program) only upon the RF President's decision, per the effective Act on privatization. In its original wording (as of the summer of 2004), it comprised 514 FSUEs and 549 JSCs.

Since that time the RF President made more than 100 decisions that modified the List. Their main vector became slashing the number of organizations and a minimum inclusion of new ones therein. That said, it should be borne in mind that some organizations were unfilled not for the sake of their subsequent reselling but for their prospective inclusion in the composition of emerging integrated structures, which later joined the List of backbone organizations.

As a result of the above, as of early 2011, the List comprised 149 FSUEs (3.4 times less than originally) and 49 JSCs (11.2 times down vs. the original figure). It goes without saying, such cuts shall not be attributed to the year of 2010 only, as large-scale cuts in the List used to be made earlier, too, eg. in 2007–2008. But the 2010 cuts appeared different from the previous ones as they did not pursue the goal of a subsequent formation of integrated structures; rather, they centered on scaling back on the number of JSCs dominated by corporations wherein the size of the federal stake was below the control value.

Third, the 2010 privatization program for the first time ever embraced a three year period (2011–2013) and accentuated the structural priority of privatization. The structural priority is fairly ambitiously labeled as “*one of instruments of “attaining the goals of transition to innovation-based socially oriented advancement of the economy”*”. When compared with the previous analogous document, the last privatization program holds such new tasks as (1) reducing the public sector for the sake of bolstering and fostering private investors' innovative initiatives; (2) improving corporate governance, and (3) encouraging the stock market's advancement.

<sup>1</sup> For more details, see the IEP's review “Rossiyuskaya ekonomika v 2010 godu. Tendentsii i perspektivy. (Vypusk 32)” (pp. 426-458)

Alongside with the traditional task of formation of the federal budget revenues, the list of the government policy tasks in the area of privatization of federal assets also comprises creation of conditions for attraction of extrabudgetary investment in development of JSCs (per the 2010–2012 prognostic privatization plan (program)) and shaping integrated structures in strategic sectors (per the 2009–2011 and 2010–2012 prognostic privatization plans (programs)).

So, it can be asserted that compared with the pre-crisis privatization programs, the government seriously revamped the set of officially declared public policy objectives in the privatization sphere.

Meanwhile, the recent program no longer cites such privatization tasks as privatization of assets not engaged in securing the exercise of government functions and powers (since the 2011–2013 prognostic privatization plan (program)), contraction in the number of SUEs (since the 2010–2012 prognostic privatization plan (program))<sup>1</sup>. Unlike the previous two prognostic plans (programs) of privatization of federal assets, the current one lacks the task of pursuing structural transformations in individual sectors.

Meanwhile, the newness of most privatization policy tasks appears a relative one, as back in 2003 the prognostic plan (program) comprised the task of attracting investment in the real sector, promoting the stock market and continuing structural transformations in the economy (the same task, albeit modified in regard to individual sectors, was cited in the 2004–2006 prognostic plan (program)).

Yet another drastically distinctive feature is plans to privatize 10 largest companies, with the respective decisions on the timing and method of selling of each of them being made at the governmental level. The group of companies with respect to which the Government is going to diminish its share in capital by selling different stock packages over 2011–2015 may ultimately include Rosneft, Rushydro, FSK, Sovkomflot, RZHD, United Grain Company (OZK), Rosagroleasing, as well as VTB, Sberbank, Rosselkhozbank. That said, it should be noted that the government is going to retain majority control in nearly all the aforementioned corporations and to sell mostly blocking and minority stakes in them.

As to the practical perspective, the 2010 privatization process renewed after some break caused, first and foremost, by the global financial crisis.

According to the RF Ministry of Economic Development, in 2010 the government cashed in RUB 22.67 bln.<sup>2</sup> from sales of privatized public assets, which not just proved to be many times in excess of the respective 2008 and 2009 volume (RUB 7.19 bln. and 1.93 bln., respectively) but secured over-fulfillment of the target figures for the first time over recent years.

In all, the government sold 134 stakes in JSCs, including 14 stakes in JSCs, the sale of which was announced according to the previous year's prognostic privatization plan. For reference, the 2009 figures were 52 and 26, respectively. So, the total number of stakes sold increased more than 2.5 times.

That the 2010 financial results proved to be relatively high should be ascribed to the sale of the state-owned stake (13.1%) in JSC Rosgosstrakh, which added RUB 8.765 bln. to the federal budget. This is likely to turn out to be the largest privatization deal since 2005; however, the offer price proved to be equal to the final one. As well, the government sold a full stake in JSC Metrostroy for RUB 7.559 bln., but the gap between the offer price and the closing one was more than three-fold<sup>3</sup>.

Meanwhile, quantity-wise, the 2010 privatization figures appear relatively modest vis-a-vis the previous years' results. Specifically, sales of federal stakes accounted for less than 2/3 of the 2008 figure (209 units), while the number of FSUEs with regard to which decisions were made on conditions of their privatization (62 units) fell 5-fold vs. the 2009 figure (316 units) (even without

1 In the prognostic plan (program) of privatization of federal assets for 2009-2011 this task was re-formulated as a simple transformation of FSUEs into JSCs.

2 Meanwhile, according to preliminary data of the Report on execution of the federal budget as of January 1, 2011, www.roskazna. Ru, the aggregate volume of the federal budget revenues from privatization and sales of assets (including land sites) accounted for a far less amount of RUB 18.68 bln.

3 www.rosim.ru, 29 September, 23 December 2010

regard to enterprises whose incorporation was subject to the MoD's decision as an addition to FSUEs the analogous decision on which was made by Rosimuschestvo).

Other important trends in the property relations area in 2010 were:

- Prevalence of renewable sources in the general structure of the federal budget revenues from privatization and public property management, albeit their proportion, which has been on the upswing over several previous years, somewhat plummeted (roughly to 79%), thus matching the pre-crisis 2007 year;

- Continuation of consolidation of public assets, albeit at a scale far less than in 2009 (in all, in 2010, decisions on inclusion in the composition of vertically integrated structures concerned 24 FSUEs and stakes in 46 JSCs vs. 124 FSUEs and 102 stakes in JSCs, without account of stakes in JSCs and unitary enterprises the proprietor powers with regard to which were assigned to MoD;

- A relatively low profile kept by corporations with government participation on the market for corporate control (which is quite natural for a post-crisis period), which formed the background for a vigorous performance by banks that became the government's agents in carrying out anti-crisis measures;

- Some progress towards reforming public corporations (ROSNANO transformed into a JSC with the government as its sole shareholder; operations of the public corporation "The Fund for Assistance to Reforming the Housing and Utilities Sector", which initially were set for termination on 1 January 2012, were extended for one more year; the act on the Public corporation for construction of Olympic objects and development of the city of Sochi as a mountain climatic resort was amended to include a clause abolishing the infinitive nature of its operations).

As to prospects of the privatization process, it is worth noting that the privatization program for 2011-2013, which was adopted in November 2010, displays a great deal of variability. The peak value of privatization revenues over the period of 2011-2013 is estimated at the level of RUB 1 trln., providing a favorable state of affairs on the market and the RF Government making individual decisions on privatization of highly attractive investment-wise stock in largest corporations. These factors aside, the 2011 privatization is estimated to gross just RUB 6 bln, while those in 2012 and 2013 – 5 bln. each.

The probability of this or that scenario finds itself reliant on prospects of selection of concrete privatization policy priorities<sup>1</sup> as well as the need to cover the budget deficit whose parameters, as shown by results of Q1 2011, can differ notably from original projections.

In the meantime, out of 26 investment-wise attractive JSCs (sea and river ports and steamships, airports) included in the privatization program after their exclusion from the List of backbone corporations and JSCs in summer 2010 on the basis of the RF President's decision the sweetest spots are 16 JSCs the federal stakes in which were set for sale by Rosimuschestvo in late December 2010.

As to the recent state property policy, the important developments became changes of heads of a string of large corporations with government participation in their capital (eg in the United Aircraft Corporation), which have not affected natural monopolists yet, though, as well as the decision to change government representatives, deputy prime ministers and ministers, in boards of 17 of such companies, for independent directors. The move is supposed to affect VTB, ALROSA, Rosselkhozbank, Rosspirtprom, Roasagroleasing, United Grain Company, Rosneft, Rosneftegas, INTER, RAO UES, Rushydro, Gazprom, Zarubezhneft, Aeroflot, Sheremetyevo, Oboronservis, Svyazinvest, the First Channel. That said, there is no complete clarity in regard to proportions of such changes and the array of companies the novelty would affect.

The move seems to bring about ambiguous results. On the one hand, it generates potential prerequisites for improving corporate governance, which is one of the new privatization program's objectives. On the other hand, it is highly likely that given the physical shortage of independent directors capable to stand up to requirements engendered by the significance of companies with the governmental participation in their capital, the situation will get back to the one of the early 2000s, with lower-rank civil servants representing the state interests in such companies. In any case it is not desirable to have the state lose its levers of influence on the corporations' management

<sup>1</sup> For more details about the structural and budget approaches to privatization, see the IET monthly review "Economiko-politicheskaya situatsiya v Rossii v yanvare 2011" (p. 60-63).

because of a lower status of its representatives sitting on their boards and a possible lowering of requirements to nominees to the boards, by analogy with insolvency officers, as it was noted, for example, in the course of implementation of the law on insolvency (bankruptcy) between the late 1990s and early 2000s. In all likelihood, on the eve of the envisaged “new privatization wave” the problem of the search for efficient corporate governance mechanisms in companies with government participation that should secure a due balance between strategic interests of the state and private shareholders’ ones has grown increasingly pressing. ●



## THE US STATE POLICIES REGARDING AGRICULTURAL LANDS: WHAT CAN RUSSIA LEARN?

N.Shagaida

*The converting of farmlands from the category of lands for agricultural purposes is a pressing problem in Russia. The corrupt practice of charge-free entitling of farmland owners with development rights should be replaced with the procedure of their official sale basing on the pre-set and easy-to-check criteria for decision making: the quality of land, the vicinity of roads and electric power lines, long-term plans of rural area development. In view of that the US experience in preserving agricultural lands for farm production could be useful.*

First of all, agricultural lands are the basic production factor in agriculture. Besides, they are the main resource for area development – the space for building roads, other communications, rural settlements, cities. In case no state policies for preserving agricultural lands are enforced, there is a great danger that the most valuable farmlands will be used for building since at the moment and in the short run these activities are more lucrative as compared with agricultural production.

The transfer of agricultural lands from rural residents to other categories of owners after their privatization was expectable: both then and now incomes of rural population were far below the national averages. Among the factors inducing transfer of land from the owners who got it in the course of privatization there are also high transaction costs associated with certification of titles to land and effecting of deals with it, the lack of limitations for buyers of farmlands. After the adoption of Federal Law “On the transfer of agricultural land” the transfer of land to persons that either were not engaged in farming at all or discontinued these activities as soon as there appeared a buyer for their land plots became a common practice.

What can one do to preserve the most valuable agricultural lands? In view of that it would be useful to examine the experience of countries with market economy, in particular the United States<sup>1</sup>.

Institutional economists define the title to land as a “bunch” of rights. These “bunches” are different for owners of land plots in the US and Russia. A Russian owner of farmland has to be engaged in farming. Only individual private farmers are officially allowed to build something on agricultural lands. But the Federal Law “On peasant (individual private) farm” does not specify directly that one can build a dwelling on farmer land – only premises needed for production purposes are mentioned. Owner of a plot in Russia cannot extract natural resources located deeper than 5 meters from the surface and sell selected titles to his plot. The titles of land owner are not clearly specified: seemingly there is no right to build a settlement on farmland but one can request such a permission from the regional or municipal authorities and get it – formally free of charge.

An American farmer or owner of farmland does not have to be engaged in farming. The general requirement is to do no harm to the environment while the question of whether the owner is occupied in agricultural production or not is of secondary importance. It’s even better if he is not – the more wild species will be preserved. An American farmer has the right to build a house for himself, houses for his children and various premises in case this does not contradict the farm area zoning. There are special rules for rural areas being a different zone. A farmer or another owner can build a settlement on his land even if his plot is situated in an agricultural zone or an agricultural district formed at the wish of farmers’ community since there is an opportunity to substantiate the alteration of zone and the withdrawal of land from agricultural district. It’s obvious that the constraints are rather soft. An American farmer can recover oil on his plot, hunt himself and let other people hunt. He can ban walking through his plot. So, the rights of an American land owner are defined or, in other words, specified. And this is the first difference from a Russian farmland owner whose rights for his plot are not clearly specified.

<sup>1</sup> The article is based on the results of study under the Fulbright grant in the Woodrow Wilson international research center (Washington, D.C.) in September 2010 – February 2011.

In the United States the system of guarding farmland from non-agricultural usage is based on the rights of American farmers. *First*, the inter-settlement area is zoned and the building density in agricultural zones is restricted as a measure to prevent construction of settlements on fields. There are no agricultural zones in Russia. One speaks about the need to zone inter-settlement areas but there are no debates about what should there be in such a zone, what are the principles of its establishment and how can one withdraw his land from it.

*Second*, in the United States agricultural activities in specific areas are supported. The respective mechanisms applied for that are the already mentioned zoning, establishment of voluntary agricultural districts, long-term area development plans, signing of agreements with owners of plots who intend to use them for farming. The combination of tools for such support varies greatly in different states. It depends on many factors: from the urgency of withdrawing farmland from agricultural usage to the structure of local community. There are states with abundant land resources but strong farmer traditions where multiple tools-incentives are applied to preserve land for agricultural production. In Russia there is a kind of substitute for this measure. There is a special category of lands – lands for agricultural purposes. Some general restrictions are in place for them but they are the same for the whole vast territory of the country despite very different social and soil conditions. For instance, the requirement to farm such lands is in force everywhere. Meantime, there can be both no demand for agricultural land and no registered and viable farm producers in some areas. Given the current ratio of prices for inputs and farm products profit-making in agriculture can be impossible. There can also be no demand for using such land for non-agricultural purposes. But despite all this a farmland owner there should be engaged in farming just like in areas with the best agricultural lands and numerous farm producers.

*Third*, in the United States there is a special mechanism of protecting farmers that reduces demand for plots near farms. Acts and rules are adopted at the district level specifying what is a normal agricultural activity. They state that claims of residents of newly built settlements won't be supported in court if they complain about noise, pollution and odors from the farm. The court will reject the claim if they complain about cow lowing early in the morning, the smell of manure, slow movement of tractors at the road, etc. In Russia there is no similar mechanism for protecting farmer operations although such a need has already appeared. Settlements grow in fields, not far from farms. Since there are no respective acts, houses will be readily bought forming high demand for agricultural lands to be used for building. New owners will defend their rights for odor-less air near their houses. And will win. This can have a negative effect not only on the emergence of new farm producers but also on the operation of existing ones – they may be forced to stop their activities. And agricultural lands will continue to be withdrawn from farming.

*Fourth*, a mechanism of lowering taxes for persons engaged in farming is applied in the United States. Property taxes are calculated similarly for a farm and any other real estate. They depend on market estimate that is determined by value of a plot (that can be used for different purposes – not only for farming) and associated property. If a farmer commits to be engaged in agricultural production, he can enjoy tax breaks that differ in the country's states. In case several years later the farmer breaks his promise not to build anything on his land he will pay to the budget all the saved taxes and the fine. The type of breaks, the set of taxes eligible for deductions and the size of fines differ by states. This mechanism of encouraging farm production is to some extent applied in Russia as well. But there are several principal differences. In the United States breaks are granted to those owners who commit to refrain from building on their fields while in Russia – to all owners of fields. In the United States regulations encourage agricultural occupation while in Russia – allow to pay little but force to be engaged in farming. And it's not always rational. It can be more rational to maintain a field in the condition enabling to involve it in agricultural production in case of necessity than to continuously farm it. But such questions are not even discussed: if you have a field you should produce farm output. Notwithstanding such pressure, the state has no commitments to buy this output at prices covering costs of forced production.

One of the tools for protecting farmland in the United States is the transfer of right to develop farmer plot. This right is transferred in exchange for payment or as a charitable contribution – donation to a special fund. After that the plot remains in the ownership of farmer who can dispose of it in any way – even sell. But the new owner too buys the plot without the right to build

settlements, roads and other buildings on it. Like the farmer he can build a house for his family, for his children but not for sale to other people. He may not be engaged in farming but the plot will never be built-up. The price for farmer plot without development right is far below that for a plot whose owner hasn't sold this right. That is why the property tax will be reduced. When inheriting such plot the heir will pay smaller tax for the inherited property since he acquires land without the development right. In case the development right is donated to a special fund, the personal income tax will be reduced by the amount of donation. Can such a mechanism be applied in Russia? It's obvious that it cannot. Donation of a selected right by plot owner in Russia is impossible. The sale of selected rights for plot is not envisaged as well.

This mechanism – the transfer of development rights to a special fund – is indeed a working mechanism for protecting farmlands. But it cannot be applied in Russia: owners cannot sell or donate development rights since they do not have them.

Given that there are no rights to develop agricultural lands in Russia there seems to be no problem of losing them. It's a paradox but one can get such rights from the state or municipal authorities and do it absolutely free of charge. Any owner can file an application to change the category of lands: to transfer them from the category of lands for agricultural purposes to the category of lands of settlements. This right is granted by the head of RF regional authorities. One can apply to the municipal bodies with the request to change the type of allowed use and get the right to build country houses on lands for agricultural purposes. While the procedure for altering the category of land is imperfect but still established, the procedure for altering the allowed use of inter-settlement areas does not exist at all. There are also no criteria for determining who can be granted such a right and who cannot. Nevertheless, this practice exists and formally no charge is required for getting this additional right. To obtain it one has to collect signatures of numerous officials. Each such signature makes the plot owner richer. When all the needed approvals are received, the price for a plot with development right rises hundreds times. The practice is very corrupt since the right greatly increasing the value of a plot is given free of charge<sup>1</sup>. Many officials become richer after such approvals.

Having assessed the US experience, one could surely recommend the transfer to sale of rights to develop plots of farmland in Russia. At first glance this seems to be a stimulus for converting lands from agricultural production. But this is not so. First, farmlands will be used for building in any case. There are almost no other land resources for these purposes. Second, it's rational to sell the right for developing agricultural lands that are not valuable. That is to return to their evaluation not on the basis of purely theoretical cadastral prices (that are applied now) but on the basis of nutritive and physical characteristics of soils. In the Soviet times such examination of chemical and physical properties of soil was done for each field almost each year. It's known where more and less valuable lands are located. In case there is no recent evaluation one can use previous results of soil examinations. Criteria for qualifying farmlands as the least valuable should be set. Third, development rights should be sold taking into account long-term area development plans including location of roads and other communications. Fourth, the new procedure of selling development rights will re-channel money flows from the pockets of dishonest officials to municipal budgets. The selling price for development rights is to be determined.

The price for development rights can be calculated differently. For instance, there is a market price for services of altering the category of lands for agricultural purposes. At present, one can find in Internet the cost of such services “in the crisis period”: 15 thousand rubles per hundred square meters. The second option is to base the estimate on prices of plots offered for sale in the same area. For instance, on the territory of one farm situated along Mojaisk road the plots for individual private farming (i.e. without the development right) are currently sold for 1,500 rubles per hundred square meters while those for building country houses (i.e. with the development right) – for 15,000 rubles per hundred square meters. The difference is the cost of development right.

<sup>1</sup> For instance, authorities in Moscow region bought plots for individual private farming and after changing the category of allowed land use sold them for building country houses (dachas). The profitability of these transactions exceeded 900% as compared with expenditures on purchasing farmer plots. N.Shagaida “Transfer of farmland in Russia: transformation of institutions and practice”. Moscow, Gaidar Institute for Economic Policy, 2010, pp. 267-270.

To conclude with, one can say that (1) the problem of withdrawing farmlands from agricultural production is pressing in Russia; (2) there is experience of working out state policies to preserve agricultural lands for farming in the world; (3) it's rational to transfer from the corrupt procedure of charge-free granting of development rights for farmlands to the procedure of their official sale basing on the pre-set and easy-to-check criteria of decision making: the quality of soil, the vicinity of roads and electric power lines, long-term plans of rural area development. ●

## ON THE INITIATIVE OF ESTABLISHMENT OF THE FEDERAL FUND FOR SUPPORT OF REGIONAL INVESTMENT IN RUSSIAN FEDERATION

A. Alaev

*The 2011 federal interbudgetary policy is supposed to undergo changes with regard to establishment of a special fund to incentivize regions to grow into locomotives of economic growth. Subsidies should be allocated only to those Subjects of the Federation that have posted the best performance in terms of boosting their tax capacity over the previous three years. The new policy should result in a prompt increase of the national welfare and creation of highly technological competitive products.*

While addressing the 8<sup>th</sup> Krasnoyarsk economic forum on 18 February 2011, Mr. A. Kudrin, the Vice Premier and Minister of Finance, suggested a special federal fund for support of regional investment should be established since 1 January 2012<sup>1</sup>.

It is planned that the pool of funding for the future Fund should be formed by unallocated federal budget revenues, which by results of 2010 accounted for Rb. 40 bln., of which 10 bln. (25%) should be allocated during the year for the purposes of the future Fund. The Minister reckoned that the purpose of creation of such a fund lies in the need to encourage regions to launch investment in innovation and to boost their tax capacity.

The Fund's distinctive feature should be a special mechanism of allocation of funding. Specifically, as many as 20 Russian regions that displayed the best economic performance over the previous three years should be entitled for a special bonus in the form of the federal funding.

To identify the most efficient regions eligible for the federal funding under the auspices of the future Fund, the government suggests employing such indicators as the average rate of increase in per capita investment over the previous years, an industrial output index, and an income growth index.

While elaborating further on the issue, Mr. A. Siluanov, Deputy Minister of Finance, clarified that underlying qualification assessments should be indicators calculated on the basis of investment performance in the non-oil-and-gas sector. "This is critical, and we are not going to give an upper hand to those who pump their resources into the mining sector instead of investing in innovations"<sup>2</sup>, said Mr. Siluanov. He also added that the indicators in question "shall be assessed by both their dynamic and statics", ie. the federal bonuses will be made available both to regions with a low level of investments but high growth rates of this indicator and regions boasting of a high, albeit unchanged, level of investments. Mr. Siluanov did not rule out that the Fund could be established as early as in 2011, with the basis of the calculations formed by the 2008–2010 figures.

Give the new initiative, it is possible to calculate the pattern of allocation of the future Fund's resources across RF Subjects, with account of the currently available open data on the level and dynamics of the non-oil-and-gas sector's performance.

Ideally, the indicator "Per capita investment in capital assets" should mirror which volume of funding a given region spends on modernization and renewal of local capital assets. That said, the indicator "Per capita investment in capital assets" might prove more accurate, as in addition to investment in capital assets, it also accounts investment in good-will assets, other non-financial assets, as well as costs of R&D, pilot-plan and technological works, which could more accurately reflect investing in innovations. However, Rosstat did not provide this indicator region-wise in its reports on 2008–2010. Given a huge proportion of investments in capital assets in the structure

1 <http://www.minfin.ru/ru/press/speech/index.php?id4=12465> – A. Kudrin's statements to news agencies at the plenary session of the 8<sup>th</sup> Krasnoyarsk economic forum

2 <http://www.minfin.ru/ru/press/speech/index.php?month41=11-1990&pg56=2&id4=12089> – A. Siluanov's statements to news agencies at the 8<sup>th</sup> Krasnoyarsk economic forum



of investment in non-financial assets (98.7% in 2008–2010), it seems permissible to employ the indicator in question to run a current assessment.

A more significant challenge arises due to the fact that Rosstat does not provide sector-wise data on investment in capital assets across RF Subjects over the period 2008–2010.

*Table 1*

INDICES OF THE DYNAMICS AND LEVEL OF INVESTMENT IN CAPITAL ASSETS PER CAPITA ACROSS RF SUBJECTS (WITHOUT REGARD TO INVESTMENTS IN THE MINING SECTOR) IN 2008–2010

	RF Subjects	The average growth rate in per capita investment in capital assets in 2008–2010, %	RF Subjects	The average growth rate in per capita investment in capital assets in 2008–2010, Rb.
1	Primorsky krai	163.7	Yamal-Nenetsky AO	197 179
2	Republic of Tyva	135.9	Republiv of Sakha	172 661
3	Kamchatka krai	132.9	Nenetsky AO	167 013
4	Tverskaya oblast	131.3	Leningrad oblast	123 692
5	Jewish AO	128.1	Sakhalin oblast	99 441
6	Krasnodar krai	127.9	Tyumen oblast	95 794
7	Leningrad oblast	127.1	Chukotka AO	94 183
8	Khabarovsk край	126.4	Amur oblast	85 692
9	Bryansk oblast	124.9	Khanty-Mansy AO	84 550
10	Kaluga oblast	124.7	City of St. Petersburg	77 964
11	Smolensk oblast	124.5	Lipetsk oblast	76 161
12	Voronezh oblast	124.2	Krasnodar krai	74 916
13	Tula oblast	123.2	Komi Republic	74 578
14	Republic of Dagestan	122.8	City of Moscow	74 255
15	Stavropol krai	119.3	Khabarovsk krai	69 530
16	Novgorod oblast	119.3	Primorsky krai	69 151
17	Ivanovo oblast	118.5	Republic of Tatarstan	68 514
18	Tambov oblast	118.5	Jewish AO	65 309
19	Komi Republic	118.5	Arkhangelsk oblast	64 471
20	Amur oblast	117.6	Kaluga oblast	63 848
	Across RF on the whole	108.8	Across RF on the whole	50 994

*Source:* Rosstat, calculations by IET named after Ye. T. Gaidar

*Table 1* shows that it was Primorsky krai that posted the highest growth rate (163.7%) in 2008–10. Plus, while enjoying a relatively low ranking by the level of investment (the 46<sup>th</sup> and 82<sup>nd</sup> positions, accordingly), such RF Subjects as Republic of Dagestan and Republic of Tyva joined the leading group by investment growth rates (122.8% and 135.9%). So, this is a proof to the thesis that regions differing by their level of economic development can qualify for bonuses from the Fund.

That said, it is noteworthy that while the indicator in question was calculated without regard to investments in the mining sector, there are among the Top-20 regions such oil-and-gas producing territorial entities as Yamal-Nenetsky, Khanty-Mansy and Nenetsky AOs. For instance, in Yamal-Nenetsky AO, the average investment volume per capita proved to be 3.9 times greater than the average nationwide one, which testifies to a significant accumulated volume of investment in sectors, which statistics does not directly account under the heading “The mining sector”, but which are associated with that category (eg. pipeline transport, construction of mining facilities). As well, the value of the indicator concerned found itself affected by a relatively small local population along with a high proportion of rotators.

*Table 2* below ranks the 20 regions by indicators of growth rate in, and level of, tax revenues to the RF Subjects’ consolidated budgets (less the mineral tax). It should be noted that the

diminishment of the aggregate volume of tax revenues by the value of the mineral tax did not exert any substantial influence on the final ranking. The main reason for that is that the tax in question has a small impact on the RF Subjects' consolidated budgets due to its centralization on the federal level within a fraction of revenues from the oil-and-gas operations.

Table 2

INDICES OF THE DYNAMICS AND LEVEL OF TAX REVENUES TO CONSOLIDATED BUDGETS (LESS THE MINERAL TAX) PER CAPITA ACROSS THE RF SUBJECTS IN 2008–2010, WITH ACCOUNT OF BEI<sup>1</sup>

	RF Subjects	The average rate of growth in tax revenues of the RF Subjects' consolidated budgets per capita over 2008–2010, %	RF Subjects	The average rate of growth in tax revenues of the RF Subjects' consolidated budgets per capita over 2008–2010, Rb.
1	Chukotka AO	137.0	City of Moscow	102 933
2	Republic of Ingoushetia	134.8	Tyumen oblast	69 144
3	Chechen Republic	131.3	City of St. Petersburg	61 015
4	Amur oblast	128.2	Khanty-Mansy AO	57 324
5	Karachay-Cherkessia Republic	126.8	Yamal-Nenetsky AO	50 965
6	Republic of Dagestan	125.4	Moscow oblast	40 646
7	Sakhalin oblast	124.9	Leningrad oblast	32 321
8	Republic of Adygeya (Adygea)	124.3	Sakhalin oblast	31 461
9	Jewish AO	121.9	Samara oblast	30 938
10	Altay krai	120.9	Republic of Татарстан	30 423
11	Kabardino-Balkaria Republic	120.8	Sverdlovsk oblast	30 372
12	Primorsky край	120.5	Lipetsk oblast	29 251
13	Kaluga oblast	120.5	Perm край	28 317
14	Altay Republic	119.5	Belgorod oblast	28 201
15	Novgorod oblast	118.4	Yaroslavl oblast	27 783
16	Ulyanovsk oblast	118.4	Vologda oblast	27 133
17	Voronezh oblast	118.3	Krasnoyarsk край	26 486
18	Ivanovo oblast	118.0	Nizhny Novgorod oblast	26 451
19	Khabarovsk krai	117.9	Kemerovo oblast	26 353
20	Republic of Sakha (Yakutiya)	117.7	Kaliningrad oblast	25 863
	Across RF on the whole	108.3	Across RF on the whole	29 315

Source: Rosstat, calculations by IET named after Ye. T. Gaidar

Table 2 suggests that it was only Sakhalin oblast which in 2008-2010 secured both high growth rates and volume of tax revenues. As many as 4 Subjects of the North-Caucasian federal district found themselves in the leading group of regions in terms of growth rate in tax revenues, which was determined by the effect of low income base over previous years and the currently increasing robustness of their local economies.

It should be noted that finding non-oil-and-gas revenues<sup>2</sup> by clearing tax revenues from the mineral tax does not constitute an absolutely accurate option, for corporations engaged in production

1 For such RF Subjects as Arkhangelsk oblast, Nenetsky AO, Tyumen oblast, Khamty-Mansy AO, Yamal-Nenetsky AO, Perm krai, Trans-Baikal krai and Kamchatka krai a design index of budget expenditure was developed, with the calculations being made proceeding from the correlation of budget expenditure indices of the respective subjects as well as their population.

2 In compliance with p.2 art. 96.6 of the Budget Code of RF, the following taxes and levies fall under the category of oil-and-gas revenues to the federal budget: the tax on extraction of minerals in the form of hydrocarbon raw materials (crude oil, natural gas from all kinds of deposits of hydrocarbon raw materials, gas condensate from all kinds of deposits of hydrocarbon raw materials); export customs duties on crude oil; export customs duties on natural gas; export customs duties on goods manufactured from oil. In compliance with art. 56 of the Budget Code, it is only 5% of the mineral tax which is collected to a region's consolidated budget.

of carbohydrate resources also pay other kinds of taxes, including the personal income tax, the property tax, and the corporate profit tax, which combined can account of a substantial part of all a region's tax revenues. Besides, the tax statistics do not allow singling out oil-and-gas corporations, and it is not clear yet, whether the RF Ministry of Finance will ever do so.

Table 2 also shows that practically a half of the leading group of regions (9 out of 20) have the level of consolidated tax revenues per capita under the average nationwide one, which can be explained by a great contribution of 11 regions atop of the list which raise the average nationwide level. That is why the identification of Top-20 regions is to some degree a provisional one. Thus, in 2010, the Top-11 regions by the indicator in question combined held 49.7% of all tax and non-tax revenues of consolidated budgets of RF, which seriously influenced the average nationwide level.

The last indicator in the list is industrial output, which is studied both in dynamics and statics (Table 3). After "clearing" of industrial output from the mining sector the ranking of Russian regions underwent drastic changes. This can testify to the prevalence of activities relating to mineral extraction in the structure of industrial output in individual RF Subjects.

Table 3

INDICES OF THE DYNAMICS AND LEVEL OF INDUSTRIAL OUTPUT PER CAPITA ACROSS RF SUBJECTS IN 2008–2010

	RF Subjects	The average per capita growth rate of industrial output across RF Subjects over 2008–2010, %	RF Subjects	The average per capita growth rate of industrial output across RF Subjects over 2008–2010, Rb.
1	Тверская oblast	140.2	Lipetsk oblast	1 095 390
2	Chechen Republic	139.3	Tyumen oblast	327 798
3	St. Petersburg	131.2	Vologda oblast	272 546
4	Nenetsky AO	124.1	Kursk oblast	260 634
5	Kamchatka krai	123.5	St. Petersburg	244 130
6	Republic of Adygeya (Adygeya)	122.2	Leningrad oblast	241 141
7	Kabardino-Balkaria Republic	121.5	Perm krai	215 086
8	Karachay-Cherkess Republic	121.4	Kaliningrad oblast	211 580
9	Republic of Tyva	120.9	Chelyabinsk oblast	211 455
10	Republic of Ingushetia	120.6	City of Moscow	206 297
11	Republic of Kalmykiya	120.2	Nizhny Novgorod oblast	205 075
12	Stavropol krai	119.5	Sverdlovsk oblast	201 627
13	Khanty-Mansy AO	118.5	Omsk oblast	198 641
14	Yamal-Nenetsky AO	118.1	Belgorod oblast	189 487
15	Republic of Buryatiya	117.0	Krasnoyarsk krai	187 072
16	Primorsky krai	116.6	Samara oblast	176 878
17	Republic of Dagestan	115.9	Republic of Tatarstan	175 477
18	Belgorod oblast	115.3	Khanty-Mansy AO	173 039
19	Kostroma oblast	115.1	Kostroma oblast	169 763
20	Republic of Sakha (Yakutiya)	115.0	Ymal-Nenetsky AO	163 872
	Across RF on the whole	109.2	Across RF on the whole	135 755

Source: Rosstat, calculations by IET named after Ye. T. Gaidar

As far as the index of the average level of industrial output with account of mineral production is concerned, atop of the list would undoubtedly be oil-and-gas regions. That said, after clearing industrial output from the mining sector, which substantially modified the ranking, such oil-and-gas regions as Khanty-Mansy AO and Yamal-Nenetsky AO are still therein. A similar situation was noted in the course of evaluation of tax revenues. The problem is that an identification of Top-

20 RF Subjects not focusing on mineral production and, at the same time, enjoying high economic advancement rates is just a provisional exercise. That is why taking into consideration of just non-oil-and-gas indicators does not cross rich oil-and-gas regions out of the list, for even without regard to their oil-and-gas revenues, many other Subjects are incapable to catch up with them. That said, the discussion on creation of a stimulating fund for leading regions at a round table held in the fall 2010 at the State Duma concerned only 10-15 Subjects of the Federation. Meanwhile, according to the RF Ministry of Finance's data as of late 2010, only 8 RF Subjects have the proportion of interbudgetary transfers in their revenues under 5%, while the number of donor regions makes up only 14 at best.

In addition to Yamal-Nenetsky AO and Khanty-Mansy AO, the group of leading regions (by both the volume and dynamic of volumes of industrial output) also comprises St. Petersburg and Belgorod oblast. In this context, it is worth noting a high level of industrial output in Lipetsk oblast (8-fold the average nationwide one), which is secured largely by industrial output of just a sole metallurgical corporation - NLMK<sup>1</sup>.

It would be methodologically inaccurate, however, to focus on individual Subjects' impressive performance in this or that kind of activity – it must be only Subjects that have been able to demonstrate both sustained growth rates and a high level of development, which can qualify for federal budget bonuses. That is why specific weight of indicators in the areas of investment activity, industrial output and taxation is set in equal shares, that is, 1/3, and the aggregate score of an RF Subject is computed using the following formula:

$$K_i = 1/3 \times (\text{Rank } I_i^I + \text{Rank } I_i^Y) + 1/3 \times (\text{Rank } H_i^I + \text{Rank } H_i^Y) + 1/3 \times (\text{Rank } P_i^I + \text{Rank } P_i^Y),$$

where:

Rank  $I_i^I$  – ranking of the  $i$ -Region of Russian Federation by the indicator of dynamic of investment in capital assets;

Rank  $I_i^Y$  – ranking of the  $i$ -Region of Russian Federation by the indicator of level of investment in capital assets;

Rank  $H_i^I$  – ranking of the  $i$ -Region of Russian Federation by the indicator of the dynamic of tax revenues;

Rank  $H_i^Y$  – ranking of the  $i$ -Region of Russian Federation by the indicator of the level of tax revenues;

Rank  $P_i^I$  – ranking of the  $i$ -Region of Russian Federation by the indicator of the dynamic of industrial output;

Rank  $P_i^Y$  – ranking of the  $i$ -Region of Russian Federation by the indicator of the level of industrial output.

The score of an RF Subject in each of the three spheres of activity in question is calculated by summing up their ranks by the above indicators of dynamic and output.

The final ranking of the group of leading Subjects with account of the above is presented in *Table 4*.

Table 4

RANKING OF THE SUBJECTS OF RUSSIAN FEDERATION BY AGGREGATE SCORE

№		Investment in capital assets		Tax revenues		Industrial output		The Subject's Score in			The Subject's aggregate score
		Growth rate	Level	Growth rate	Level	Growth rate	Level	Investment activity	Taxation	Industrial output	
1	Leningrad oblast	7	4	47	7	21	6	11	54	27	31
2	Tver oblast	4	32	31	35	1	27	36	66	28	43
3	Novgorod oblast	16	26	15	26	26	22	42	41	48	44

1 <http://www.nlmk.ru/>- Novolipetsky Metallurgical Plant

Table 4, cont'd

№		Investment in capital assets		Tax revenues		Industrial output		The Subject's Score in			The Subject's aggregate score
		Growth rate	Level	Growth rate	Level	Growth rate	Level	Investment activity	Taxation	Industrial output	
4	City of St. Petresburg	37	10	79	3	3	5	47	82	8	46
5	Yamal-Nenetsky AO	80	1	24	5	14	20	81	29	34	48
6	Primorsky krai	1	16	12	47	16	66	17	59	82	53
7	Kaluga oblast	10	20	13	21	44	51	30	34	95	53
8	Chukotka AO	54	7	1	45	24	28	61	46	52	53
9	Lipetsk oblast	23	11	78	12	36	1	34	90	37	54
10	Tyumen oblast	33	6	48	2	78	2	39	50	80	56
11	Republic of Tatarstan	27	17	66	10	34	17	44	76	51	57
12	Krasnodar krai	6	12	27	25	56	55	18	52	111	60
13	Voronezh oblast	12	34	17	43	27	53	46	60	80	62
14	Khanty-Mansy AO	67	9	75	4	13	18	76	79	31	62
15	Belgorod oblast	44	25	74	14	18	14	69	88	32	63
16	Kaliningrad oblast	34	22	41	20	64	8	56	61	72	63
17	Nizhny Novgorod oblast	30	23	59	18	55	11	53	77	66	65
18	Khabarovsk krai	8	15	19	46	62	50	23	65	112	67
19	Amur oblast	20	8	4	51	47	71	28	55	118	67
20	Komi Republic	19	13	56	29	63	31	32	85	94	70

Source: Rosstat, calculations by IET named after Ye. T. Gaidar

The amount of subsidies allocated to budgets of the RF Subjects that make up Top-20 by the score aggregating the three indicators in question is made using the following formula

$$S_i = S \times \frac{1/K_i}{\sum_{i=1}^D 1/K_i},$$

где:

$S_i$  – the amount of the subsidy allocated to the budget of the  $i$  Subject of Russian Federation;

$S$  – the overall amount of subsidies accounting for Rb. 10 bln.;

$K_i$  – aggregate score of the RF Subject.

The ultimate allocation of the Federal Fund for Support of Investment in Regions can be done as shown in *Table 5*.

Table 5

ALLOCATION OF RESOURCES OF THE FUND FOR SUPPORT OF REGIONAL INVESTMENT ACROSS THE RF SUBJECTS THAT DISPLAYED THE BEST PERFORMANCE WITH REGARD TO BOLSTERING THEIR TAX CAPACITY

	RF Subjects	Adjusted OR standardized? aggregate score	Allocation of the Fund's resources across the RF Subjects, Rb.	The share of the Fund's resources in aggregate RF budgets, %
1	Leningrad oblast	1,000	2 779 522 965	3,90
2	Tver oblast	0,500	1 389 761 483	2,97
3	Novgorod oblast	0,333	926 507 655	4,01
4	City of St. Petresburg	0,250	694 880 741	0,20



Table 5, cont'd

	RF Subjects	Adjusted OR standardized? aggregate score	Allocation of the Fund's resources across the RF Subjects, Rb.	The share of the Fund's resources in aggregate RF budgets, %
5	Yamal-Nenetsky AO	0.200	555 904 593	0.52
6	Primorsky krai	0.167	463 253 828	0.49
7	Kaluga oblast	0.143	397 074 709	1.03
8	Chukotka AO	0.125	347 440 371	2.56
9	Lipetsk oblast	0.111	308 835 885	0.80
10	Tyumen oblast	0.100	277 952 297	0.19
11	Republic of Tatarstan	0.091	252 683 906	0.14
12	Krasnodar krai	0.083	231 626 914	0.14
13	Voronezh oblast	0.077	213 809 459	0.30
14	Khanty-Mansy AO	0.071	198 537 355	0.12
15	Belgorod oblast	0.067	185 301 531	0.29
16	Kaliningrad oblast	0.063	173 720 185	0.45
17	Nizhny Novgorod oblast	0.059	163 501 351	0.15
18	Khabarovsk krai	0.056	154 417 943	0.21
19	Amur oblast	0.053	146 290 682	0.32
20	Komi Republic	0.050	138 976 148	0.28
	Total, across the 20 Subjects	3.598	10 000 000 000	0.53

Source: Rosstat, calculations by IET named after Ye. T. Gaidar

Should the Fund's resources be allocated using the above formula, it will be only 5 Subjects the proportion of the federal resources in whose aggregate budget revenues will account for more than 1%, while in the other 15 budgets it will be far lower than this figure. So, the role played by allocated resources of the Fund in encouraging regions to boost their own revenue base will be insignificant.

Meanwhile, of all the Top-20 regions, only 7 ones appear highly self-sufficient donors (Leningrad oblast, city of St. Petersburg, Yamal-Nenetsky AO, Lipetsk oblast, Tyumen oblast, Republic of Tatarstan, Khanty-Mansy AO) and do not receive subsidies out of FFSR. The total number of the Subjects not receiving such subsidies was 14.

Thus, the present evaluation of the concept of establishment of a Fund to encourage investment in innovation and the three indicators proposed for identification of leading regions exposed a whole range of substantial drawbacks.

First, the concept of an additional financial encouragement of wealthy regions conflicts with the task of equalizing budget sufficiency rates.

Second, the evaluation of the proposed indicators revealed their loose correlation with indicators of innovational development – regions with a high proportion of investment, huge tax revenues and steady economic growth rates (for instance the oil-and-gas ones, such as Yamal-Nenetsky AO and Khanty-Mansy AO) do not necessarily care to build infrastructure to foster cutting-edge technologies.

Third, given a relatively small amount of the Fund's resources and a big number of the Subjects entitled for bonuses thereof, budget funds will ultimately be just dispersed, and their small amount will not affect a Subject's strive for shaping a new financial policy aiming at earning money on its own.

We believe that a sound policy on encouragement of RF Subjects to boost their own tax capacity necessitates revival of the institution of direct gubernatorial elections, which will help solidify the local governance and bolster the authorities' accountability. It is only with and through the elections and stable rules of the game in the form of perpetual rates of contributions out of the federal taxes to the RF Subjects' budgets that incentives to boost a region's own revenue base automatically arise. ●

**KABARDINO-BALKARIA: EXTREMISM AND THE LAND ISSUE<sup>1</sup>**

I.Starodubrovskaya, N.Mironova

*Growing extremism in Kabardino-Balkaria is related to violations in the legal and political spheres. However, it would be incorrect to explain that by the above factors alone. Also important is such a violation of the economic rights as is the result of the unsettled issue of land ownership. In order to oppose the extremism, the Republic should switch over from a search for the ways of legal reinforcement of the existing land regulation which is a cause of serious conflicts to active land reforms.*

Aggravation of the political situation in Kabardino-Balkaria was a surprise to many people. Until recently, it was believed that the Republic which maintained the image of a territory with a developing economy and growing incomes<sup>2</sup> was one of the most peaceful regions in North Caucasus. A wave of acts of terror began in mid-September 2010 when Anas Pshikhachev, Chairman of the Spiritual Administration of Moslems of Kabardino-Balkaria and renowned opponent of proliferation of radical Islam<sup>3</sup> was killed. During the following two months, a few heads of municipal authorities in the territory of Balkaria and other civilians were killed too (on December 29, 2010 Arsen Tsipanov, researcher-ethnographer, Doctor of Science (philology) and Kabardian by nationality was murdered). However, the strongest public reaction was to the tragic events which took place on February 18, 2011 when three tourists from Moscow were killed and two more wounded in the vicinity of the Mt. Elbrus, while a few hours later a skyline ropeway situated between the Azau Station and the Stary Krugozor Station was blown up.

Growing terrorist activities and the subsequent introduction of the regime of the counter-terrorist operation (CTO) took place in the most economically developed areas of the Republic: in a number of districts of the city of Nalchik which is the Republic's capital and in the territory of traditional tourist destinations, that is, in the part of the Elbrus District, the Baksan District, the Chegem District and the Cherek District. The above developments pose a serious threat to the prospect of economic development of the region. The image of one of Russia's most famous and prosperous ski resort may be endangered and the small business may be ruined there. It is unclear yet when or if the situation recovers after such damage caused.

In such a situation, there have been various proposals as regards making radical changes in the political situation up to immediate introduction of a direct federal rule<sup>4</sup> in the territory of the Republic. At the same time, before making this or that political decision it would be important to understand the cause of that situation which has resulted (and not for the first time) in a rise of the radical extremism. One cannot but remember now the simultaneous attacks of the armed radical youth on 13 facilities of law-enforcement agencies on October 13, 2005. According to the official information, 35 law enforcement officers were killed on that day, while the attackers lost 94 persons dead with 69 persons imprisoned.

1 In preparation of this review, materials of Denis Sokolov, an IET expert were used.

2 Despite the positive image of the social and economic situation in Kabardino-Balkaria, in the past few years the objective data has pointed to quite the opposite situation. Research carried out by the Independent Institute of Social Policy (N.V. Zubarevich. The Monitoring of the Crisis and Post-Crisis Development of Russian Regions. [http://www.socpol.ru/atlas/overviews/social\\_sphere/kris.shtml](http://www.socpol.ru/atlas/overviews/social_sphere/kris.shtml)) shows that as compared to 2008 and 2009 in 2010 virtually all the important indices of the economic development of Kabardino-Balkaria declined. For example, a drop was observed in the dynamics of investments in capital assets, industrial production and households' income. It is to be noted that in 2010 in Kabardino-Balkaria the dynamics of households' income was the lowest as compared to other republics of the North Caucasian Federal District. In addition to the above, it was below the nation-wide average index.

3 The information was published on the site of the Rossiiskaya Gazeta on December 30, 2010. <http://www.rg.ru/2010/12/30/reg-kuban/cipinov-anons.html>. Yelena Brezhitskaya, Nalchik.

4 According to the Council of Elders of the Balkarian people, in the existing situation that would be the only efficient measure which could help restore the constitutional order and fight the terrorism which has recently inundated the region. Kavkasion – <http://www.kavkasion.ru> – February 14, 2011 in the News column.

The above events were discussed at large at the Civic Chamber where a round table – Kabardino-Balkaria: Problems of Radicalism among the Youth – was held on April 12. Participants in the above round table included representatives of public organizations, human rights activists, lawyers, senators, deputies and President of the Republic of Kabardino-Balkaria Arsen Kanokov. Most participants in the so-called Nalchik revolt are still kept in the investigatory isolation ward. According to some information, they are subjected to such inadequate measures of retaliation as tortures and beatings. It is obvious that the sheer fact that such a major legal trial (where public prosecutors, participants in the revolt and the general public have different versions of the above event) has been dragged on for many years is a destabilizing factor for the entire North Caucasus<sup>1</sup>. Such a situation contributes to growing mistrust of the authorities by the general public. However, the present rise in extremism can hardly be explained by those old events and the prolonged investigation which is not over yet.

Some participants in the round table did not limit themselves to discussion of the consequences of the Republic's political upheavals of the mid-2000s and pointed to the fact that Kabardino-Balkaria experienced a system crisis which manifested itself through acute political, social and economic problems. According to Andrei Yepiphantsev, a round table participant, a part of those problems is ethnisation (to be precise, “kabardinization”) of the political space, clan privatization and degradation of education and culture. It is worth paying a particular attention to the economic preconditions of the political instability in the region.

In the preface to the second edition of his book – *The Other Way: An Economic Response to Terrorism* – Hernando de Soto, a leading Peruvian economist analyses in detail the connection between the fight against terrorism and involvement of masses of people (primarily, those which are poor and dissatisfied with their living conditions) in legal economic activity. In that context, it is particularly important to settle the issue of the property relations. According to De Soto (the success of the reforms in Peru has proved that he was right), “if the state fails to protect the assets of the poor it actually leaves that function to terrorists who can use it to win over the outcast to their side. It is evident that one of the ways to sideline terrorists is the assumption by the government of the role of the guarantor which enforces the rights of ownership”<sup>2</sup> (it becomes clear from the book that de Soto means broad masses' private property which legalization is a must for creation of the market economy).

The above issue is particularly topical to Kabardino-Balkaria where violent conflicts related to the issue of land ownership have taken place time and again since the first half of the 2000s. That issue was repeatedly analyzed in publications of IET experts<sup>3</sup>. Here is a brief description of the problem.

As in most republics of North Caucasus, in Kabardino-Balkaria the land reform has not been carried out in accordance with the scheme which was adopted in the Russian Federation in general. A moratorium was introduced on privatization of the land. At the same time, that problem which was typical of the entire North Caucasus was aggravated by a serious conflict related to the inter-settlement territories.

Territorial organization of local government in Kabardino-Balkaria was established by Law No.13-RZ of February 27, 2005 on the Status and Borders of Municipal Entities in the Republic of Kabardino-Balkaria. Under the above law, the borders of municipal entities were fixed for the first time on the legislative level. It is to be noted that borders of many settlements were determined in such a way that they included only the land of settlements. As a result, the territory of a number of settlements decreased ten folds and was limited to the boundaries of the residential area; even cemeteries happened to be beyond settlements' borders. All the remaining land in a number of regions of the Republic was attributed to the inter-settlement territory. In the original law, the area of that territory amounted to more than a half of the entire territory of the Republic.

1 For instance, Fatina Tlisova, a journalist called the inmates ‘the prisoners of conscience’. See the text which was submitted and read aloud at the above round table of the Civic Chamber. The text was placed at the Internet site <http://nalchik-2005.blogspot.com/> on Tuesday, April 12, 2011.

2 H. De Soto. *The Other Way: The Economic Response to Terrorism*. – Chelyabinsk: Sotsium, 2008, c. XXIX.

3 I. Starodubrovskaya and N. Mironova. *The Municipal Reform in the Republics of the Southern Federal District*. – M.: IEP, 2010. [http://www.iep.ru/files/text/working\\_papers/132.pdf](http://www.iep.ru/files/text/working_papers/132.pdf). I. Starodubrovskaya, D. Sokolov, T. Intigrionova et al. *North Caucasus: Modernization Challenge* (the book is to be published by the Delo Publishing House).

In 2006, the area of those territories was considerably reduced, primarily, at the expense of the three mountain districts (the Cherek District, the Chegem District and the Elbrus District). The reduction of the land in the above districts amounted to 54.6% to 77.3%, while the area of such territories in the Republic in general reduced to 28%<sup>1</sup>. Though the Constitutional Court of the Russian Federation found such formation of inter-settlement territories in the Republic illegal, the issue remains unsolved till the present day.

At present, the Republic of Kabardino-Balkaria is preparing the Law on the Procedure for Determination of Territories and Utilization of Land for Free-Range Animal Husbandry. In reality, the above statutory act is going to be used to legitimize such an approach to distribution of the land as was used in formation of inter-settlement territories. The draft law provides for that:

- the base for determination of the land for free-range animal husbandry is historic borders of such a land and not the principle which takes into account the actual utilization or the best possible option of utilization of that land;
- territories of free-range animal husbandry are established by such a supplement to the law as includes a cartographic description of borders of such territories (in other words the composition of the territories of free-range animal husbandry is approved by the law and cannot be changed on an operational basis);
- the land for free-range animal husbandry are in the ownership of the Republic;
- the land for free-range animal husbandry cannot be included in the territories of settlements (that is, the inter-settlement principle is preserved).

It is to be noted that in other regions of the Russian Federation where similar laws have been passed they are not that tough as in Kabardino-Balkaria. For instance, similar laws were enacted in the Republic of Tuva and the Republic of Altai, however, they provide for a more flexible approach:

- a distant pasture is determined as such a land plot out of the land of agricultural designation as is meant for live-stock handling and ranging and allotted by decision of the Republic's authorized government authority or a local government authority;
- land for free-range animal husbandry can be included in the territory of municipal entities which historically maintain traditional forms of free-range animal husbandry;
- the above land can be in the republican ownership (in management and at disposal of the authorized government authority) and municipal ownership (in management and at disposal of the local government authority).

It is unlikely that a change alone in terminology of the legislation of the Republic of Kabardino-Balkaria without adjustment of the content of the land relations and fulfillment of the real land reform can reduce political tensions there. Despite the ban on privatization of the land, redistribution of the land is actually under way, but it is not carried out on a legal and administrative basis. Many respondents who were interviewed pointed to the fact that such a situation is dangerously explosive: "the land issue is not solved, it remains to be a problem which is going to explode one day"; "the best way to deceive people is to maintain the unaccomplished state of the land reform"; "even in the 1990s the issue of land relations was not that topical as it is now"; "one day we wake up and learn that all our land is somebody else's private property and then people will revolt". It is high time to discuss comprehensively to what extent and in what form approaches which proved to be effective in the fight against extremism in Peru can be applied in North Caucasus. ●

1 See: I. Starodubrovskaya and N. Mironova. The Municipal Reform in the Republics of the Southern Federal District. – M.: IET. 2010, p. 125.



## SECURING THE MILITARY SERVICEMEN'S RIGHTS AND FULFILMENT OF SOCIAL OBLIGATIONS BEFORE THEM

V.Tsymbal, A.Privetkin

*Problems in the area of ensuring the Russian military servicemen's rights have aggravated, and new initiatives are launched to address them. The present paper focuses on evaluation of new legislative initiatives on realization of concepts of raising the military's pay and ex-militaryservicemen's pensions.*

There is nothing new in the imperative to satisfy the military, civil personnel, military pensioners and their family members' social needs. The RF Government has lately paid a particular attention to the problem. In July 2007, a draft Strategy of Social Development of the Armed Forces of RF (AF RF) for the period until 2020 was designed<sup>1</sup>. The Strategy was subsequently approved in April 2008, and with his executive order of 28.04.2008 №241 the Defense Minister established the commission tasked to implement it.

The outlay seemed Andean. As a reminder, the intention was to make sure the AF RF join "the top five armies worldwide, particularly by main socio-economic indicators", while contract enlisted servicemen were supposed to join "the middle class in the country". To that end, it was suggested that their pay should have exceeded at 25% average salaries and wages in the country, and military pensions should have been raised to the level of 80% of the military money allowance (MA). As well, the military leadership vowed that, "The civil society for the first time ever will be able to contribute to control over the process of implementation of measures and programs that secure completion of the program". That said, the next statement, that is, "the army is growing genuinely transparent", contravened the source wherein the strategy was published<sup>2</sup> and even more so – the Commission's actual performance and the behind-the-door fashion in which bills on changes in AF RF were developed and respective debates in the State Duma were held.

In the aftermath of the military conflict in Southern Ossetia in August 2008 and the start of the economic crisis, the RF President (at the instigation of the military leadership) announced transition to a "new look" of our AF, which, notably, was likewise developed by stealth, thus leaving most civilians and military alike unaware of them. Life exposed erroneousness of those concepts and the manner they were implemented, including the AF recruitment system, in particular. That is why in February 2011, parameters of the "new look" were once again modified and became "the newest" ones<sup>3</sup>.

The RF President and Prime Minister used to publicly reminded bureaucrats of the need to develop a law on a new military pay. A draft document for some time was available on the Internet, but then vanished from the Web. Perhaps, an explanation is, someone in the MoD HQ benefited from the previous state of affairs, as it guaranteed a high level of MA. Implementation of the Strategy, which should have been completed under any "look" of AF RF, was brought to a halt.

Numerous civil and military experts, including the IEP ones<sup>4</sup>, debated the situation and reasons behind the arrested implementation of the Strategy. It was only after a preliminary consideration of the respective bill in the State Duma Defense Committee and a partial publication of background materials in media<sup>5</sup> that it became possible to incept a concrete evaluation. Note that there has

1 Novy vector. Dokumenty.Proyekt strategii//Krasnaya zvezda. 18.04. 2008.

2 Strategiya sotsialnogo razvitiya VS RF na period do 2020 goda//Voenny zheleznodorozhnik. №19 of 12–18.05.2008 and № 20 of 19–25.05.2008

3 For a more thorough analysis of the "newest" look of AF RF, see E. Trofimova's paper "Nekotorye dostizheniya i problem sotsialnogo razvitiya Vooruzhennykh Sil RF" in the IEP's February publication.

4 E. Trofimova. Denezhnoy dovolstviye voennosluzhaschikh – glavny factor perekhoda k dobrovolno komplektuyemoy professionalnoy armii//Ekonomiko-politicheskaya situatsiya v Rossii. 2008 №4. –M: IEPP. P. 39–44; V. Tsymbal, E. Trofimova. Problemy sovershenstvovaniya systemy obespecheniya denezhnym dovolstviyem voennosluzhaschikh//Ekonomiko-politicheskaya situatsiya v Rossii. 2010, №7. –M.: IEP. P. 64–71.

5 Materials on the bills on money allowance//VPK № 14 of 13–19.04.2011



been no official presentation of the bills as yet, while given the deadline of 01.01.2012, little time left for their taking through all the instances,.

In the meantime, the following documents are available for evaluation:

1) Draft Federal Act “On money allowance and individual compensations to servicemen”, along with a Letter of Comment and a Financial-Economic Rationale;

2) Draft Federal Act “On introducing amendments to individual legislative acts of Russian Federation due to adoption of the Federal Act “On money allowance and individual compensations to servicemen”, along with a Letter of Comment and a Financial-Economic Rationale.

At the same time, experts considered a string of other accompanying documents and publications on the issue.

### Evaluation of the rationale and objectives of the bills

That such bills were designed is a positive development of course. They contain provisions that are worth support; however, their evaluation demonstrated that such support cannot be an unqualified one.

To begin with, the bills in question do not imply they match the critical objectives, that is:

- most citizenry’s hopes;
- the course towards modernization of society and combat with corruption proclaimed by the RF President;

- the military’s socially significant interests, at least, in the form presented in the Strategy of social development of AF RF for the period until 2020.

All the above has its effect on comments and recommendations below.

First, neither letters of comments to the bills, no background reference materials developed for the State Duma Defense Committee’s meeting helped answer the question as to what was the reason behind the need for a radical change in the military pay and military pensions for servicemen who were (or will be) dismissed with the right to military pension.

The letters of comments contain a list of some executive orders with reference to which the bills were designed. However, the list in question (see *Table 1*) cannot be considered a complete one, nor it can be conceived of as being available for independent experts’ evaluation. Judging the defense classification upon them, not all MPs were cleared to view their contents.

*Table 1*

№	Documents cited	Comments
1	The RF President’s budget address on budget policy for 2011–2013	No direct link to the bills
2	The list of the RF President’s executive orders of 30.09.2010 № K4196 for 2011–2015 and through 2020	Classified or restricted
3	Executive order of Deputy Chairman of RF Government S.B. Ivanov of 07.10.2010 № СИ-П4-686с	Classified
4	The RF President’s executive orders of 05.07.2010 № Пп-1946	Classified or restricted

Meanwhile, as shown in *Table 2*, there exist official documents on the issue which should have long been implemented, let alone the aforementioned Strategy, which, as a departmental document, could be omitted by the authors of the bills. *Table 2* contains some effective documents of the supreme level that are associated with the need for giving the military service’s appeal a face-lift. They were not implemented for long, their texts were repetitiously adjusted and, perhaps, some might forget them, while we believe it is high time they were dusted off and implemented.

*Table 2*

№	Documents omitted but subject to execution	Comments
1	Resolution of the RF Government of 30.11.1992 № 918 on the start of transition towards draft	Execution interrupted in 1995 r. due to a number of reasons, including an insufficient appeal of military service, in particular.

Table 2, cont'd

No	Documents omitted but subject to execution	Comments
2	Decree of the RF President of 25.11.1996 № 1592 on completion of transition towards draft-based recruitment to the AF	Execution delayed until “necessary conditions are created”, which depends primarily on ensuring a positive appeal of the military service
3	The 2009 Address by the RF President	Obliges to develop an act on a new system of money allowance for the military.
4	The Military Doctrine of RF, as approved, by the RF President on 05.02.2010 (sub-point ‘g’ p. 30)	Cites the necessity of “training highly professional, loyal to the Motherland military, increasing prestige of the military service”

Needles to say, it is impossible to bolster prestige of the military service in the absence of a decent money allowance. That was the cause behind the failure of the federal target program of transition of military units of combat readiness towards draft-based recruitment by 2008. In its annual accounts on progress in implementation of the FTP, the RF Ministry of Economic development cited the need for monetary incentives for contract enlisted servicemen, while the MoD leadership opted for another stimulus – that is, compelling rank and file to “voluntary” conclude service contracts.

Any rate, it is preterlegal to ignore interests of servicemen of any category, nor it is authorized to forget genuine causes underpinning the money allowance reform. Basing on publicly available information, *Table 3* below comprises a provisional list of the causes in question. Notably, *Table 3* should be complemented just with *the requirement to ensure a highest possible pace* of manning the national military structure with highly professional servicemen and bolstering the AF’s military capabilities.

Table 3

No	Causes behind the need for a legislative reform of money allowance (MA) and military pensions	Comments
1	Impossibility to solve (under the previous procedure and size of MA) the problem of draft-based recruitment of individuals keen and capable to solve all the military tasks of peace- and wartime	As proved by the failure of the first stage of recruitment after 1992, the failed 2004–2007 FTP, and early retirements of young officers and cadets
2	Corruptogenicity of the conscription, retention in it, as a rudiment of the Russian serfdom, inequality between citizens and extrapolation of the inequality onto the MA sphere	As witnessed by materials of the Military Prosecutor and data of soldiers’ mothers committees
3	Impossibility for Russia to enter the top five nations with the best modern military, by socio-economic indicators, in particular, as per the Strategy of social development of AF RF	Since 2001, Russia has remained a sole G8 state retaining conscription.
4	Unmotivated violation of the constitutional principles of equality of citizens	Regular facts of MAs to AF RF falling behind respective rates in other military formations and MAs of civil public servants
5	The absence of a legislatively set alignment of the military’s MAs with the average salaries and wages (ASW) in the country	Both the size and the growth pace of MAs are not aligned to those of ASW, thus making AF RF uncompetitive on the labor market
6	Currently inaccurate, from the socio-economic perspective, proportions of the correlation between the maximum and minimum MAs (up to 10 times, with all uplifts), which results in the growing social dissatisfaction and is pregnant with negative consequences	The bills contradict the National Security Strategy through 2020: the document cites such correlation among critical indicators of the socio-economic security.

Table 3, cont'd

№	Causes behind the need for a legislative reform of money allowance (MA) and military pensions	Comments
7	Fall in the military pensions vis-a-vis those of civil public servants and some other categories of citizenry	Is pregnant with negative, socially perilous consequences
8	The general decline of the military service's prestige, contrary to the declaration of contract enlisted servicemen entering the category of "the middle class of the country", which should help solve the problem of human resources in the defense area.	The concurrent fall of MA and MP and other incentives, which in other countries bolster the military service's appeal and the servicemen's status
9	Depriving citizens of a decent military pension, as the length of their service in AF RF and other military structures does not make them qualified for it.	Unlike other employers, the national military structure does not contribute to the military taxpayer's individual pension plan.

### Main Findings

1) The bills in question constitute an attempt to execute orders of the national supreme military-political leadership about introduction since 2012 of new, substantially raised amounts of money allowances to the servicemen and military pensions to those dismissed from the service. This is worth support in principle.

2) That said, the bills lack provisions of direct force in regard to main parameters of military allowances and military pensions, but reference to prospective bylaws.

3) The published tables of future amounts of MAs and MPs, which are provided as illustrations to the bills, have *de facto* no direct relation to the law, as they are not fixed legislatively. This means that upon adoption of the respective acts the promised parameters of MAs and MPs will not be guaranteed, while following the tradition, the bylaws will be designed without a due public (and even parliamentary) control, and the question as to whether the parameters would match the current promises remains unanswered.

4) Some provisions appear unproductive, inaccurate and even erroneous, which compels the experts to make the following marginalia:

– The bills comprise *provisions conflicting with the RF Constitution of 1993* (p. 2 art. 19 and p. 2 art. 55);

– *Some provisions conflict with a number of effective acts*, but there are no proposals to abrogate some due to promulgation of new acts. Thus, there arise preconditions of violation of some rights of the citizenry, disruption of the integrity of the national public service system: more specifically, it may occur due to a potentially widening gap between the MA system for the military and the one for civil servants; the measures earlier articulated in presidential Decree №249 of 2002 "On measures on improvement of the monetary allowances system for the servicemen" are placed in doubt;

– The bills absolutely ignore the rights of low-paid categories of the military to a decent MA, which derails the concept of an accelerated transition of active duty force towards voluntary, draft-based service by means of *competition-based* recruitment of much-needed specialists; hence, ultimately, the objective set in the presidential Address would remain unattained;

– *Low-paid military pensioners* would continue to be pariahs, which may engender social tensions;

– If signed into law, the bills would abolish some legal provisions regulated by other acts; they do not specify amendments to a number of effective acts and retain possibilities for a by-law extension of the *allegedly "ultimate" list of compensations*.

5) The bills suffer from substantial inaccuracies, which mirror an absence of a thorough work on them. The bills do not match reference materials of the RF Ministry of Finance. More specifically:

– Main principles and tasks fail to meet the substance of the bills: eg. the declared "setting of the closed (final) list of compensations to all the servicemen and individuals equaled to them" was not accomplished, while the definition does not match the title of the act (in regard to "equaled individuals" referenced to in the bill);

– Authors of the bill failed to consider all the compensations that fall under the category of those subjected to abolition or which should be abolished in effect of the bills;

– Rank and service grade-wise, amounts of wages provide for establishment of several “sorts” of servicemen, which contravenes the equality principles, while there is no rationale for reasons for their violation.

Overall, the bills cannot be recognized as meeting modern requirements, particularly by amounts of MAs and MPs.

**Is there an alternative in the current situation?**

From our perspective, there can be two answers to the above question:

- Developing a new alternative bill and proposals on its broad and public discussion;
- As a starting point, formulation of conceptual (fundamental) provisions which the law should match. The latter option seems more realistic (see *Table 4*)

*Table 4*

Effective legal provisions	Provisions as per the bill
<p>Art. 12 of FZ № 76 of 1998 “On the status of the servicemen” p. 2, part 3: The amount of salaries across standard military ranks of the servicemen, salaries by military grades of the contract enlisted servicemen and extra compensations are determined by the RF Government upon submission of the RF Ministry of Defense (other federal agency of executive power (FAEP), the military service in which is provided for by the federal law) with observance with the condition of uniformity of basic norms of money allowances due to the military servicemen.</p> <p>Art. 50 of FZ № 58 of 2003. “On the public civil service of RF”: Amounts of post salary and salary for the grade rank of federal public civil servants are set by Decree of the RF President upon submission of the RF Government.</p>	<p>Art. 1 of the bill on MA and individual compensations by points:</p> <p>5. Uniform amounts of salaries by military grade are determined by the RF Government.</p> <p>6. Amounts of salaries by standard military grades of <u>the contract enlisted</u> servicemen are set by the RF Government upon submission of heads of federal agencies of executive power (FAEPs), the military service in which is provided for by the federal law)</p> <p>7. The amount of salaries across standard military ranks of the servicemen, as well as extra compensations and their amount due to <u>conscripted</u> servicemen are set by the RF Government upon submission of heads of federal agencies of executive power (FAEPs), the military service in which is provided for by the federal law)</p> <p>8. Amounts of salaries by non-standard military grades of the servicemen are set by heads of federal agencies of executive power (FAEPs), the military service in which is provided for by the federal law as applied to salary amounts across standard military ranks.</p>
<p>Comment. Authors of the bill de facto destroyed the principle of uniformity of the public service system (see Federal Act of 2003 № 58-FZ «On the system of public service of Russian Federation », p. 1 Art. 3)</p>	
<p>Alternative version (fundamentals) of main legal provisions on MA: Amounts of the military servicemen’s MAs are set (adjusted) by the RF President upon submission of the RF Government annually (in the course of development of the federal budget) with contribution from all the FAEPs, the military service in which is provided for by the federal law, proceeding from the following values:</p> <p>a) the amount of ASW across the country: for citizens who enter in the first contract on military service in active forces (with the MA/ASW contingency factor of 1.25, that can be further specified in the course of developing the draft federal budget),</p> <p>б) salaries volumes of the civil service: for all the contract enlisted servicemen re-appointed to new positions and/or renewing their contracts, with a specified scale of congruity between the military service and civil service ranks. Citizens conscripted to exercise their constitutional duty on protection of the Motherland and performance of active duty are awarded with the following MA:</p> <ul style="list-style-type: none"> <li>– during the training period in military training units (centers) for preparation for a subsequent military service in active forces or joining the reserve training: MA should match standard government student stipendiums ;</li> <li>– during the period of soldiers, able ratings, and sergeants’ subsequent conscription-based military service, their MAs should match those of contract enlisted servicemen.</li> </ul> <p>All the servicemen performing their active duty in RF are entitled for MA in accordance with the same scales of amounts of position salaries, grade salaries and all extra compensations, except for the one for special conditions of military service that can vary across different FAEPs the military service in which is provided for by the federal law.</p>	



## PRUDENTIAL OVERSIGHT AND INVESTING OF PENSION SAVINGS

L.Sycheva, L.Mikhailov

*In early 2011, the State Duma passed in the first reading a bill “On introducing amendments to the Federal Act “On securities market” and other legislative acts of Russian Federation”. The bill is supposed to introduce amendments to a number of federal acts, including FZ-75 “On non-governmental pension funds”. As the bill establishes requirements to participants on the securities market, including private equity plans in particular, it became known as the bill on prudential oversight.*

More specifically, as far as NPFs are concerned, the bill suggests amending art. 7 “Requirements to the fund” and art. 34 “State regulation of activities in the area of non-governmental pension provision, compulsory pension insurance and professional pension insurance. Oversight of, and control over, the said operations”. Specifically, it is proposed to complement art. 7 with requirements to the pension funds to have a risk management system and requirements to the person managing the risks (a head of the respective division). The urgency of the provisions in questions is evident, particularly in the light of challenges Russian NPFs faced during the last financial crisis. That said, organization of a risk management system at NPFs does not drain the problem of prudential standards in savings pension insurance institutions. Prudential oversight cannot be reduced to the issue of risk management. Furthermore, in a situation when regulation of investing of pension reserves and savings rests upon established restrictions on their investment, and oversight centers on examination of compliance with them, efficacy of the proposed standards will be fairly limited.

Plus, risk management cannot be introduced in isolation from other elements of NPFs’ operations. The very art. 7 (p.8) holds that the internal control in an NPF is limited by compliance, and it does not center on assessment of operational risks. Meanwhile, an NPF’s operations can be overly risky, albeit fully in line with the law. An overseeing agency does not have levers to control risks at the NPF, either, while functions and instruments of prudential risk-oriented oversight appear differing substantially from the approach resting on establishment of portfolio limitations<sup>1</sup>. The effective law does not imply existence of a supervision system matching the prudential standard, nor do NPFs have the standard in question. It seems that introduction of the prudent person<sup>2</sup> or prudent investor standards into the savings pension insurance indeed emerged as a plumbing issue, which, however, requires far more fundamental modifications in the law on nongovernmental pension funds and collective investing as a whole.

### 1. The prudent person rule and the prudent investor rule

Underpinning the prudent person rule and the prudent investor rule are common fundamental principles, albeit with substantial differences in their interpretation. In both cases, trustees of pension funds are required to operate reasonably, or to exercise caution (fiduciary obligations); however, under the prudent person rule, they are not required to have professional expertise in the investment area – rather, they have to seek due advice about that. By contrast, the prudent investor rule suggests heads of funds should have professional expertise in the respective area.

The countries that employ prudential principles in regulation of pension funds, as a rule, are oriented towards the prudent person rule. This approach was codified in the EU Directive “On the activities and supervision of institutions for occupational retirement provision” and

1 IOPS defines risk-based oversight as a structured approach which focuses on the identification of potential risks faced by pension plans or funds<sup>1</sup> and the assessment of the financial and operational factors in place to minimize and mitigate those risks (see: Good practices for pension funds risk management systems, OECD/IOPS, 2011)

2 Translated to Russia, the term prudent person rule has numerous variants: prudential approach, the principle of a sensible, or cautious, or circumspect, or decent person, while below throughout the text the term “the prudent person rule” is used.



Recommendation of the OECD Council “OECD Guidelines on pension fund asset management”, among other documents. In the US, the prudent person rule evolved over time into the prudent expert (investor) rule, with decisions by pension funds managers being compared to those by professionals operating in the investments area, while prudence is construed from the financial and economic perspective, ie. in terms of maximizing risk-adjusted returns. The concept of prudent investor in the US is fixed by the Uniform Prudent Investor Act, which regulates responsibilities of trustees of funds in the investment area.

As to the RF law, some requirements to NPFs in the frame of the prudent person rule already exist therein, including investing principles, in particular. It is the organizational paradigm in NPFs and the risk management system in the first place that are in need for change.

## 2. The objective of securing a pension income and prudential principles

In compliance with the OECD Guidelines on pension fund asset management, the prudent person standard requires designing such a regulation of a pension fund asset management which would focus on attaining its principal objective, that is, securing a retirement income, and which would ensure investment management is guided by prudential principles of reliability, profitability and liquidity in tandem with employment of such risk management principles as diversification and a robust leverage. The effective Russian law just partially employs the principle that obligates a pension fund’s leadership to operate for the benefit of beneficiaries. Specifically, p. 2 art. 25 of FZ-75 “On nongovernmental pension funds” holds that placement of resources of pension reserves is made solely for the purpose of their maintaining and increasing for the benefit of participants in pension plans. An analogous provision with regard to pension savings is effective solely in regard to the managing company that exercises trust management operations with pension savings (art. 36.14): *“The managing company that exercises investment of pension savings is obliged to invest the pension savings resources solely for the benefit of insured individuals”*.

## 3. Prudential principles and corporate governance

With pension funds employing prudential management principles, the NPFs’ operational fundamentals shift towards behavior and procedural arrangements. Better still, they require a greater quality of corporate governance at NPFs. The mandatory condition of transition to the prudent person standard is the governing bodies assuming the ultimate responsibility for the pension fund’s operations.

To match the prudent person standard the governing body of the pension fund should display the following qualities (to name a few):

- *Risk management strategy and robust systems;*
- *A clear vision of critical external and internal risks that faced the NPF, ability to identify the risk acceptability limits and to ensure the existence of systems to gauge and control them;*
- *A thoroughly developed process according to which investment operations are carried out, including establishment of due internal checks and procedures aiming at an efficient implementation of, and control over, the investment management process;*
- *A business behavior code and a conflict of interest regulation policy for the governing body and the staff of the pension fund, as well as for any third party mandated to exercise the respective operational functions;*
- *The internal reporting and audit system.*

An adequate risk management process in the pension fund requires not just gauging and controlling portfolio risks, but a consistent and integrated management of assets and liabilities.

Members of the governing body should meet a range of reputational and qualification requirements.

Pension funds that are directly exposed to financial and demographic risks should be in possession of a minimum level of free, untied funds or otherwise have access to relevant financial resources. The volume of capital depends on risks it is supposed to cover. In order to secure the guaranteed function of minimum capital, the law should demand for provisioning of respective assets or requirements to capital can be met by buying an insurance securing an analogous level of protection for participants in, and beneficiaries of, a given plan.

#### 4. Prudential principles and investing

While introducing the prudent person standard, a particular attention is paid to organization of investment. In compliance with the OECD Guidelines on pension fund asset management, the investment of pension assets is undertaken with care, the skill of an expert, prudence and due diligence, and it requires monitoring of investments and those who were delegated the investing function.

Where they lack sufficient expertise to make fully informed decisions and fulfill their responsibilities the governing body and other appropriate parties should be required to seek the external assistance of an expert.

The legal provisions should require the governing body of the pension plan or fund to establish a rigorous process by which investment activities are carried out, including the establishment of appropriate internal controls and procedures to effectively implement and monitor the investment management process.

The governing body of the pension fund should set forth in a written statement and actively observe an overall investment policy. In the event a pension organization<sup>1</sup> manage different pension plans or funds, it is recommended to design individual investment declarations for each pension fund and, where necessary, for each pension plan. The investment policy should:

- The investment policy should establish clear investment objectives for the pension fund that are consistent with the retirement income objective of the pension fund;
- Take into account the need for proper diversification and risk management, the maturity of the obligations and the liquidity needs of the pension fund;
- at a minimum identify the strategic asset allocation strategy for the pension fund (the long-term asset mix over the main investment categories), the overall performance objectives for the pension fund, and the means of monitoring and, when necessary, modifying allocations and performance objectives in the light of changing liabilities and market conditions;
- Imply a sound risk management process that measures and seeks to appropriately control portfolio risk and to manage the assets and liabilities in a coherent and integrated manner;
- Identify parties responsible for the overall implementation of the investment policy together with any other significant parties that will be part of the investment management process. In particular, the investment policy should address whether internal or external investment managers will be used, the range of their activities and authority, and the process by which they will be selected and their performance monitored.

There should be procedures and criteria by which the governing body or other responsible party periodically *reviews the effectiveness* of their investment policy and determines whether there is a need to change the policy, its implementation procedures, the decision-making structure, as well as the responsibilities linked to its design, implementation, and review.

#### Prudential principles and portfolio restrictions

Whilst the prudential approach and portfolio ceilings are still sometimes viewed as competing forms of regulation, they can efficiently complement each other, and governing and regulatory bodies should seek a due balance.

The prudent person standard focuses on qualitative aspects of the investment management process. Meanwhile, as specified in the OECD Guidelines on pension fund asset management, portfolio limits can help establish limits that inhibit or bloc adverse or extreme decisions with regard to investment management; however, they cannot efficiently regulate the procedure according to which decisions on managing the pension fund's assets are made within the said limits. As well, a sound investing requires a well diversified portfolio.

Under the prudent person standard, strategic allocation of assets and establishment of limitations under the investment is exercised in the first place by pension funds. Meanwhile, according to the OECD Guidelines on pension fund asset management, the legal provisions may include maximum levels of investment by category (ceilings) to the extent that they are consistent with and promote

<sup>1</sup> In compliance with the EU Directive on Institutions for Occupational Retirement Provision the subject of relations in the occupational retirement area is the institution for occupational retirement (IORP) whose organizational and legal form is country-specific.

the prudential principles pursuant to which assets should be invested. Legal provisions could also similarly include a list of admitted or recommended assets. Within this framework, certain categories of investments may be strictly limited. As a rule, investments in assets issued by the same issuer or by issuers belonging to the same group should be limited. The legal provisions should not prescribe a minimum level of investment (floors) for any given category of investment, except on an exceptional and temporary basis and for compelling prudential reasons.

#### Prudential principles and assets valuation.

For the sake of efficient management of the pension fund's assets, its governing body and other parties engaged in their management should be able to promptly find their value, regardless of the nature of a given pension fund's investments. In principle, valuation at current market values should be used, where available. If the said values are not available, a fair valuation methodology should be employed. If employment of alternative methodologies is permitted nonetheless, it is recommended that the valuation be accompanied by the disclosure of the results that would have been obtained using a current market value or fair valuation methodology.

The methodology used for valuing pension fund assets should be transparent to the pension fund's governing body, all others involved in the investment management process for the given pension fund, while valuations and methods employed should be easily available for or disclosed to members and beneficiaries.

#### 5. Prudential principles and risk management

An effective risk management system is comprised of strategies, processes and reporting procedures necessary to identify, measure, monitor, assess, control and report, on a continuous and an ad hoc basis, all material risks, at an individual and an aggregated level, to which the pension fund or plan is or could be exposed, and their interdependencies.<sup>1</sup>

Main elements of the architecture of risk management on the pension fund level are:

- An adequate risk management strategy;
- Its Board's contribution to managing risks;
- Risk-management functions built in the structure of governance of the Fund;
- The obligation to maintain other parties' awareness.

*The general risk management architecture* implies three major parties:

1. *Pension funds per se*;

2. *A supervisory authority*, one of major tasks of which is to ensure an adequate risk management on the institutional level. The focus of the supervisory authorities' operations shifts towards the risk management architecture and its procedures at the institutions concerned, as well as solvency maintenance rules (for plans providing fixed premiums and guarantees to their members);

3. *Other participants in the market*, who can have a possibility to influence the pension funds' decisions (auditors, actuaries, members of pension funds, rating agencies, market analysts). They all are tasked to maintain the "market discipline". Regulators can bolster discipline either by increasing the traditional institutions' (auditors, actuaries) role, or by enhancing transparency of the regulated institutions' reporting to let external parties run a more thorough evaluation of that.

#### 6. Prudential oversight

While transiting to the prudent person rule, the government regulation and oversight authorities' mission shifts from ensuring the pension funds' compliance to securing that established procedures at NPFs meet the prudential behavior as it is construed these days. To this end, the supervisory authority should have at hand methods of evaluation of adequacy of internal decision making processes at the NPF and its bodies, instruments to gauge the NPF's fundamental strength, as far as different kinds of risks are concerned. The nature of the interaction between the regulator and the sector takes a new form: as the prudent person rule and investor rule inherently establish only general behavioral standards, to secure compliance and an effective restraint of violations, they need

1 Good practices for pension funds risk management systems, OECD/IOPS, 2011

to be construed. It is regulatory authorities that play a major role in this process, particularly in the countries that lack a sufficient record of using this principle (the nations that use a civil code).

On the legislative level, the pension fund's executive management aside, it must be determined to whom the prudent person standard applies. At a minimum, those should be managing companies to whom asset management functions are mandated.

#### 7. Instruments of risk-management oversight

While main goals of the risk-oriented oversight in the banking and insurance sphere are to ensure that the supervised institutions employ adequate risk management procedures and maintain a sufficient level of capital, in the pension sphere, the focus on an adequate risk management is required to solidify the supervised institutions' financial robustness and to ensure effective premiums to pensioners.

As demonstrated by other nations, regulators have a certain set of instruments to attain the above goals, including:

- Regulative provisions, including recommendations on minimum standards of risk management with an emphasis on the pension fund's architecture and risk management procedures;
- Rules of maintenance of solvency (capital sufficiency in the cases where necessary, i.e. in plans with fixed premiums and those with established contributions that provide for guaranteed premiums);
- Risk assessment models the supervisory authorities employ in their operations. They form a pillar to both the remote and on-site monitoring, with the number of countries using VAR model to this effect.

To bring organization of the oversight operations in line with new tasks will require substantial changes in the regulation of market entry (requirements to funds in the course of their licensing), organization of interaction with NPFs, managing companies, a specialized depository, and in the conceptual aspect of monitoring of the supervised institutions' operations. It is imperative to design monitoring systems that would enable one to forecast individual NPFs' financial sustainability.

In some countries, requirements to risk management formed a part of the licensing/registration process: the pension fund is bound to submit a risk management plan or guidelines. To cite a particular example, the Australian regulator introduced recommendations in regard to risk management, which clarify the legislatively established standards; it also completed re-registration of pension funds, that decimated their cohorts, particularly, because some of them failed to prove the ability to prepare or implement a relevant risk management plan.

As to the supervisory authority per se, it should be organized to match requirements generated by the oversight system's elements. At a minimum, it should have divisions specializing on measurement and evaluation of various types of risks. As well, the oversight authority's corporate governance standards should be modified. Under the structural adjustment of the system of oversight of the NPFs' operations according to the requirements of the prudent person standard, it seems appropriate to employ the OECD Guidelines on pension fund asset management as a reference. ●



## THE REVIEW OF THE ECONOMIC LEGISLATION

I.Tolmacheva

*In April, a new procedure for regulation of relations related to use of an electronic signature was adopted.*

Federal Law No. 63-FZ of April 6, 2011 of the Russian Federation on the Electronic Signature has established a new procedure for regulation of relations related to use of an electronic signature. The law is aimed at upgrading of the previously effective legislation on the electronic digital signature, as well as expansion of both the sphere of application and the range of admissible types of electronic signatures. Law No. 1-FZ of January 10, 2002 on the Electronic Digital Signature is considered null and void.

In particular, the new law regulates the following types of relations in the sphere of use of the electronic signature:

- use of different types of electronic signatures;
- issue and use of the certificate of the signature key;
- verification of electronic signatures;
- rendering of services by authentication centers;
- accreditation of authentication centers.

Such a definition of the electronic signature is given as specifies the main feature which pertain to all the types of electronic signatures, that is, a possibility of use of the electronic signature for identification of the individual or the legal entity that has signed the information in an electronic and digital format. There are two types of electronic signatures depending on the criteria set by the Law: an simple electronic signature and the sophisticated one. The latter, in its turn, may be a qualified one and non-qualified one.

It is established that the information signed by a qualified electronic signature is deemed an electronic document which is equal to the hard copy document signed by one's own signature, except for the cases where the need for execution of a hard copy document only is required by the law. Similar amendments have been introduced into the Civil Code of the Russian Federation and other statutory acts of the Russian Federation. Electronic documents signed by a simple electronic signature or non-qualified signature are deemed equal to signed hard copy documents in cases specified by the legislation. It is to be noted that the rules established by different codes of the Russian Federation in respect of facsimile reproduction of a signature on paper with use of mechanical or other means of copying remain in force.

The new law permits, in particular, legal entities or public agencies to use an electronic signature while the previous law did not. It is stipulated that with a receipt of the certificate of the verification key of the legal entity's electronic signature it is required to specify, apart from the name of the owner-legal entity, the name of the individual who acts on behalf of that legal entity on the basis of the founding documents or a power of attorney. The law provides for the cases where such persons may not be specified and, then, the sole owner of the above certificate is the legal entity. Such a signature can be used in rendering of public and municipal services and in other cases provided for by the Federal Law and applicable statutory acts.

The rights and obligations of the participants in the relations in the sphere of use of the electronic signature have been established. The above participants include the federal executive authority which is authorized in the sphere of the electronic signature, the authentication center (a legal entity, a structural unit of the legal entity or an individual entrepreneur which engages in establishment and release of certificates of a signature key) and the owner of the certificate of a signature key (an individual or a legal entity which is issued the certificate of a signature key).

Also, the law has determined the requirements to authentication centers in order to be accredited ones. They include requirements to the size of the net assets of the authentication center, avail-



ability of financial security and use of such means of the electronic signature and technical means of the authentication center as have been approved to be in compliance with the specified norms. Also, authentication centers are required to hire employees with relevant education and skills. The authentication center must ensure compliance with the above requirements within the entire period of its accreditation. The rules of accreditation of authentication centers are set by the federal executive authority which is responsible for development and implementation of the state policy and legal regulation in the sphere of information technologies. The requirements to the means of the electronic signature are brought in line with the Russian legislation on technical regulation. A list of the information (including all the data which, in case of need, permits to carry out the investigation) which is subject to safekeeping by the authentication center has been determined. ●

## THE MAIN DEVELOPMENTS IN THE GOVERNMENT OF THE RUSSIAN FEDERATION IN APRIL 2011

M. Goldin

*In April 2011, Vladimir Putin, the Chairman of the Government of the Russian Federation held a meeting of the Government Commission on High Technologies and Innovations and reported to the State Duma on the activities of the government in 2010.*

**On April 1<sup>st</sup>** Vladimir Putin, the Chairman of the Government of the Russian Federation held a meeting of the Government Commission on High Technologies and Innovations. Approved at the meeting was the list of 25 so-called “technological platforms” representing the lines of development of breakthrough technologies which determine the prospects of new markets of high-tech products and services, as well as fast expansion of advanced technologies, for instance, in medicine, bioengineering, power engineering, aviation, space, nuclear engineering, information and communications and other.

The official definition of a technological platform is included in the Procedure for Formation of the List of Technological Platforms approved by decision of the Government Commission on High Technologies and Innovations on August 3, 2010 (Minutes No. 4). According to the above document, the technological platform means a communication instrument aimed at activation of efforts on development of perspective commercial technologies and new products (services), attraction of additional resources for R&D on the basis of participation of all the interested parties (business, researchers, the government and civilians) and upgrading of the regulatory and legal base in the area of the science and technology and innovation development (hereinafter, a technological platform).

Formation and realization of technological platforms is aimed at solution of the following objectives:

- 1) boosting of the influence of the business and public needs on implementation of important lines of the research and technological development;
- 2) identification of new research and technological opportunities of upgrading the existing sectors and formation of new sectors of the Russian economy;
- 3) determination of the key lines of upgrading of sectorial regulation for fast expansion of perspective technologies;
- 4) motivation of innovation and rendering of support to research and technological activities and processes of modernization of industries with the specifics and options of development of branches and sectors of the economy taken into account;
- 5) expansion of the research and industrial cooperation and formation of partnerships in the sphere of innovation;
- 6) upgrading of the regulatory and legal base in the area of research, technological and innovation development.

Each technological platform was assigned a coordinator-entity which submits to the working group on a regularly basis on time until February 1 a written report on fulfillment of the project of implementation of the technological platform with a plan of actions for the forthcoming year. The report on fulfillment of the project of implementation of a technological platform should include the following:

- 1) concrete results achieved in the period under review;
- 2) the analysis of implementation of the plan of actions in the period under review.

**On April 20,** Vladimir Putin, the Chairman of the Government of the Russian Federation reported to the State Duma on the activities of the Government of the Russian Federation in 2010. In his report, Premier V. Putin declared that “the fact that in the most complicated period of the global crisis Russia managed to live through without serious distress and risks which being quite

real ones could have resulted in weakening of the country and its economic and human potential, as well as critical decline of social standards is our common achievement”.

Premier Vladimir Putin gave a few examples of unpopular measures which had to be taken in a number of countries due to the global economic crisis which started in 2008; those measures varied from lowering of the pension age to renouncement by the authorities of their social liabilities. Premier Vladimir Putin noted that under the Russian Constitution Russia was a social state and it would keep warranting its social commitments in future. In support of his statement, Premier V. Putin said that despite of the deficit of the federal budget 250,000 apartments were provided to military servicemen and World War II veterans in the past two years. In 2010, labor pensions were increased by 45%. In his report, Premier V. Putin attached particular importance to forthcoming programs of social development.

On the basis of the results of his address in the State Duma, Premier V. Putin signed a list of instructions to a number of federal agencies. The above list was made up of 12 instructions as regards development of measures mainly of social nature.

In particular, the Ministry of Industry and Trade of the Russian Federation, the Ministry of Economic Development of the Russian Federation, the Ministry of Agriculture of the Russian Federation and the Federal Antimonopoly Service of the Russian Federation were ordered to develop jointly and submit to the Government of the Russian Federation proposals on further upgrading of the legislation of the Russian Federation as regards state regulation of commercial activities, including that as regards ensuring of access by domestic producers of food products to distribution commercial networks.

In formation of the federal draft budget for the year 2012 and the 2013–2014 planned period, the Ministry of Culture of Russia, the Ministry of Finance of Russia and the Ministry of Economic Development of Russia were ordered to develop jointly proposals on increase in financing of the culture and art sphere with particular importance attached to financing of the following:

- Major overhaul and technical equipment of museums, libraries and educational establishments of culture and art;
- Measures aimed at development and upgrading of the system of warning and liquidation of emergency situations and provision of institutions of culture and art with security, fire fighting and anti-terrorist security systems;
- Upgrading of the all-Russian system of the library and information service to the general public on the basis of state-of-the art technologies;
- Gradual raising of the level of the average monthly pay of employees of federal institutions of culture and art and educational establishments in the sphere of culture to the level of the average monthly pay in the sector;
- Building and overhaul of museums, libraries and museum depositories. ●

## A REVIEW OF REGULATORY DOCUMENTS ON TAXATION IN MARCH–APRIL 2011

L. Anisimova

1. In continuation of the previously published analysis of the recent trends in the field of taxes and other mandatory charges (dues) in the Russian Federation, a few more aspects should be focused on, one of which can be characterized as reinforcement of stochastic (unpredictable) random selection of entities which are subject to payments to budgetary and extrabudgetary funds (which also includes replacement of the single social tax with a system of insurance premiums payable to public extrabudgetary funds at higher rates, and mandatory payments to road funds, and mandatory environmental payments) with a view to financing specific, preset public expenditures. This is a disturbing event, because it shows, on the one hand, shortage of state financial resources which are mobilized by traditional methods of taxation, and, on the other hand, a shift from market methods of building the public revenues base towards planning and administrative methods. The point is that the taxation system of a market-based economy is not a random selection of methods of charges, because it evolved through different stages and adopted to the free market, based on reallocation of newly created value in the society (as either personal income, or profit as investable personal income which is concentrated within legal persons' activity) by way of pro rata exaction of the value which is newly created every market entity (the principle of neutrality and equity of the taxation system). This is true for the taxes payable in most of market economies. The maximum allowable tax burden in the market economy is limited by the possibility of the entities of a national economy to obtain newly created value as at least a share applicable to the entities of the free (global) market, rather than through upper parameters preset by the government authorities for government expenditures.

Under a classic scheme of taxation, a mandatory payment is charged post factum (in spite of technical advancing of the payment), upon the entity appropriates the profit and, as noted above, preliminary on a share basis to the same. In case of mandatory administrative charges, for example: in case of enforced payment of public services or penalties, – such payments are directly involved in creating manufacturing costs of economic agents and included into the manufacturer's price.

Where the state runs short of money amidst the market economy, it is indirect taxation arrangements that are used first, such as VAT (it has the widest taxation base; it has the least effect on the pattern of market prices, because it is indirectly reflected in prices of goods at all stages; it is a classic consumption tax – i.e. in case of limited domestic demand, manufactured products can be offered at market prices for sale in external markets) with subsequent allocation of mobilized resources to finance budgetary expenses in the form of subsidies.

What we see in Russia, however, is quite an opposite trend. Special revenues as all kinds of additional mandatory charges which have to be financed by manufacturers of goods and paid to state funds and government authorities, have been actively introduced and legally formalized; restrictive and prohibitive rules regulating the procedure for granting an access to public services but not recognizing them as natural monopolies, have been established. The government authorities explain that they made these decisions in order to get businesses involved in financing socially relevant expenditures.

The recently adopted Federal Law No. 68-FZ of 6.04.2011 is an example of such policy. The Federal Law introduced penalties and sanctions payable to relevant budgets for violation of the rules of transportation of bulky cargos, as well as payment due to the federal budget in consideration for compensation for the damage to public motor roads caused by a vehicle whose weight is more than 12 tons.

Let's make a detailed analysis of the decision. The payment in question can't be defined as a state duty. The Tax Code of the Russian Federation already regulates issue of a special permit for transportation of cargo vehicles on motor roads (except for trans-border cargo vehicles): RUB 400 for hazardous cargos, RUB 500 for heavy and/or bulky cargos. Formally, such a small penalties

constitute a registration payment for issue of a permit allowing non-standard vehicles to use main highways and are therefore included into a list of actions which are subject to state duty (p. 86, c.1, art. 333.33 of the Tax Code of the Russian Federation). The case in question can't be defined as tariffs payable for the provision of natural monopoly services – formally, though no public motor road toll was established, a cargo vehicle with a tonnage of more than 12 tons has no opportunity to use other similar roads within the infrastructure, and no monopoly entity was defined (i.e. the entity which is entitled to collect payments for the provision of natural monopoly services). Therefore, the newly introduced payment constitutes a special type of mandatory federal public motor road toll – a compensation payment for damage caused to the road by vehicles weighting more than 12 tons, irrespective of whether or not such a damage is caused or the size thereof.

Under the Law, the procedure for compensation payment for damage to motor roads will be established by the Government of the Russian Federation. Failure to pay for the use of public roads by heavy vehicles weighting more than 12 tons is subject to a penalty of RUB 450,000 for a single violation and RUB 1 mln for recurrent violation.

The selected scheme of mandatory payment was not selected randomly. The Federal Law No. 68-FZ specifies the basic size ( RUB 254,1 bln ) of the Federal Road Fund for 2011 and that the volume of budget appropriations to the Federal Road Fund approved by the Federal Law “On the Federal Budget” for the ensuing financial year and planning period can't be less than the basic volume of budget appropriations to the Federal Road Fund as adjusted to reflect the forecast level of inflation for the ensuing financial year and planning period. It was established that the size of regional road funds and a list of other revenues added to those listed in the Federal Law No. 68-FZ are to be approved by the laws of the constituent entities of the Russian Federation. Municipal entities are also entitled to establish municipal road funds and how they should be created and used. The Federal Law No. 68-FZ contains an explicit list sources of road funds (which also includes revenues from paid motor roads which are not analyzed in this review). Since the size of the Federal Road Fund is legally formalized, the Fund's expenditures would seem to be financed irrespective of real revenues from the assigned sources. Under the circumstances, it is very likely that the specifics of mandatory compensation payment for damage caused to federal public motor roads by vehicles weighting more than 12 tons will consist in setting a variable payment to be calculated annually on the basis of an amount which the Fund would need to meet the size specified for the ensuing year by the Federal Law “On the Federal Budget”.

We believe that the introduction itself of the mandatory payment may have an adverse effect on the Russian market and Russian transport operators (trans-border transport companies are subject to international agreements, if any). The point is that a balanced system of demand and supply (including different cities and towns) which specifies a specific scale of delivery of goods (works, services), logistics of flow of goods in different directions, level of costs incurred to deliver a product unit to the consumer, deadlines for transportation of each type of goods (shipment, storage in gateways and transshipment points, delivery) etc. has been established to date on the entire territory of the Russian Federation. The 12-ton limit may imply the following to manufacturers: vehicle fleet replacement (let's recall that a standard 20-foot container can store about 20 tons of goods, and long-distance refrigerators or trailer trains for transportation of motor cars, furniture, household appliances, medical equipment, etc. with a total weight of more than 12 tons are unlikely to be effective: furthermore, transportation of the same number of goods would require 5-person teams instead of two persons, medium-duty cargo vehicles can neither provide the required level of cargo safety, nor meet the sanitary regulations in harsh climatic conditions for drivers during long-term business trips), revision of logistic schemes, re-equipment of warehouses etc., or mandatory payment for every leg.

It is obvious that the new mandatory payment will inevitably result in obligatory cumulative growth in manufacturers' costs and, consequently, growth in consumer prices. Since the market would see changes in the consumer demand volume, physical market indicators would decrease and the consumer demand would have to be reoriented to other goods. The first stage may even provide positive effects such as replacement of import goods with domestic goods of different quality which in other circumstances would fail to compete with imported goods of similar type (such a mandatory payment implies “cutoff” of transport operators on the basis of upper limits on weight



parameters for cargo vehicles, which is a hidden form of protectionism in the Russian circumstances). Furthermore, the same tools of involuntary creation of product cost would result in loss-making export of domestic goods to other markets, i.e. make them uncompetitive. Eventually, this would lead to economic stagnation, investment effectiveness would become artificially detracted.

We believe that the foregoing example readily illustrates different consequences of classic tax regulatory measures and imposing additional payments on manufacturers, thereby increasing costs. Indeed, in case of increase in VAT, limited consumer demand would “force out” goods (works, services), which are found to be excessive, of a relevant market, but would not create barriers for their move to other markets, result in artificial increase of manufacturing costs and manufacturers’ prices, because it would not have an effect on competitive power of goods and effectiveness of investments in this market. Methods which are based on involuntary increase in business costs make production itself non-competitive and force out real investments of a relevant territory.

2. We have analyzed the foregoing situation, when the state deemed it wise to impose a mandatory payment on cargo vehicles weighting more than 12 tons for the economic service providing access to federal public highways without recognizing such highways as natural monopolies. A series of mandatory payments for other types of public economic services were abolished at the same period which is referred to port charges in inland waterways (tonnage, pilotage, navigation dues). These dues were introduced by the Order of the Ministry of Transport of the Russian Federation No. 90 of June 4, 2009 pursuant to the decision of the Government of the Russian Federation (c. 2 “6” of the Order of the Government of the Russian Federation No. 293 of 23.04.2008) on the establishment of state regulation and control of prices in implementing art. 6 of the Federal Law “On Natural Monopolies”. Inland waterway’s port charges were abolished as part of liberalization of the scheme of payment for services, replacement of the regulated prices established by the Government of the Russian Federation with natural monopoly tariffs. Relevant amendments were made to the Code of Inland Water Transport by the Federal Law No. 47-FZ of 5.04.2011, and to the Air Code of the Russian Federation by the Federal Law No. 51-FZ of 5.04.2011. The natural monopoly is a specific condition of the commodity market, as defined in the Federal Law No. 147-FZ of 17.08.1995. Economically viable transition of natural monopolies from the natural monopoly condition to the competitive market condition must not be restrained.

In comparing the situation described in pp. 1 and 2 hereof, we may infer that quite an opposite phenomena are taking place at the same time in Russia: on the one hand, a part of mandatory payments for economic services which used to be quoted by the Government of the Russian Federation, was transferred to the jurisdiction of the legislation of natural monopolies (under the Law, natural monopolies will subsequently be transferred to the competitive market condition); on the other hand, restrictions were legally imposed on transportation of heavy vehicles (which weight more than 12 tons) on public motor roads without being recognized as natural monopolies, and mandatory payment for non-observance of the permitted tonnage on federal public motor roads was imposed. While transition of a monopoly towards the competitive market is regulated by the law, the opposite measure – the procedure for imposing public restrictions or establishing a monopoly – is unclear.

3. The Order of the Constitutional Court of the Russian Federation No. 2-P of 29.03.2011 explained a few of the common issues related to the establishment of monopoly. The Constitutional Court pointed out that under the legal proposition of the Constitutional Court of the Russian Federation, which is expressed in a series of Court rulings (the definitions No. 255-O of July 8, 2004, No. 288-O-P of February 8, 2007 and No. 291-O-P of February 8, 2007), regulations of the Constitution of the Russian Federation, no economic activity can be allowed for the purpose of monopolization and unfair competition (art. 34, Part 2), while the Russian Federation is entitled to establish legal frameworks of a single market and pricing policy principles (p. “ж”, art. 71). According to the Constitutional Court of the Russian Federation, this leads directly to the possibility and necessity of state regulation of prices. In our opinion, the fact that the Russian Federation is exclusively entitled to establish a monopoly derives from p. 10, art. 4 of the Federal Law “On Protection of Competition” No. 135-FZ of 26.07.2006 (as amended on 01.03.2011) under which “monopolistic activity means abuse of dominance by an

economic agent, a group of persons, agreements or concerted actions which are prohibited by the antimonopoly legislation ...”, – after all, public authorities and agencies which impose restrictions on transportation of vehicles weighting more than 12 tons on federal public motor roads are not treated as economic agents. In our opinion, the question is when state economic monopoly may be established with regard to publicly accessible natural sites, or publicly accessible facilities which were constructed on account of taxpayers, requires a special study. The objective of this review is to pinpoint the possibility to impose mandatory payments for the usage of natural resources or facilities which used to be publicly accessible, being beyond the scope of tax payments, state-regulated prices and/or natural monopolies’ tariffs in the Russian Federation.

*Conclusion on pp. 1–3 of the Review.* The practice has shown that no efforts aimed at regulating the mandatory payment system exclusively within the Tax Code and restricting the extreme load on market entities through market instruments were successful in the Russian Federation. At present, we are witnessing active creation of a sphere of mandatory payments beyond the scope of the Tax Code of the Russian Federation. In addition, there is no visible restriction on exaction of publicly accessible resources for the purpose of establishing a state monopoly.

Since the legal status of the newly introduced payment for vehicles weighting more than 12 tons (tax or natural monopoly price) remains to be defined, we believe that competent legal agencies should give explanations on this issue. In addition, in our opinion, to ensure attractive investment climate in the Russian Federation, the Constitutional Court of the Russian Federation should explain whether or not the applicable legislation of the Russian Federation specifies the feasible limits on market players’ rights to exact assets in the form of establishing various types of mandatory payments, as well as on the procedure for the establishment of state monopoly for resources which are publicly accessible at the moment of establishment of such a monopoly.

4. The letter of the Ministry of Finance of Russia No. 03-11-09/13 of 03.03.2011 and the letter of the Federal Tax Service No. KE-4-3/5226 of April 4, 2011 specified the differences in the principles of expenditure accounting in creating the profit tax base and simplified system of income less costs. The Labor Code of the Russian Federation holds employers responsible for compensation to employees for the costs related to itinerant job and business trips (article 168.1 of the Labor Code of the Russian Federation). Article 346.16 of the Tax Code of the Russian Federation establishes the procedure for creating the tax base when such an employer applies the simplified system. The Ministry of Finance and the Federal Tax Service of the Russian Federation pointed out that p. 1, art. 346.16 of the Tax Code of the Russian Federation doesn’t particularize expenditures as compensation to employees for costs related to itinerant job. Therefore, though under the common procedure for profit taxation these expenditures decrease the profit tax base inside other costs related to manufacturing and sale, they are not recognized when the simplified taxation scheme is applied, because other costs are not interpreted and recognized as deductions under this scheme.

The situation with unmatched deductions which form the tax base is typical of the common procedure for profit tax payment and simplified system. We simply would like to note that if employers are competent enough to draw up labor and collective contracts with employees, these amounts could be recognized in labor costs provided for by art. 255 of the Tax Code of the Russian Federation rather than in other costs, which would result in decrease in the tax base under the simplified system.

5. The Supreme Arbitration Court (SAC) Presidium on 20.03.2011 (under the Definition No. SAC-16400/10 approved on 17.01.2011 ) set up a final position of the SAC with regard to the moment when the buyer of a real estate is to be held responsible for payment of the property tax. According to the SAC Presidium, the seller is deemed to be the owner and, consequently, taxpayer until state registration of title to the real estate. The decision was made with regard to real estate, however, since the SAC Presidium set up primarily the common methodological approach towards owners’ obligations for payment of the property tax, general proxy sellers of real property (e.g., motor cars) are likely to encounter problems.

## CHANGES IN THE SPHERE OF BUDGET LEGISLATION

M.Goldin

*In April 2011, road funds were renewed.*

By Federal Law No. 68-FZ of **April 6, 2011** on Introduction of Amendments into the Budget Code of the Russian Federation and Individual Statutory Acts of the Russian Federation (hereinafter, Law No.68-FZ), road funds were established again.

The system of road funds operated in Russia from 1991 on the basis of Law No. 1759-1 of the Russian Federation of October 18, 1991 on the Road Funds of the Russian Federation and was abolished by Federal Law No. 150-FZ of the Russian Federation of December 27, 2000. Renewal of road funds is carried out through amendment of the Budget Code of the Russian Federation, the Code of the Russian Federation on Administrative Offences, Federal Law No. 257-FZ of November 8, 2007 on Motor Roads and Road Activities in the Russian Federation and Introduction of Amendments to Individual Statutory Acts of the Russian Federation (hereinafter referred to as the Law on Road Activities).

In establishment of road funds, it was decided to introduce such a procedure for replenishment of those funds as was similar to the requirements of formation of the Investment Fund of the Russian Federation. Balances of the Federal Road Fund as of the beginning of the current fiscal year will be used for increasing the volumes of the Fund's budget allocations in the current year.

The Budget Code of the Russian Federation was supplemented with new Article 179.4. Under the above amendment, the Road Fund is determined as a portion of budget funds meant for utilization for the purpose of financing road activities as regards public motor ways. It is to be noted that under the Law on Road Activities the definition of road activities means the work related to design, building, restructuring, overhaul, repair and maintenance of motor roads.

The road funds include the Federal Road Fund, road funds of constituent entities of the Russian Federation and municipal road funds.

In 2011, the base volume of budget allocations of the Federal Road Fund is set in the amount of RUR 254 100 000.0 thousand.

The volume of budget allocations of the Federal Road Fund is approved by the Federal Law on the Federal Budget for the Next Fiscal Year and the Planned Period in the amount which is not less than the sum of such a base volume of budget allocations of the Federal Road Fund as adjusted both to the expected level of the inflation rate in the next fiscal year and the planned period and the expected volume of the federal budget revenues.

The Federal Road Fund is expected to be formed, in particular, from the following sources:

- payment of such excise duties on oil products as are subject to crediting to the federal budget;
- utilization of the property which is a part of public motor ways;
- fees charged from foreign cars for motor way transit in the territory of the Russian Federation;
- compensation charges for the damage caused to public motor ways of federal importance;
- subsidies and uncompensated payments by individuals and legal entities.

Decisions on establishment of road funds of constituent entities of the Russian Federation are to be made by regional laws on the budget not later than January 1, 2012. The above funds will be formed through receipt of excise duties on oil products, transport tax payments and other revenues.

Municipal entities may establish road funds as well. To do that, a resolution of a representative body of the municipal entity is required. Also, the above resolution needs to specify the procedure for formation and utilization of such road funds.

From January 1, 2012, Law No. 68-FZ introduced such a charge for compensation of the damage caused to public motor ways of federal importance by transportation vehicles with permitted maximum weight of over 12 tons as would be credited to the revenue side of federal budget. Revenues from the above payments will be taken into account in determination of the volume of budget allocations of the Federal Road Fund.

By the same law, amendments were introduced into the Code of the Russian Federation on Administrative Offences. The above amendments set the responsibility for a failure to meet requirements as regards payment of a compensation for the damage caused. In particular, a sanction in the form of a fine is provided for such an offence:

- RUR 5000 for a driver of a transport vehicle;
- RUR 40,000 for officials;
- RUR 450,000 for legal entities. ●

## THE GLOBAL TRADE WITH MERCHANDISE AND SERVICES IN 2010

R.Volkov, A.Pakhomov

*In early April 2011, the WTO Secretariat published its annual analytical review on results of development of the global trade in 2010 and prospects of its advancement in 2011. The review also comprises preliminary cross-country statistical data on the global trade with goods and services in 2010<sup>1</sup>. The review suggests that growth rates of the global export of merchandise proved to be the highest ones over the whole period of observations (1950). Russia became one of leading nations in terms of growth in trade. However, negative developments, including the turmoil in the Middle East countries and cataclysms in Japan, may decelerate the 2011 growth in trade.*

According to the WTO analysts, with the global GDP posting a 3.6% increase in 2010, the growth rate of the global trade in real terms accounted for a record-breaking 14.5% export-wise (vs. the 10% projected by WTO a year ago) and 13.5% import-wise vis-a-vis their 12.0 and 12.8% decline, respectively, in 2009.

“The figures show how trade has helped the world escape recession in 2010. However, the hangover from the financial crisis is still with us. High unemployment in developed economies and sharp belt-tightening in Europe will keep fuelling protectionist pressures“, asserted Mr. Pascal Lamy at the presentation of the review.

The global export of goods in nominal terms posted a 22% increase, which should be ascribed primarily to the price rise for energy sources and minerals, and accounted for USD 14.9 trln. Export of commercial services surged by 8% in nominal terms (after the 12% fall a year before) and made up USD 3.7 trln., with the sector for transport services boasting of the greatest (14%) growth rate of. In all, the proportion of services in the global trade plummeted to 19.4% vs. 21.3% in 2009.

The ultimate average annual increase rates in global trade with merchandise and services in nominal terms accounted for 8% over the period between 2005 and 2010, despite their varying dynamics in individual years. In all, the average annual increase rates in global trade between 2000 and 2010 are estimated at the level of 6%, or twice as high the dynamic of the global GDP (3.5%).

Behind the rise in the global trade in 2010 were the same factors that sent it nosedive in 2009, including, in the first place, the price rise for minerals, which boost production costs of finished goods and lowers the volume of final demand for them. Specifically, the increase rates in export prices of metals in 2010 made up 48%, agricultural raw materials – 33%, fuel and energy commodities – 26%<sup>2</sup>. Sector-wise, it was supplies of telecommunications and office equipment which became the forerunner, while automobile industry was falling behind all other sectors.

One of the causes propelling growth is the revival of the emerging markets, which formed the major drivers of trade. Export of the emerging economies and the CIS countries combined soared by 16.7% in real terms (vs. the developed nations’ 12.9%), while import – by 17.9% (10.7%). The last year’s WTO projections suggested an 11% growth in the emerging economies’ exports and a 7.5% one – in the developed nations’ exports.

According to WTO, by results of 2010, China once again proved an unbeatable leader in terms of exports of goods (USD 1.658 bln., or 10.4% of the global export) and left the US (USD 1.278 bln., 8.4%) and Germany (USD 1.269 bln., 8.3%) behind. The US secured its position of the global leader in terms of import (USD 1.968 bln., 12.8% of the global import), followed by China (1.395 bln., 9.1%) and Germany (1.067 bln., 6.9%). The detailed ranking of the leading exporters and importers of goods and commercial services is presented in *Tables 1* and *2*.

1 «Trade growth to ease in 2011 but despite 2010 record surge, crisis hangover persists», WTO, Geneva, Press/628, 7 April 2011, 27 p. ([http://www.wto.org/english/news\\_e/pres11\\_e/pr628\\_e.htm](http://www.wto.org/english/news_e/pres11_e/pr628_e.htm))

2 Trade growth to ease in 2011 but despite 2010 record surge, crisis hangover persists, WTO, Press/628, 7 April 2011 ([http://www.wto.org/english/news\\_e/pres11\\_e/pr628\\_e.htm](http://www.wto.org/english/news_e/pres11_e/pr628_e.htm))



Table 1

## LEADING EXPORTERS AND IMPORTERS IN THE GLOBAL TRADE WITH GOODS IN 2010

Rank	Country-exporter	Volume, USD bln.	Share, %	Change in nominal terms to 2009, %	Rank	Country-importer	Volume, USD bln.	Share, %	Change in nominal terms to 2009, %
1	China	1578	10.4	31	1	US	1968	12.8	23
2	US	1278	8.4	21	2	China	1395	9.1	39
3	Germany	1269	8.3	13	3	Germany	1067	6.9	15
4	Japan	770	5.1	33	4	Japan	693	4.5	25
5	The Netherlands	572	3.8	15	5	France	606	3.9	8
6	France	521	3.4	7	6	UK	558	3.6	15
7	Republic of Korea	466	3.1	28	7	The Netherlands	517	3.4	17
8	Italy	448	2.9	10	8	Italy	484	3.1	17
9	Belgium	411	2.7	11	9	Hong Kong, China	442	2.9	25
						-import for the domestic consumption <sup>1</sup>	116	0.8	31
10	UK	405	2.7	15	10	Republic of Korea	425	2.8	32
11	Hong Kong, China	401	2.6	22	11	Canada <sup>2</sup>	402	2.6	22
	- export of goods produced domestically <sup>1</sup>	18	0.1	7					
	- re-export <sup>1</sup>	383	2.5	23					
12	Russian Federation	400	2.6	32	12	Belgium	390	2.5	11
13	Canada	387	2.5	22	13	India	323	2.1	25
14	Singapore	352	2.3	30	14	Spain	312	2	6
	- export of goods produced domestically	183	1.2	32					
	- re-export	169	1.1	28					
15	Mexico	298	2	30	15	Singapore	311	2	26
						-import for the domestic consumption <sup>3</sup>	142	0.9	24
16	Taiwan, R.O.C.	275	1.8	35	16	Mexico	311	2	29
17	Saudi Arabia <sup>1</sup>	254	1.7	32	17	Taiwan, R.O.C.	251	1.6	44
18	Spain	245	1.6	8	18	Russian Federation <sup>2</sup>	248	1.6	30
19	UAE <sup>1</sup>	235	1.5	27	19	Australia	202	1.3	22
20	India	216	1.4	31	20	Brazil	191	1.2	43
21	Australia	212	1.4	38	21	Turkey	185	1.2	32
22	Brazil	202	1.3	32	22	Thailand	182	1.2	36

Table 1, cont'd

Rank	Country-exporter	Volume, USD bln.	Share, %	Change in nominal terms to 2009, %	Rank	Country-importer	Volume, USD bln.	Share, %	Change in nominal terms to 2009, %
23	Malaysia	199	1.3	26	23	Switzerland	176	1.1	13
24	Switzerland	195	1.3	13	24	Poland	174	1.1	16
25	Thailand	195	1.3	28	25	UAE <sup>1</sup>	170	1.1	13
26	Sweden	158	1	21	26	Malaysia	165	1.1	33
27	Indonesia	158	1	32	27	Austria	159	1	11
28	Poland	156	1	14	28	Sweden	148	1	23
29	Austria	62	1	11	29	Indonesia	132	0.9	46
30	Czech Republic	133	0.9	18	30	Czech Republic	126	0.8	20
By 30 countries, total <sup>4</sup>		12541	82.3	-	By 30 countries, total <sup>44</sup>		12712	82.7	-
The world, total <sup>4</sup>		15238	100	22	The world, total <sup>4</sup>		15376	100	21

<sup>1</sup> As estimated by the WTO Secretariat.

<sup>2</sup> Import by FOB prices

<sup>3</sup> Import for the domestic consumption of Singapore is calculated as the aggregate import less re-export

<sup>4</sup> Including considerable re-export or import for the purpose of re-export.

Source: WTO Secretariat, Press release, PRESS/628, Geneva, April 7, 2011, p.21 (Appendix Table 3 «Merchandise Trade: Leading Exporters and Importers, 2010»).

Meanwhile, according to the WTO experts, the impact of the financial and economic crisis on the global trade has still been there and the 2010 indicators of the volume of global export were lower than they could have been otherwise basing on the 1990–2008 trend.

Table 2

LEADING EXPORTERS AND IMPORTERS IN GLOBAL TRADE WITH COMMERCIAL SERVICES\*  
IN 2010

Rank	Country-exporter	Volume, USD bln.	Share, %	Change in nominal terms to 2009, %	Rank	Country-importer	Volume, USD bln.	Share, %	Change in nominal terms to 2009, %
1	US	515	14.1	8	1	US	358	10.2	7
2	Germany	230	6.3	2	2	Germany	256	7.3	1
3	UK	227	6.2	0	3	China <sup>1</sup>	192	5.5	22
4	China <sup>1</sup>	170	4.6	32	4	UK	156	4.5	-1
5	France	140	3.8	-1	5	Japan	155	4.4	6
6	Japan	138	3.8	9	6	France	126	3.6	0
7	Spain	121	3.3	-1	7	India	117	3.3	...
8	Singapore	112	3	20	8	The Netherlands	109	3.1	1
9	The Netherlands	111	3	0	9	Italy	108	3.1	1
10	India	110	3	...	10	Ireland	106	3	2
11	Hong Kong, China	108	2.9	25	11	Singapore	96	2.7	21
12	Italy	97	2.6	3	12	Republic of Korea	93	2.7	17
13	Ireland	95	2.6	3	13	Canada	89	2.6	15

Table 2, cont'd

Rank	Country-exporter	Volume, USD bln.	Share, %	Change in nominal terms to 2009, %	Rank	Country-importer	Volume, USD bln.	Share, %	Change in nominal terms to 2009, %
14	Republic of Korea	82	2.2	13	14	Spain	86	2.4	-1
15	Belgium	81	2.2	2	15	Belgium	76	2.2	4
16	Switzerland	76	2.1	6	16	Russian Federation	70	2.0	18
17	Luxemburg	68	1.9	13	17	Brazil	60	1.7	35
18	Canada	66	1.8	15	18	Hong Kong, China	51	1.5	15
19	Sweden	64	1.7	9	19	Australia	50	1.4	22
20	Denmark	58	1.6	7	20	Saudi Arabia <sup>2</sup>	49	1.4	...
21	Austria	53	1.5	-1	21	Denmark	49	1.4	-1
22	Australia	48	1.3	17	22	Sweden	48	1.4	6
23	Russian Federation	44	1.2	6	23	Thailand	45	1.3	21
24	Taiwan, R.O.C.	41	1.1	29	24	UAE <sup>2</sup>	42	1.2	...
25	Norway	40	1.1	5	25	Norway	41	1.2	12
26	Greece	37	1	-1	26	Switzerland	38	1.1	-1
27	Thailand	34	0.9	15	27	Luxembourg	38	1.1	8
28	Turkey	33	0.9	0	28	Taiwan, R.O.C.	37	1.1	28
29	Malaysia	33	0.9	13	29	Austria	36	1	-2
30	Poland	32	0.9	11	30	Indonesia	33	0.9	18
By 30 countries, total		3064	83.6	-	By 30 countries, total		2810	80.2	-
The world, total		3665	100.0	8	The world, total		3505	100.0	9

\* Foreign trade with commercial services is understood as one country performing for another one paid-for works (services) not directly relating to creation of material values; non-commercial services embrace chiefly the so-called public services rendered domestically and outside of the competition environment.

<sup>1</sup> Preliminary estimates.

<sup>2</sup> As estimated by the WTO Secretariat

*Note.* Data on a number of countries and territories are based on the WTO Secretariat's estimates. The values of annual rates of growth and ranking are affected by gaps in data series across a big number of countries and by limited possibilities for their cross-comparison.

*Source:* WTO Secretariat, Press release, PRESS/628, Geneva, April 7, 2011, p.23 (Appendix Table 5 «Leading Exporters and Importers in world trade in commercial services, 2010»).

According to the WTO experts, in 2011, increase rates in the volume of foreign trade in real terms can hit the level of 6.5%, which is slightly better than the average values of the past decade. The forecast takes into account effects of the recent earthquake in Japan and a possible contraction in its import-export operations. Plus, the turmoil in the Middle East countries may result in a negative adjustment of the forecast. As to a longer-term outlook, the WTO experts already noted earlier that volumes of the global trade would be growing annually by more than 7% over the next decade.

As to most likely development trends in 2011, the IMF experts suggest the global markets would see increasing shortages of oil due to a rapid rise in demand by emerging economies and fall in its offer, and the largest economies running trade imbalances<sup>1</sup>. The IMF believes that the world has entered the period of expensive oil, whose prices should remain over USD 100/b. over the next 5

<sup>1</sup> See: The IMF World Economic Outlook, the OECD Economic Outlook, the UN DESA World Economic Situation and Prospects.

years, and price hikes for minerals can impede the global economy's revival. Meanwhile, fears of a double-dip recession proved vain, and the global economy's growth rates should remain in the region of 4.4–4.5% in 2011–2012, thus proving accuracy of the last year's projections<sup>1</sup>.

According to the WTO data, in 2010, Russia posted one of the highest growth rates in value volumes of export and import operations among leading trading nations, which, however, did not practically affect its respective ranking among leading importers and exporters of merchandise and commercial services. Russia proved to be a leading nation in terms of import and export growth rates among Top-30 countries which combined secure over 90% of global trade: Russia's import in value equivalent posted a 30% growth (the 10<sup>th</sup> best performance in the group), while export – a 32% one (the 4<sup>th</sup> position). These results, however, were determined by a dramatic plunge of the country's volume of export-import operations in 2009, when Russia posted a worldwide record-breaking 36% fall in imports.

So, according to WTO preliminary data, in 2010, Russia climbed by one step up the WTO rating vs. its 2009 figures and now ranks 12<sup>th</sup> in the world by value volume of its export of goods worth a total of USD 400 bln. Meanwhile, the nominal rate of its annual increase tumbled 36%. Russia's specific weight in global export was 2.6% (2.9% in 2008 and 2.4% in 2009). By value of import of goods (USD 248 bln.; up by 30%) Russian Federation slid from the 17<sup>th</sup> to 18<sup>th</sup> position, with its share in the global import accounting for 1.6% (1.8% in 2008 and 1.5% in 2009). Without regard of the intra-regional trade in EU (the so-called inner merchandise turnover between the EU members states), Russia ranks 7<sup>th</sup> by export of goods and 12<sup>th</sup> – by their import worldwide (in 2009, the 8<sup>th</sup> and 11<sup>th</sup> positions, respectively).

As to the 2010 rating of suppliers of commercial services, with its exports worth a total of USD 44 bln., (up by 6%) Russian Federation holds the 23<sup>rd</sup> position worldwide, and its share accounted for 1.2% (the 22<sup>nd</sup> position and 1.3% in 2009). As concerns import of commercial services (USD 70 bln., (up by 18%)), the nation retained the 16<sup>th</sup> position, with its specific weight surging up to 2.0% compared with 1.9% reported in 2009<sup>2</sup>. Without regard to the intra-regional trade with services in the EU, Russia is ranked 12<sup>th</sup> by export and 9<sup>th</sup> – by import worldwide (12<sup>th</sup> and 9<sup>th</sup> positions, accordingly).

Table 3

DYNAMICS OF RUSSIA'S RANKING IN THE WTO RATING AND ITS SHARE IN THE GLOBAL TRADE WITH MERCHANDISE AND COMMERCIAL SERVICES IN 2000–2010

	2000	2005	2006	2007	2008	2009	2010
Export of goods	17/1,7	13/2,4	13/2,5	12/2,5	9/2,9	13/2,4	12/2,6
Import of goods	29/0,7	19/1,2	18/1,3	16/1,6	16/1,8	17/1,5	18/1,6
Export of services	31/0,7	26/1,1	25/1,1	25/1,2	22/1,3	22/1,3	23/1,2
Import of services	22/1,2	17/1,6	18/1,7	16/1,9	16/2,2	16/1,9	16/2,0

\* The first figure is the position in the rating; the other figure is the proportion, as %.

Source: calculated by the WTO statistics over the respective years.

Interestingly, Russia posts comparative dynamic of the global rating by volume of GDP the IMF computes in nominal indices. Specifically, in 2008, Russia ranked 8<sup>th</sup> worldwide (with its GDP accounting for USD 1.677 bln.), while in 2009 it slid to 12<sup>th</sup> (USD 1.229 bln.) and climbed up to the 10<sup>th</sup> position in 2010 (USD 1.477 bln.). As a result, the country's share in the global GDP accounted for 2.7, 2.1 and 2.4%, respectively<sup>3</sup>. The said direct correlation is yet another demonstration of the dependence of economic growth in Russia on volume of exports, primarily the ones of energy sources.

1 "However, the revival displays "two speeds"- the gap between growth rates of the emerging world and the developed one has remained more than two-fold: 2.5% vis-a-vis 6.5%, respectively. In developed countries, volumes of output are still far from the pre-crisis ones, unemployment runs high, budget deficits are slashed, and wages indexation is frozen. By contrast, emerging economies face the perils of overheating and high inflation". Vedomosti, 13 April, 2011

2 WTO Secretariat, Press release, PRESS/628, Geneva, April 7, 2011, pp. 21-23.

3 International Monetary Fund, World Economic Outlook Database, April 2011: Nominal GDP list of countries. Data for the year 2010.

According to Rosstat and CBR, Russia's 2010 foreign trade turnover calculated by the balance-of-payments methodology accounted for USD 648.8 bln., or up by 31% vs. the 2009 figure (*Table 4*). Positive balance of the balance of trade surged by 35.2% and hit USD 151.4 bln., with exports surging by 31.9% compared with the same period of 2009 and standing at USD 400.1 bln., while import soared by 29.6% (USD 248.7 bln.)<sup>1</sup>.

Table 4

## MAIN INDICATORS OF RUSSIA'S FOREIGN TRADE IN 2010

Data	2010, as USD bln.				as % to 2009		
	turnover	export	import	balance	turnover	export	import
FCS of Russia	625.4	396.4	229.0	167.4	133.3	131.4	136.8
Bank of Russia and Rosstat*	648.8	400.1	248.7	151.4	131.0	131.9	129.6
The RF Ministry of Economic Development*	646.8	398.0	248.8	149.2	130.4	131.2	129.1

\* By the balance-of-payments methodology.

Source: compiled by the author on the basis of respective data.

According to FCS data, Russia's 2010 merchandise turnover with Far-Abroad partners, whose share in Russia's foreign trade accounts for more than 85%, increased by 33.4%, up to USD 534.1 bln., including the one with the EU members states (their specific weight making up 49%) – up by 29.6%, up to USD 306.2 bln. The country's foreign trade turnover with the CIS countries increased by 33% and hit USD 91.3 bln.<sup>2</sup>

As a result of the Bank of Russia's final calculations of the nation's 2010 foreign trade indicators, export of goods exceeded the FCS data by 0.9% (in 2009 – 0.8%), which is a fairly permissible standard. As to import of goods, the gap was 8.6% (8.5% in 2008 and 14.6% in 2009), which evidences the trend to decline in the proportion of "grey" imports ("shuttle" trade, the practice of lowering of the customs value of goods, smuggling, etc.) in the post-crisis period. In 2010, however, a new headache for the statisticians in the foreign trade area became not registered by FCS supplies to Russia from Belarus and Kazakhstan under the aegis of the Customs Union. As this fraction of Russia's trade is now being calculated more thoroughly, there are no trustworthy date series in this area yet<sup>3</sup>.

Over the 9 months 2010, Russia's indices of foreign trade displayed a moderate increase in both prices and volumes of exported goods, with average import prices remaining unchanged in combination with a considerable growth in physical volumes of imports. Specifically, the indices in question made up: for export – 116.9% price-wise and 110.2% – by physical volume; for import – 101.2% and 130.8%, respectively<sup>4</sup>.

The basic variant of scenario-based conditions of Russia's economic development over 2012–2014<sup>5</sup> developed by the RF Ministry of Economic Development suggests the 2011 average annual price of oil being up by USD 24/b. vs. the one cited in the previous version of the forecast back in December 2010, ie. USD 105/b. instead of 81/b. That said, the Ministry envisages a consistent, albeit insignificant, decline in the price over 2012–2014<sup>6</sup>. The trend is likely to explain the envisaged stagnation of value volumes of export in 2012–2014 (growth by 8.5%), while import of goods is projected to rise by 26.2% over next three years – from USD 352.4 bln. to 444.6 bln. (*Graph 1*).

1 Platezhny balans Rossiyskoy Federatsii tovarami za 2010 g. [www.cbr.ru](http://www.cbr.ru), 4 April 2011

2 Vneshnaya trgovlya Rossiyskoy Federatsii po osnovnym stranam za yanvar-dekabr 2010; [www.customs.ru](http://www.customs.ru), 08.02.2011

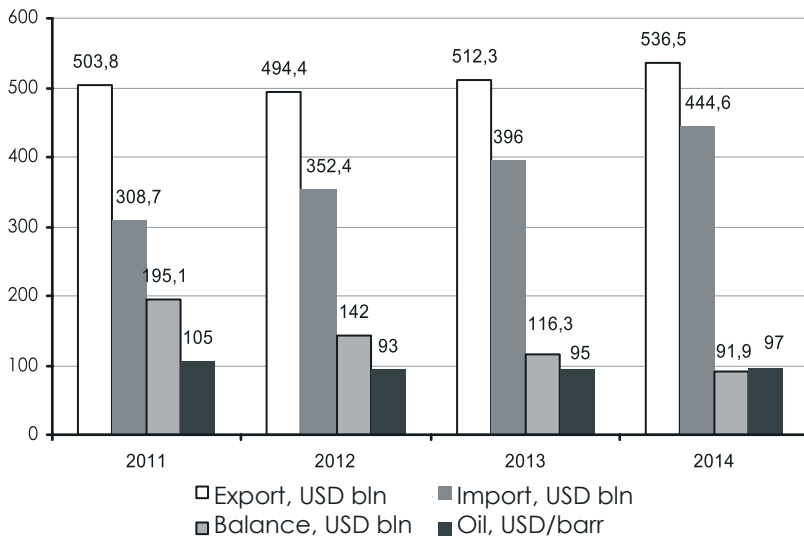
3 Kommersant, 8 April 2011

4 According to Rosstat data; see: [http://www.gks.ru/free\\_doc/new\\_site/vnesh-t/doc/oper\\_razd/ind2-vn.htm](http://www.gks.ru/free_doc/new_site/vnesh-t/doc/oper_razd/ind2-vn.htm).

5 O scenariykh usloviyakh, osnovnykh parametrah prognoza sotsialno-ekonomicheskogo razvitiya Rossiyskoy Federatsii i predelnykh urovnyakh tsen (tarifov) na produktsiyu (uslugi) subyektov estestvennykh monopoliy na 2012 g. i na planovyi period 2013 i 2014 gg. (approved by the RF Government on 21 April 2011).

6 In December 2010, the RF Ministry of Economic Development prepared a specified forecast of socio-economic development of Russian Federation for 2012-2013 wherein the range of oil price was extended from USD 75-79/b to 78-84/b. Consequently, the ultimate projections of export for the same period increased by 5.6-6.1% and those of import – by 5.1- 6.6%. [www.economy.gov.ru](http://www.economy.gov.ru)





Source: calculated on the basis of Scenario-based conditions of economic developments for the period 2012-2014 (The RF Ministry of Economic Development, April 2011)

Graph 1. Forecast of Russia's Value Volumes of Foreign Trade with Merchandise in 2011-2014

It should be noted that the current trends prove the expectations: according to the FCS's preliminary estimates, in Q1 2011, export of merchandise from Far-Abroad countries de facto added 46%<sup>1</sup>. Such a growth rate should be ascribed primarily by a 56.8% increase in import of machine-building products from Far-Abroad counties, with the proportion of these products in the overall import rising from 41.3% to 45%<sup>2</sup>. Demand for import food stuffs and consumer goods rises steadily, too, and its further increase is most likely to accelerate import in the short run – it is projected to surge at a pace twice as high as export over the coming three years, which should result in a respective contraction in Russia's balance of foreign trade.

The pace of increase in export falls behind that of import considerably: in Q1 2011, it accounted just for 17.7% (including the 4.5% increase in exports to EU as Russia's major trading partner). In all, during the period in question, Russia's merchandise turnover hit USD 103.4 bln., or 125.8% relative to the same period a year before.

In conclusion, it should be noted that in the end of the past decade, Russian economy faced long-term challenges that mirror both global trends and domestic obstacles to development, which intensified notably during the period of the global crisis.

The 2010 dynamic of the nation's foreign trade with merchandise and services shows that the country faces systemic challenges which require a serious analysis and development of new strategic approaches to development of the sphere of foreign trade on the whole. At this point, it is transformation of the foreign trade sector's role in the nation's post-crisis economic development that matters a great deal.

<sup>1</sup> According to FCS data, back in January 2011 exports from Far-Abroad countries surged by 43.2%, while in March 2011, the annual increase rate of the indicator in question hit 47.6%.

<sup>2</sup> According to the FCS data ([www.customs.ru](http://www.customs.ru)) for January – February 2011.