



RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES

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MONTHLY BULLETIN:

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SOCIAL AND POLITICAL BACKGROUND: TENTATIVE DATA AND BASIC TRENDS IN MAY 2011

Political events of May have actually cleared up the disposition of power in presidential and parliamentary elections of 2011–2012. Prime Minister Vladimir Putin has announced the creation of a “Popular Front”. Although the Prime Minister referred to the experience of countries that formed broad coalitions when choosing a strategic development path, the very first practical steps in the formation of a “Front” demonstrated that it is a new design for the “dominant party”, rather than a coalition. Creation of the Front is delegated to the functionaries of the “United Russia”, and the little-known social organizations join the Front “in packs”, the number of which, according to the Spokesman of the Prime Minister, is about 450. This allows to speak of the two functional aspects of the Prime Minister initiatives: firstly, it confirms his role as the leading political actor, structuring the political space around himself and for himself, and secondly, it allows to “dilute” the brand of “United Russia”, which according to sociologists and analysts, is noticeably losing popularity. Even with the support of administrative methods, constitutional dominance of “United Russia” after the elections will not look legitimate in the eyes of the population; this fact forces to search for a new “package” to preserve the political monopoly.

Against this background, the first extended press conference given by the President Dmitry Medvedev is no less «significant»: according to the unanimous opinion of the observers and experts, the press conference was distinguished with the complete absence of significant policy initiatives and statements. In fact, Dmitry Medvedev has demonstrated, that he is not going to extend his «scenario» to a political program and that there will be no confrontation between him and the Prime Minister. Both those events indicate that the political initiative and political levers will remain in the hands of the Prime Minister – it is his opinion that will be decisive in determining the next potential President (in particular, in the capacity of the “Popular Front « Leader), and in that sense, it is not even so important, who is that candidate – Putin himself or his nominee. It is essential, that the choice will be apparently made in favor of a «consolidation» model, rather than in favor of the unlimited competition within the «two-party system”, as some experts and elite groups hoped.

Another reference to the chosen scenario can be noted in the retirement of Sergei Mironov, Speaker of the Federal Council. The only meaning in the resignation of the powerless Speaker was a reduction of the administrative capacity of the «Fair Russia» party, headed by him. The name of the Speaker allowed to join elite and various elite- and near-elite groups (primarily at the regional level) under the roof of the Party, who for whatever reasons, have entered into a confrontation with the “United Russia», and made it possible to legalize the confrontation with the «party of power». Conceived some time ago dissolution of “United Russia” disloyal electorate, in the face of declining popularity of the «United Russia», Mironov’s party became one of the factors that undermined its dominance. With Mironov’s resignation, the party will loose attraction for the «underprivileged» elite groups.

Macroeconomics and finance: old diseases

The events of May once again demonstrated the volatility of the world markets and the urgency of the threats to the Russian economy. Oil prices fell sharply in early May: from April 30 to May 5 Brent crude oil price dropped from USD 126.03 per barrel to USD 109.85 (by 12.8%); in future price has stabilized in the range of USD 109–116 per barrel. A similar adjustment in prices was observed in May 2010, but at the same time, such sharp drops in the absence of fundamental news testify in favor of the assumption that there is a significant speculative component in the oil price.

Despite the decline in commodity prices, ruble at the beginning of the month continued to strengthen against both, dollar and Euro. As a result, on May 12 the cost of the two-currency basket has dropped to post-crisis level (RUR 33.1), but due to the subsequent weakening of the ruble, the value of the basket returned back to the April values (RUR 33.45–33.65). The clearest demonstration of the uncertainty urged by the volatility of the world markets situation, became the dynamics of the Russian stock

markets: having reached the post-crisis peak in early April (when oil prices reached their peak after the crisis), the stock indices went down, having overcome the decline in oil prices, and were declining up to May 23 (the decline in the MICEX index amounted to 15% and the RTS – to 17%).

According to the tentative estimates of G. Melikyan, First Deputy Chairman of the Bank of Russia, in April the outflow of capital is not stopped, and even increased, having reached USD 7.8 billion. It is worth recalling that in the first quarter of 2011 capital outflow was smoothly slowing: according to the CBR assessment, in January it made USD 11 billion, in February – USD 6 billion, and in March – USD 4.3 billion. In total for the first quarter the outflow amounted to USD 21.3 billion, which is nearly twice more than in the same period of the last year (USD 14.7 billion).

After a sharp peak in autumn – winter, inflation during the spring months is slowing down. It is promoted as by seasonal factors, as by the trends in the global market – the cessation of growth in the world food prices and ruble strengthening, which extends competition of imports. However, the annual inflation rate remained at a level close to 10% and its reduction in May was halted: the May inflation (0.5% for the period from May 1 to 30) is at the last year's level and above 0.1 percentage points against April of prices growth rate. One of the main reasons for this, apparently, was the fuel crisis: in May, gasoline prices rose by 3.8%. In addition, the role is played by monetary factors: excessive liquidity from the inflow of petrodollars, not sterilized by the Bank of Russia, is pushing prices up. Inflation decrease is likely to be expected only in the third quarter, with good new crop and low world prices for food.

Import growth in the first months of 2011 is at the record level: import growth in quarter I was 141.1% against the same period of the last year. In April, imports from CIS countries (according to customs statistics) amounted to 144.2% by April 2010, which corresponds to the previous month level (145.9% in January 2011 against January 2010, 144.7% in February against February and 146.6 in March against March). In general, the growth of imports of the first four months against the same period of 2010 amounted to 145.9%. Herewith, the share of food imports has stabilized (the rates of growth in this sector are close to the overall growth rates of imports), the share of chemical industry is getting reduced and the share of machinery is rapidly increasing (from 45.7% in April 2010 to 49.5% in April 2011). At the same, it is early to make a conclusion about the rapid modernization of Russian industry: imports of vehicles is increasing at a record pace, while the share of other machinery industries imports declined from 32.7% to 29.6% (increase of import rate made 26.6%, significantly lower than overall imports growth rate).

Real sector: growth of economy or prices?

According to preliminary estimates from Rosstat, the index of GDP volume in the first quarter of 2011 amounted to 104.1% versus 103.5% in the first quarter of 2010. Within January–April 2011, industrial production index was 105.5% as compared with the same period of 2010 and 104.5% in April 2011 with respect to April 2010. Growth drivers are manufacturing industries: index of manufacturing industries in April 2011 made 105.3% as compared with April 2010 and 109.2% in January–April 2011 versus January–April 2010. The main contribution to the growth of manufacturing output contributes automotive industry (production of vehicles and equipment increased in January–April by 1.49 times compared to January–April 2010; cars production has doubled). Tentative data allow to suggest a stabilization of the situation with investments: in April, an increase of investments in fixed assets amounted to 2.2% against April 2010.

However, a serious challenge to further recovery growth is the increase in domestic prices. Compared with the beginning of the year, prices for manufacturers of industrial products in April 2011 increased by 9.1% (against 6.1% in the same period of 2010). The acceleration of growth in prices in the industry in April 2011 is pushed up by the increased prices in mining operations by 20.5% since the beginning of the year. At the same time, in the manufacturing sector prices in April 2011 were lower than in the last year (104.9% versus 106.3% in April, 2010). In addition, the recovery of manufacturing industry is accompanied by increase of wages against the average level, but it is not supported by adequate growth in labor productivity.

The second threat to the positive trend in the economy is the decline in real disposable income. According to the Federal State Statistics Service, in April 2011, as compared with the corresponding period of the last year, real disposable income fell down by 3.8%, and by 3.1% over January–April

of 2011. Under the current dynamics of income, growth in consumer spending is demonstrated by the decrease in savings and an increase in consumer credits. Savings in the first quarter decreased by 12.6% as compared with the same period of the last year. We would like to note, that at the background of the decline in the share of organized ways of savings in the form of deposits and securities, interest in buying foreign currency is restored.

Business surveys of Gaidar Institute demonstrate a clear decrease of optimism in assessments of the current situation and prospects in the industry. Actual and expected estimates of effective demand declined rapidly, and sales forecasts were significantly adjusted. As a result, reduction of stocks of finished products in the industry was sustained. Recovery of output growth rates after the January downfall is halted as well. In April, the initial results showed a return to moderate growth of February, and the results purified of seasonal factors – almost to the January low level.

However, recent data on actual and projected dynamics of enterprises price showed a decline of inflation wave observed at the beginning of the year. In April, the rate of price growth decreased by 28 points as compared with January and returned to the level of the fourth quarter of 2010. Slower prices growth rates occurred in all sectors, except for fuel industry and metallurgy. Similar changes are noted about with the price plans: they have been reduced by 27 points as compared with December peak. Adjustment of price plans toward slower growth is also noted in all sectors, except for fuel industry and metallurgy. ●

THE POLITICAL AND ECONOMIC RESULTS OF MAY 2011

S.Zhavoronkov

The main events of May 2011 were the press-conference of President D. Medvedev and some changes in the party configuration before the elections to the State Duma. At the unimpressive press-conference which was announced long in advance President D. Medvedev virtually declared that he had no political ambitions, and after that he ceased to be regarded as a real leader and candidate to the President of the Russian Federation in 2012. Premier Vladimir Putin announced the establishment of the All-Russian People's Front to be led by himself, a technological project of the United Russia party, which project is designed to symbolize the unity of all the population's strata with the ruling party. The headquarters of the Front was led by V. Volodin, the Head of the Staff of the Government of the Russian Federation which factor points to the fact that the influence of B. Gryzlov, leader of the United Russia party as regards control over the party hierarchy and finances has become much weaker. S. Mironov, leader of the Just Russia party was removed from the office of the Head of the Council of Federation, and it seems he will lead the party faction at the State Duma. Billionaire M. Prokhorov declared his readiness to become the leader of the Right Cause party, however, the prospect of the party is doubtful as the party's staff and governing bodies are actually governed by the Kremlin from the outside and it is not clear if M. Prokhorov has been granted an opportunity to carry out the election campaign independently or asked to appear as a caricature enemy of the People's Front who is to be defeated triumphantly at the elections.

On May 2011, President D. Medvedev gave a press-conference which was announced long in advance and timed to the third anniversary of his presidency. As many expected, at that press-conference President D. Medvedev could have announced his nomination to run for the President in 2012 considering the fact that in the previous month he had promised to make that decision soon. According to President D. Medvedev's public aides who are few in number, the press-conference for which President D. Medvedev personally selected questions which were put to him in advance was at least to produce a sensation.

Indeed, it was kind of a sensation. President D. Medvedev answered many questions, including sensitive ones, but for his personal image it would have been better if he did not answer them that way at all. For over two hours, the formal head of the state was saying empty and often strange words which looked more like a joke. For instance, President D. Medvedev said to the journalist who inquired about the transportation problem that the journalist may use one of the two car places of D. Medvedev's wife "if she agrees to it". Also, President D. Medvedev delivered a long speech on the fate of the deer. "...Thanks to realization of the state program on development of the northern deer breeding and horse herding, the number of deer in the Russian Arctic increased to 1.5 million. I have picked up that question deliberately because it relates to the scheme of life of the peoples of the North. The whole issue seemed abstract to me until I have started to work on the national project... We shall keep spending money on it and develop relevant programs, however, it is important to organize processing and I hope they will find funds in regional budgets for that purpose. Tell local authorities what I think about it and let them allocate funds for that".

In a similar way, President D. Medvedev answered serious and important questions. For example, replying to the question about resignation of S. Mironov, Head of the Council of Federation President D. Medvedev said: "Nobody is ensured against resignation ... Sooner or later, the state career of all the officials, including presidents (! – editor) ends up. There is nothing strange in the fact that the United Russia party has got some questions. Such a situation reflects political competition ... I cannot exclude that in future some new ideas on the way how the Council of Federation should be formed may arise. Let this system work now, but never say never. Maybe, election of the members of the Council of Federation would be, to a greater extent, in accord with the principles of the

Parliament's activities. But to achieve that we need to go the way we have chosen for ourselves. In my view, there is nothing dangerous in it".

Replying to a question about a possible dismissal of the Government of the Russian Federation, President D. Medvedev said: *"The government works as a harmonious mechanism and it would be incorrect to remove some units from it. But nobody has changed the procedure for dismissal of the government. I do not think it is correct to punish leaders of the federal level for individual failures because the system they are in charge of has been established in most cases long before they took office. However, it does not mean that I will not do that. It is obvious that sooner or later a rotation at ministries will be required. I said earlier that the government is an integrated entity with its strengths and weaknesses, however, I proceed from the fact that a new government which is to be formed in this country should be considerably renewed regardless of the fact who forms it. It is a requirement of the time"*¹.

Also, President D. Medvedev commented on the situation with election of governors. *"Some time ago, I said that that procedure should not be changed at all. Now, I am not that sure. I think that in the short-term prospect, in the foreseeable future, it would be correct to preserve that procedure as it is because it permits to manage the state effectively. However, I admit that some time in future, that procedure may be changed if not by me then by those who will work in the next 10-15 years"*.

Generally, on the basis of the results of D. Medvedev's three-year presidential rule observers are offered to wait for an uncertain period of time until all his good wishes are fulfilled. Also, it is to be noted that the horizons of fulfillment of those wishes are determined by President D. Medvedev by such a period of time which goes far beyond the term of his office even if he is re-elected the President of Russia in 2012. In addition to the above, it is interesting to note that President D. Medvedev has not made any new initiatives, except for abolition of the technical inspection of new vehicles which proposal was announced last month and implemented in May.

President D. Medvedev's press conference dissatisfied the business press a great deal. The Forbes reacted to it with a heading "Nothing", Der Spiegel: "Masochist in the Kremlin" and the Vedomosti daily: "Medvedev held his first press-conference the way as if it was his last one". E. Gontmaher, member of the Board of the Institute of Modern Development which is formally headed by President D. Medvedev commented on the above press-conference as follows: *"There was an idea that Medvedev may walk on the thin ice, emerge from nowhere and introduce signs of the competition into the Russian political system. It was a silly idea. Medvedev's goals and purposes met with serious limitations which became apparent to him of late...Limitations are related to the fact that Medvedev does not have his own political force -- a party -- he could rely on. Putin, on the other hand, has a base as the leader of the United Russia party which dominated both among the Russian bureaucrats and in almost all elected authorities of this country. Whatever Putin says, the United Russia party will fulfill. If Putin says that Medvedev should be supported at the elections the United Russia party will do that. If Putin does not say that Medvedev will be simply out of business. Such is the reality"*.

One can agree with E. Gontmaher, but with a single correction that the United Russia party like all other similar parties is only a formal instrument of power in the authoritarian system. The real power in this country is with the state machinery and security agencies, and their loyalty ultimately determines both the personality of the leader and the policy he pursues. To win the support of the state machinery (which is related to high risks for those who would like to "place their bets" on Medvedev) it is important for Medvedev (or any other contender) to look forward to that, to say the least, rather than speculate on what the country is going to be like in 15 years.

In May, important changes took place in the party sphere. Premier V. Putin declared about the establishment of the All-Russian People's Front, S. Mironov, leader of the Just Russia party left the office of the senator and speaker of the Council of Federation after he was recalled by a majority vote of deputies of the St. Petersburg Legislative Assembly which S. Mironov represented, while Russian billionaire M. Prokhorov declared his readiness to become the leader of the Right Cause party.

¹ It is worth mentioning the following fact that a bit late, beyond the frameworks of the press-conference, President D. Medvedev said that he "felt like" dismissing A. Fursenko, Minister of Education of the Russian Federation. However, it seems President Medvedev cannot do that as A. Fursenko, in his turn, publicly declared that he was not going to resign.

The least important event among the above three is that related to the People's Front. Premier V. Putin who headed the United Russia party's list at previous elections and who is planning to do so again this time declared that the need to establish such an organization as the People's Front was justified by the fact that the United Russia party should include in its party list dignified representatives of other organizations and persons who were not members of the United Russia party. The above dignified representatives were promptly presented to the general public. Surprisingly, most of them selected on the basis of age and occupation (trade-union leaders, managers of business associations and heads of youth organizations and veterans' organizations) were already members of the United Russia party, while those few non-party members whom the party had managed to get involved were either little known or notoriously known individuals (for instance, they included V. Lysakov, Head of the *Freedom of Choice Motor Association* who despite his policy statements supported the government's decision to raise import duties on cars two years ago and shortly after the association ceased to exist and carried out no activities). It was the same image-making technology of the party of "ordinary people", milkmaids and weavers which was used both in 2007 and in the days of the communist party rule. The real influence of those "ordinary people" is clear to everybody and it is worth nothing.

The People's Front is more interesting as it provides an answer to the question who is going to be the leader of the United Russia party's headquarters at the elections. As it was declared, V. Volodin, Head of the Staff of the Government of the Russian Federation would be in charge of the headquarters of the All-Russian People's Front. Recently appointed to a high-ranking post in the Government of the Russian Federation, V. Volodin (promoted by V. Surkov, actual mastermind of the Kremlin's political technologies) may be further promoted to the office of the chief of V. Putin's campaign headquarters at the presidential elections or leadership of the parliament and the United Russia party. B. Gryzlov, the present Head of the United Russia party and Speaker of the State Duma suffered another defeat as regards control over the resources of the United Russia party, though he would keep his office at least until the elections for the reasons of stability.

Officially, on the initiative of the United Russia party, but actually on the initiative of the Kremlin, S. Mironov, Chairman of the Council of Federation and leader of the Just Russia party left the Council of Federation¹. S. Mironov's formal departure from the office of the chairman of the party in the previous month was not enough for the Kremlin in a situation where S. Mironov claimed to head the party list at the elections. Though S. Mironov's removal from office makes it more difficult for him to do fundraising and ensure public coverage of the forthcoming campaign the Just Russia party has enough strength judging by the results of regional elections. A real threat to the party is an administrative closure of it as it once happened to the *Rodina* party in 2006. However, with all the lapses (many observers believe that S. Mironov's statement that unlike 2007 the Just Russia party will not support the candidate of the United Russia party at the presidential elections had a fatal role to play in S. Mironov's fate) Premier V. Putin is unlikely to punish severely his good acquaintance whom he entrusted with an important job of a back-up candidate at the presidential elections in 2004 in order to prevent a disruption of those elections. So far, it has been announced that S. Mironov will become a deputy of the State Duma and the leader of the party faction².

There has been an unexpected intrigue about the Right Cause party in the public space. Established on the base of the pro-Kremlin wing of the SPS party late in 2008, the Right Cause party was virtually in the state of "a clinical death" for a long period of time despite the fact that its trustees included numerous prominent figures (the party's supervisory council included, in particular, A. Chubais, D. Yakobiashvili and I. Yurgens). The above party has not only failed to surpass the electoral threshold, but it has never participated in any regional or municipal elections, though once its founders justified the need to liquidate the SPS party (which was to some extent an opposition party) by the need to participate in the elections and preserve the party license and that could only be done by the Kremlin's consent. Negotiations with different prominent

1 A close acquaintance of Premier V. Putin, S. Mironov could have been earlier removed from his office by a majority of deputies – members of the United Russia party -- of the St. Petersburg Legislative Assembly which majority used to obediently vote for the representative of the competitive party. This time, however, they were sanctioned to do quite the opposite.

2 He has such a right under the law if a deputy – member of the party faction in the State Duma – resigns his seat.

politicians, officials and businessman on the prospect of their becoming the leaders of the party to replace the three co-chairmen who were little known to the general public seems to have failed as those prominent figures were not given a guarantee that they would be allowed to run the party independently, nor did they want to act as mere technical figures.

So far, not much is known: the leadership of the Right Cause party has declared that it is prepared to give up the office in favor of M. Prokhorov whose forthcoming election was announced in the official mass media and positively commented on by President D. Medvedev. M. Prokhorov declared that the party was going to become the second largest winner at the parliamentary elections, however, he refused to make any policy statements until he was formally elected late in June.

M. Prokhorov is a prominent figure and it is not a problem to invent such a success story and an attractive program for him as would be aimed at the right-wing electorate which does exist. But the real problem is different. The smaller part of the problem consists in the fact that to achieve a success a party of any ideology has to criticize the United Russia party and the objective of other parties and candidates is not to irritate¹, but operate carefully within the tough frameworks and at the same time show what needs to be changed in this country. M. Prokhorov's latest public initiatives regarding extension of the length of the working day² (which initiative is not of high priority for the business, but has caused irritation with the general public) makes one doubt that he will find the correct rhetoric.

The election campaign in the present-day Russia does not boil down to TV addresses only even if one is permitted to appear on TV (other parties will never be on air as much as the United Russia party). It primarily includes a set of technical procedures which are carried out all over the country: distribution of dozens of millions of copies of high-quality printed materials, operation of network structures of election campaign canvassers, supervision at the elections and quality management (the best managers to do that job are serious leaders of regional party lists who are interested in their own election to the parliament). Many people who are not involved in politics believe that the result of the forthcoming elections is ensured if there is agreement with the Kremlin. It is only partially correct. Agreement (at least at the federal elections starting from 2007) is needed for a candidate (or a party) to be allowed to take part in the elections, but the Kremlin will not draw the election results for that candidate, nor technically rig the results of the elections in favor of the two parties as it would simply be impossible. The Kremlin's objective is to maximize the percentage of votes for the United Russia party because it reflects the extent to which governors and other officials are efficient.

Hypothetical success or guaranteed failure of the Right Cause party can be determined with regard to the seemingly unimportant issue: the fate of the staff of the Right Cause party and the majority of its Political Council where the Kremlin's direct protégés dominate. If M. Prokhorov succeeds in replacing them with a team which is both loyal to him and interested in success he has a hypothetical chance if not he is doomed to appear in the role of a caricature enemy of the People's Front and an unpopular oligarch who wins an insignificant number of votes at the elections irregardless of the fact whether he has agreed on such a technical role or not. ●

1 For example, it is prohibited to criticize V. Putin and D. Medvedev.

2 The problem which exists in some developed countries does not exist in Russia because there is no control over compliance with the labor legislation and a worker if paid decently is prepared to work overtime, while, most importantly, the sanctions provided for a violation of the labor legislation are insignificant.

INFLATION AND CREDIT AND MONETARY POLICY

N.Luksha

Nearly twofold slowing in food prices growth in April helped to reduce the growth rate of consumer prices (0.4 per cent against 0.6 per cent in March). In May, gasoline crisis started to affect inflation: Within 23 days of May, prices for gasoline rose by 0.4 per cent. In April capital outflow from Russia has remained at a high level, reaching, according to preliminary estimates, 7.8 billion dollars. The Bank of Russia continued to tighten monetary policy: from May 3, the refinancing rate was raised by 0.25 percentage points up to 8.25 per cent.

As we predicted, in April the trend of inflation slowing has remained. The rate of increase in consumer prices dropped by 1.5 times as compared with March, having reached 0.4 per cent. Nevertheless, this figure was higher than the last year indicator (0.3 per cent).

Slower growth in consumer prices was contributed by more than twofold slowing of food products price growth (0.4 per cent against 0.9 per cent in March). Like in March, in April, sugar continued to get cheaper (−4.7 per cent), fruit and vegetables (−1.5 per cent) and sunflower oil (−0.1 per cent). At the same time, the price of eggs rose more rapidly than in March (+6.2 per cent).

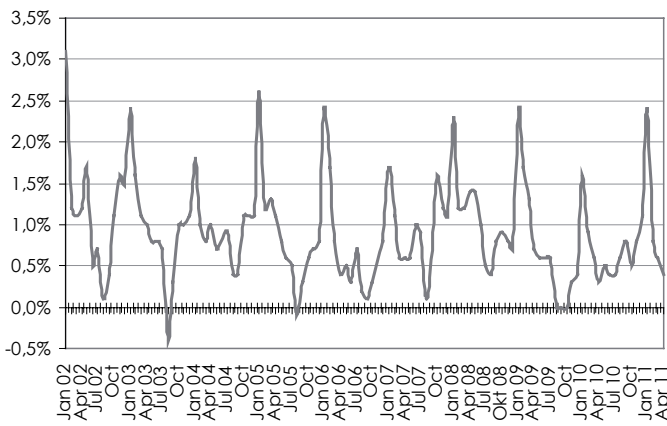
The rate of increase in prices for industrial goods in April as compared with the previous month remained unchanged at 0.5 per cent. The largest contribution to the rise in prices was again made by tobacco products (2.5 per cent). As a result, the gasoline crisis, the price of automotive fuel increased by 0.9 per cent. In the group of non-food only audio- and video-devices prices have decreased (−0.4 per cent).

After a brief slowdown in services price growth sector in April, they again increased (+0.5 per cent). To the greatest extent prices for gas have increased (+5.7 per cent). At the same time prices for communications fell down (−0.2 per cent) and heat tariffs (−0.7 per cent).

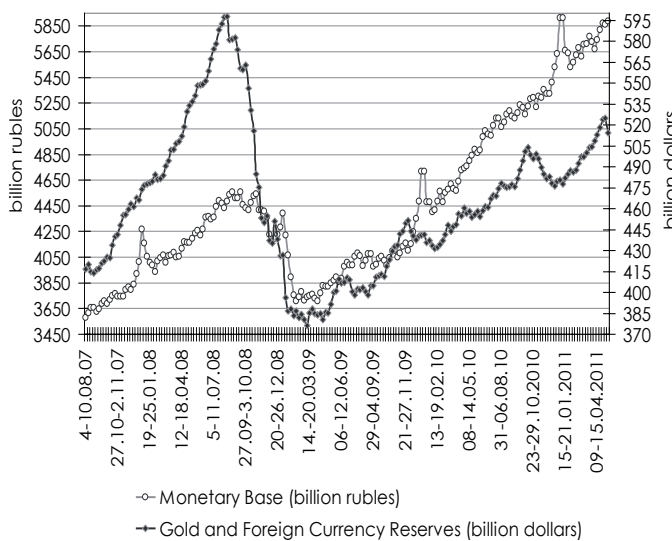
The slowdown in prices in April was largely due to seasonal trends. Starting from this month and throughout the summer period, prices traditionally get lower for a range of food products, which significantly contributes to consumer inflation in our country. In addition, the slowing of inflation was contributed by the decline in world food prices and the strengthening of the nominal exchange rate. At the same time, from the beginning of 2011 the annual inflation rate is not reduced and remains within the limits of 9.5–9.6 per cent (*Fig. 1*). Negative factor, provoking the rise in inflationary pressure was the increase in monetary inflation. The basic consumer price index¹ in April 2011 amounted to 0.5 per cent (against 0.2 per cent for the same period in 2010). Apparently, the increase in basic inflation results in accelerated growth of monetary supply in the first half of 2010.

In May, the trend for slowing down of inflation was suspended. Within 23 days of the month prices rose by 0.4 per cent, which is equal to the growth of prices for April in general and higher than in the previous year by 0.1 percentage points. As a result, the break-away of the increased difference of the accumulated inflation rate in 2011 from the same indicator of the relevant period in 2010 has grown (4.6 per cent versus 3.8 per cent). One of the main reasons inflation acceleration was the fuel crisis: in May, gasoline prices were significantly increased (+3.8 per cent since the beginning of May). In addition, the effect of food shocks was still not extinguished: the price of wheat over the same period rose by 2.7 per cent. The monetary factor has also played its role: excessive liquidity from the influx of oil dollars, non-sterilized by the Bank of Russia, is pushing prices up. Slowing rate of inflation is likely to be expected only in the III quarter, with good new crop and low world prices for food.

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



Source: RF Statistical Service.
 Fig. 1. The Growth Rate of the CPI in 2009-2011 (% year to year)



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

10 billion, or nearly 2 per cent reduction of reserves, which was associated with a negative revaluation of assets Euro, which exchange rate denominated in USD has sharply declined in early May.

In April, the net capital outflow has continued. According to a preliminary estimate of the First Deputy Chairman of the Bank of Russia G. Melikyan, the outflow has reached USD 7.8 billion³. We would like to recall that in quarter I of 2011 the capital outflow was smoothly slowing: according to the assessment of the RF Central Bank, in January it was USD 11 billion in February – USD 6 billion and in March – USD 4.3 billion. In total, for the I quarter, the outflow amounted to USD 21.3 billion, which is almost twice more than in the same period of the last year (USD 14.7 billion).

If at the beginning of the year the growth of capital outflow could be in some way explained, by a seasonal factor, its acceleration in recent months, is due most likely, to the institutional factors – political risks, increase of the tax burden on business, weakness of institutional

In April, the monetary base in broad definition continued to decrease. As of the month results, it has declined by 3 per cent to RUR 7285.4 bn. The decline of the monetary base was provoked by nearly 3-fold decrease of credit organizations' deposits with the Bank of Russia, which made RUR 264.2 as of May 1. Reduction of the bank deposits with the Central Bank of Russia was due to overall decline in excessive liquidity, which was previously absorbed in the deposits of the CBR. Other components of the monetary base were growing: cash in circulation with regard to the fund balances in credit organizations has grown by 3.4 per cent to RUR 56.7 trillion, correspondent accounts of credit organizations with the RF Central Bank grew by 3.2 per cent to RUR 616.4 billion, mandatory reserves – by 15 per cent to RUR 280.8 billion, bonds of the Bank of Russia with credit institutions – by 12.5 per cent to RUR 453.7 billion.

In April, the excessive reserves of commercial banks¹ have decreased by one quarter: as of the month results, they made RUR 1334.3 bn. Reduction of excessive liquidity was the result of further tightening of the Bank of Russia credit and monetary policy and a growing capital outflow, as well as large tax payments in April.

The growth of cash in circulation by 3.4 per cent and mandatory reserves by 15 per cent in April led to the expansion of the monetary base in narrow definition (cash plus required reserves)² by 3.9 per cent to RUR 5951.1 (Fig. 2). Within a month since the 20-th days of April the international reserves have been practically unchanged, their volume reached RUR USD 516.8 bn as of May 20. In the second week of May there was a significant – more than USD

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

2 We would like to remind, that the monetary base in the broad definition is not a monetary instrument, it reflects the obligations of the Bank of Russia in national currency. The monetary base in narrow definition is a monetary instrument (one of indicators of the volume of monetary offer), which is under total control of the RF Central Bank.

3 ITAR-TASS News www.itar-tass.com/c9/146920.html, 20.05.2011.

mechanisms for the protection of property rights, total corruption. In general, those factors form an unfavorable investment climate in the country.

In May, the ruble rate against the US dollar has been volatile. On May 6, having reached the maximum level (RUR 27.26 rubles against USD) since November 2008, the rate of national currency started to weaken. The reason for the ruble rate growth in recent months was certainly, the expensive oil, the price of which was increasing within the summer of 2008. The depreciation of the ruble in May was the result of the falling global oil prices from USD 126 to 110 per barrel.

Reduction of oil prices was due to, firstly, with decreasing International Energy Agency estimates of oil consumption for 2011, and secondly, with the news on rising stocks of crude oil and oil products in the USA, and, thirdly, with the reduced fears of investors about the expansion of the political crisis from Egypt and Libya to other oil-producing countries, in particular, to Saudi Arabia. In less than four weeks of May the RUR rate has weakened by 2.7 per cent to RUR 28.23/ USD 1 on May 27.

The dynamics of the ruble against the European currency in May was following the trend of dollar/Euro in the Forex market. The euro exchange rate was falling down to both, the dollar and the ruble. The main reasons for this were the internal problems of EU countries: weak economic growth in the Euro area, the continuing debt problems of Greece and Portugal, as well as the deterioration the Italy rating from «stable» to «negative». Since the early months of the ruble rate against Euro has grown by 1.9 per cent to 40.02 rubles per Euro on May 27.

The overall outcome of May simultaneous devaluation of the ruble against USD and its growth against EURO has led to a slight increase in the value of the two-currency basket: on May 27 it amounted to RUR 33.54.

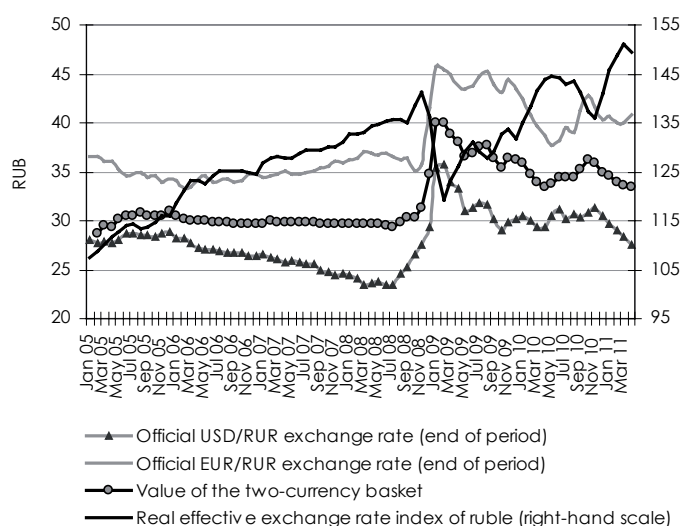
The real effective exchange rate has declined in April by 1.2 per cent, which was caused by the acceleration of capital outflow, as well as a slowing of inflation in the RF in comparison with the countries – major trade partners of Russia. Real effective exchange rate has dropped to 149.34² (Fig. 3)

On April 29, the Board of Directors of the Bank of Russia decided to raise the refinancing rate from 8 per cent to 8.25 per cent per annum and for the similar amount most of the interest rates of the RF CB operations to provide liquidity and adsorption to credit institutions (interest rates on Lombard loans and repo transactions at fixed rates remained at the same level).

We would like to recall that for the last time the Bank of Russia changed the interest rates on Feb. 25, 2010, having increased their average rate by 0.25 percentage points. Thus, the RF CB has continued its tightening of monetary policy. This rate growth was the second one in this year. In addition, the Bank of Russia for the third time already in 2011 has increased the standard of mandatory reserves.

With the help of the taken measures the Bank of Russia has reacted to the continued acceleration of inflation, which in January – April amounted to 9.7 per cent in annual terms. The sustained high global oil prices provides incentives to the monetary component of inflation, as well as the more expensive food prices in the world markets. During the first four months of 2011 the CPI reached 4.3 per cent despite the fact that the Bank of Russia intends to keep inflation within 7–7.5 per cent.

We believe that in this situation the RF Central Bank needs to limit its operations in the foreign exchange market to prevent a sharp upsurge in the monetary supply. In addition, to curb inflation, there may be required further steps to tighten monetary policy.



Source: RF Central Bank, author's estimates.

Fig. 3. Indicators of Ruble's Exchange Rate Dynamics In January 2005 – April 2011¹

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

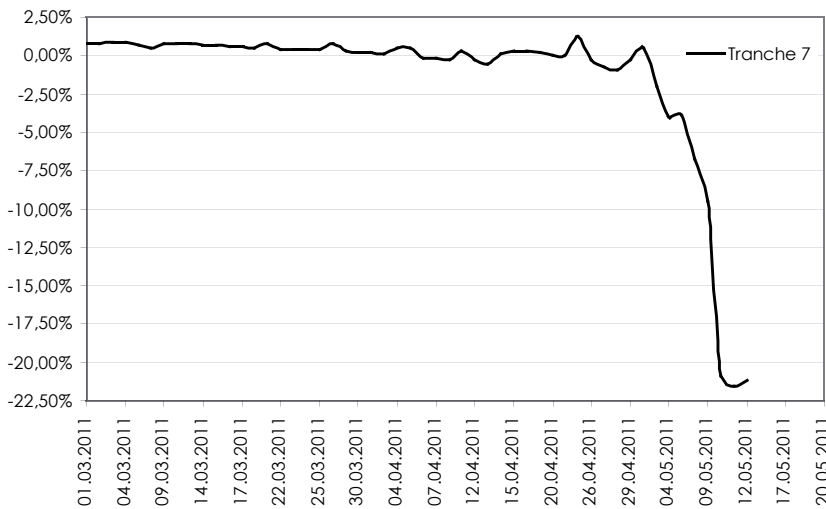
2 The level of January 2002 is accepted as 100 per cent.

FINANCIAL MARKET¹

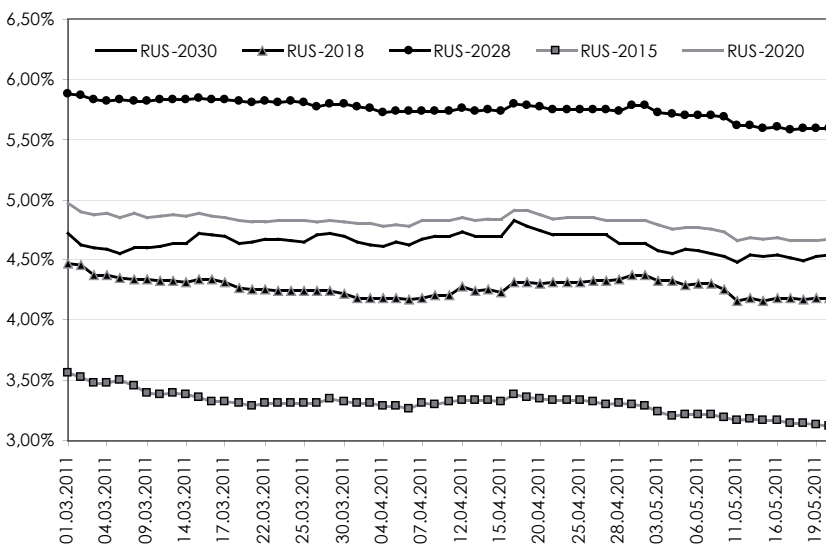
N.Burkova, E.Khudko

The main causes of the Russian stock market decline in May this year were a decrease in the global oil prices, reduced sovereign credit ratings of Greece and the lowered of the forecast rating of Japan, as well as deterioration in the economies of Japan and the U.S. In the domestic corporate bond market there emerged a seasonal factor, which resulted in substantial decline of investment activity. The weighted average yield of bonds is kept at a low level, despite the increase in refinancing rate in early May.

Government securities market



Source: “Finmarket” Information Agency data.
Fig. 1. Minfin bonds' yields to maturity in March – May 2011



Source: “Finmarket” Information Agency data.
Fig. 2. Yields to maturity of the Russian Eurobonds with maturity in 2010, 2015, 2018, 2020, 2028 and 2030 in March – May 2011

In early May 2011 the fall of the global oil prices, lowered equity markets the U.S. and Europe due to the deterioration of the international rating agency Standard & Poor's outlook for Japan rating and increased refinancing rate by the Bank of Russia has led to a decrease in investors' activity in the market for government securities. Additional pressure on the demand in the second half of the month has been provided by the information of the Ministry of Economic Development on the increase of the rate of inflation and unemployment in Russia in April 2011, as well as lowering of the long-term rating of Greece by the agency Fitch Ratings. Against this background, prices of Russian bonds declined after the underlying assets.

As of May 22 of the current year, the Russian Eurobonds RUS-28 yield to maturity has decreased as compared with the level of April 24. The greatest decrease in the yield to maturity demonstrated Eurobonds RUS-15 (by 6.3 per cent). On April 29, 2011 coupon yields were paid on Eurobonds RUS-2015 in the amount of USD 36,25 mln and on RUS-2020 in the amount of USD 87.50 million. In addition, an important event for the market of government securities was the repayment by

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

VEB, acting as General Paying Agent for the Russian Ministry of Finance, of the seventh tranche of external currency debt bonds amounting to USD 1.75 billion (*Figs 1–2*).

Within the period from April 25 to May 22, the total turnover of the secondary market of government bonds amounted to approximately RUR 154.2 billion with an average daily turnover of RUR 8.6 billion (about RUR 210.9 billion with an average daily turnover of RUR 10 billion in April), which means a decrease of an average monthly turnover by 15 per cent.

In the period from April 25 to My 22 there were held 4 auctions on federal loan bonds (OFZ) placement in the primary market (5 auctions a month earlier) (*Table 1*). Total actual amount of placement made 78 per cent of the planned volume. There were no auctions on additional OFZ placement in the secondary market.

Table 1

OFZ PLACEMENTS IN THE PRIMARY MARKET

Auction date	Emission	Emission volume, RUR mln	Emission volume at face value, RUR mln	Weighted average yield
27.04.2011	OFZ-26204-PD	20 000,00	19 782.05	7.71
04.05.2011	OFZ-25077-PD	40 000,00	31 628.97	7.39
11.05.2011	OFZ-25076-PD	20 000,00	19 409.99	6.61
18.05.2011	OFZ-25076-PD	20 000,00	6 883.31	6.60
Total:		100 000,00	77 704.33	

Source: RF Ministry of Finance.

Stock market***Stock market situation***

Reduction in demand for Russian assets in May was provoked by the negative dynamics of commodity prices, the uncertainty in the Euro zone overcoming the crisis, the poor macroeconomic statistics, as well as tightening of credit and monetary policy in China. All those factors inspired a desire to withdraw assets from the class of risk around the world, which was clearly demonstrated by the dynamics of the major stock indices in the key emerging markets. Herewith, a major factor in support of the Russian stock market in May was the preservation of the US Federal Reserve System the key refinancing rate at the same level for at least another six months.

The majority of developed markets have shown a reduction by 0.3-1.3 per cent per month, while markets in developing countries - by 4-8 per cent (*Table 2* and *Fig. 5*).

Table 2

DYNAMICS OF THE GLOBAL STOCK INDICES (AS OF MAY 22, 2011)

Index	Value	Dynamics within the month(%)*	Dynamics from the year beginning (%)
MICEX (Russia)	1 603.97	-10.59	-4.98
RTS (Russia)	1 825.34	-10.92	3.11
Dow Jones Industrial (USA) Average (USA)	12 512.04	0.05	8.07
NASDAQ Composite (USA)	2 803.32	-0.60	5.67
S&P 500 (USA)	1 333.27	-0.31	6.01
FTSE 100 (UK)	5 948.49	-1.16	0.82
DAX-30 (Germany)	7 266.82	-0.39	5.10
CAC-40 (France)	3 990.85	-0.77	4.89
Swiss Market (Switzerland)	6 530.61	1.14	1.47
Nikkei-225 (Japan)	9 607.08	-0.78	-6.08
Bovespa (Brazil)	62 596.52	-6.65	-9.68
IPC (Mexico)	35 298.67	-4.12	-8.44
IPSA (Chile)	4 818.96	1.69	-2.20
Straits Times (Singapore)	3 168.54	-0.82	-0.67
Seoul Composite (South Korea)	2 111.50	-3.93	2.95
ISE National-100 (Turkey)	63 298.58	-7.85	-4.10

Table 2. cont'd

Index	Value	Dynamics within the month(%)*	Dynamics from the year beginning (%)
BSE 30 (India)	18 326.09	-6.51	-10.64
Shanghai Composite (China)	2 858.46	-5.05	1.79
Morgan Stanley Emerging&Frontier Markets Index	901.23	-5.36	-1.15

Versus index indicator valid on April 24, 2011.

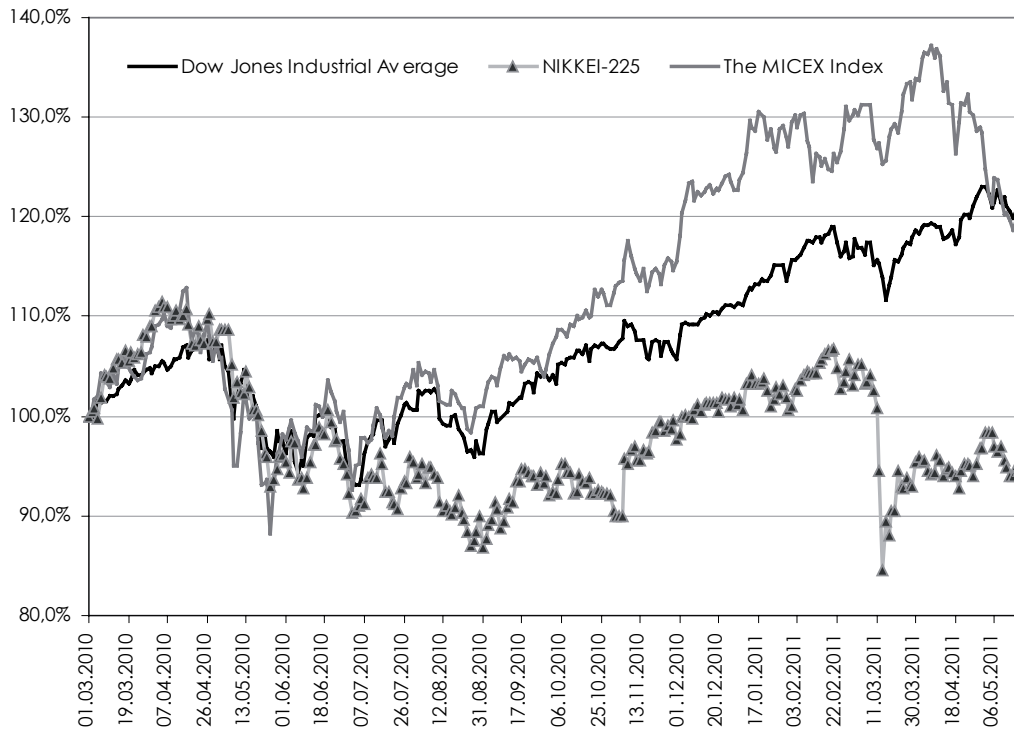


Fig. 5. Dynamics of the main USA, Japanese and Russian stock indices (in % to the date 01.03.2010)

Stock market situation development

The maximum value within the month the MICEX index has reached in May, having reached –

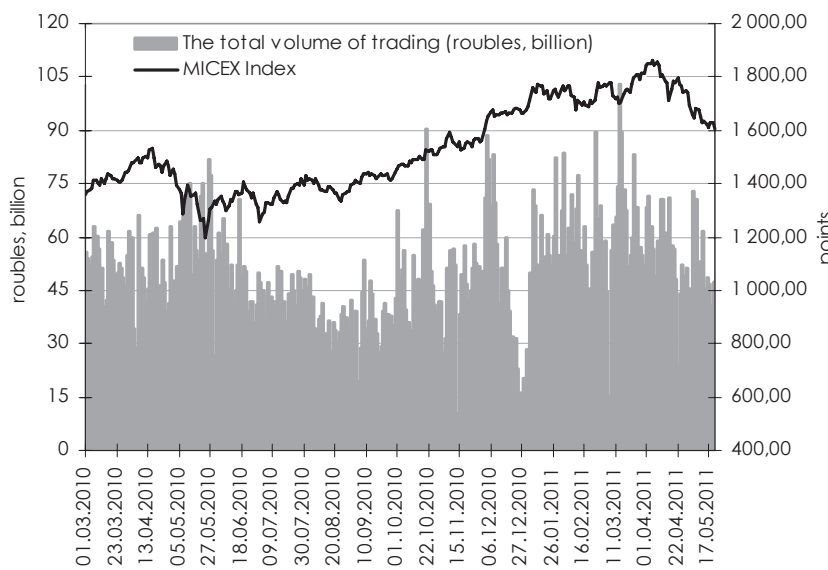


Fig. 3. Dynamics of the Russian Blue Chips from April 25 to May 22, 2011 Dynamics of MICEX Index and trading volume

1,691.45 points (1,859.99 points in the preceding month). The minimum value for the period the MICEX index has reached on May 20 – 1,603.97 points (against 1,714.07 points in the preceding month) (Fig. 3).

In general, within the period from April 25 to May 22, 2011, the MICEX index has decreased by 10.6 per cent, what makes about 190 points in absolute terms (from May 23, 2011 through May 23, 2010, the MICEX index has been upgraded by 26.81 per cent), and the turnover of trades in securities included in the stock market in March has reached RUR 952.1 bn. Therefore, the average monthly level of investors activity in the

stock market in May has decreased as compared with the preceding period by 11.6 per cent.

In the period under review, the leaders in the value decline among the “blue chips” were securities of Gazprom Neft, Tatneft and Gazprom, which have declined by 18, 161 and 15.8 per cent accordingly (Fig. 4).

According to MICEX information, as of March 22 of this year, the top five leaders of the domestic stock market in terms of capitalization were: “Gazprom” – RUR 4,720.97 bn, “Rosneft” – RUR 2,417.23 bn, “Sberbank of Russia” – RUR 2,060.26 bn, “LUKOIL” - RUR 1,472.24 and GMK Nornickel – RUR 1,362.99.

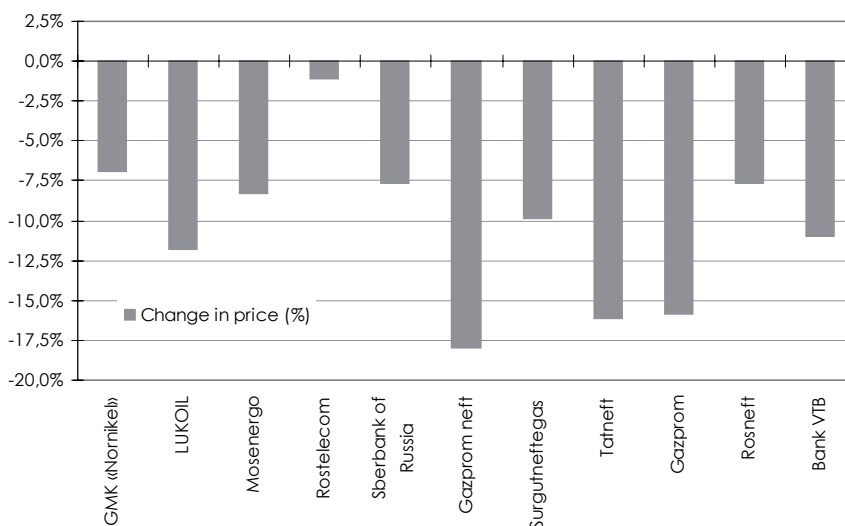


Fig. 4. Dynamics of the Russian Blue Chips from April 25 to May 22, 2011

Futures and Options Market

In May (from April 25 to May 22) the average daily turnover in the MICEX futures market has decreased by 45 per cent as compared with the preceding month. The largest volume of trading in May, like a month before, was observed in contracts for futures and equity instruments, amounting to RUR 42.97 billion (225 thousand of transactions). Herewith, in terms of the trading volume in this section of the futures market, the MICEX derivatives are followed by the futures supply contracts for the shares of Nornickel, Gazprom, Sberbank and LUKOIL. We would like to note, that the value of the MICEX index (the price of transactions) for September 2011 was at the level of 1,600–1,670 points, i.e., there expected 0.4 per cent points index growth as compared with the indicator of May 22, 2011.

The second place in terms of trading volume (RUR 10.51 bn) within the month of May was taken by foreign currency futures contracts. They are followed by futures in foreign currency (RUR 9.8 bn). Herewith, the first place in terms of trading volume in this section was taken by the futures contracts for USD, followed by the futures contracts for Euro/USD and Euro/RUR rate. Prices of futures contracts, concluded in May for RUR/USD in the MICEX market were within RUR/USD 27.8–29 for September 2011, i.e., 0-2.1 per cent decline is expected as compared with the indicator of May 22, 2011 (27.91 RUR/USD). Since May 23, 2011, futures derivatives market were introduced in the new series of interest rate futures for MosPrime Rate in MICEX (with maturity of up to 3 years) and for the U.S. dollar (up to 5 years).

In the RTS FORTS futures market the investors' average daily activity in May has increased by 26 per cent (0.24) as compared with the previous month. Herewith, in the first place in terms of futures trading volume were the futures contracts for the RTS index, which were followed with a significant margin by the futures contracts for the USD-RUR rate, for Euro/USD rate and for the shares of Sberbank of Russia and Gazprom shares. Prices of the latest transactions, concluded in the RTS FORTS on futures contracts for RUR/USD rate for the date of execution on September 15, 2011, were basically within RUR 27.6–28.6 /USD, i.e., there expected 0-2.5 per cent RUR reduction versus the indicator of May 22, 2011. The value of futures contract for the RTS index (based on the prices of recent contracts) with the execution date on September 15, 2011 made 1,800–1,990, i.e., there expected 0-9 per cent RUR growth versus the indicator of May 22, 2011. Options enjoyed far less demand, the turnover made about RUR 363.15 bn (against RUR 4.05 bn in futures).

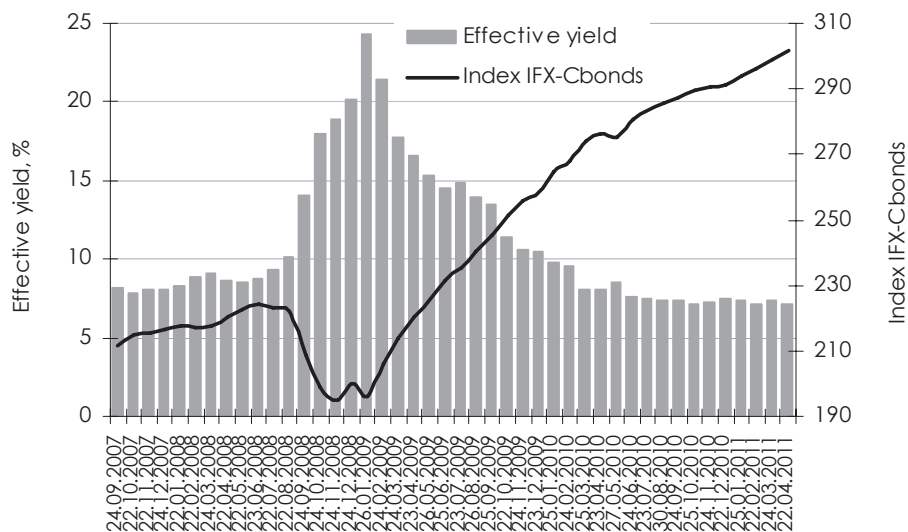
Corporate bonds market

The volume of the Russian domestic corporate bonds market (as per nominal value of shares in circulation, denominated in national currency) in May of the current year continued its growth and at the end of the month reached the level of RUR 3,144.0 bn, having demonstrated a significant growth against the relevant indicator of the late April (+4 per cent)¹. As a result, the volume of the bond market has once again updated the historical maximum. Sufficiently significant growth in the market volume due to the increase in the number of emissions recorded in the national currency, from 692 issues up to 742. Herewith, the number of emitters represented in the debt segment of the securities market, over the past month, it was virtually unchanged (347 emitters against 348 issuers at the end of April). The above statistics shows an increase in the number of loans placed by each issuer on average. There is only one emission of bonds in circulation, in Japanese yens.

After the record levels of the recent months the turnover in corporate bonds in the stock market has significantly decreased. Thus, in the period from April 25 to May 20, the total volume of transactions in the MICEX Stock Exchange amounted to 110.3 billion rubles (for comparison, from March 25 to April 22, the volume of transactions was equal to 196.9 billion rubles), and the number of transactions has reached 22.1 thousand (nearly 30 thousand over the preceding period)². However, the focus should be made on the fact that almost for a half of May the investment activity in the securities market was at its lowest level during the holidays. If we compare the average daily volume of trading in ferial days, he remained at about the same as that during March and April this year.

Index of the Russian corporate bonds market IFX-Cbonds demonstrated further growth (by 1.6 points or 0.5 per cent per month). As a result, the index has updated the highest peak since the start of its assessment. The relative weighted average effective yield of corporate bonds in the period under review has somewhat increased (from 7.13 per cent at the end of April to 7.21 percent at the end of May). Such a correction of the interest rate in the debt market was a response to the next increase of the refinancing rate. However, despite the fact that over the past three months the Central Bank raised its key interest rate twice (by 0,5 percentage points in total), the average profitability in the segment of corporate bonds in general remained within the range of June of the last year, 7.0–7.6 per cent (Fig. 6). The index of portfolio duration of corporate bonds continued the downward trend and by the end of May was 543 days, which is 30 days less than the value of the preceding month. Therefore, the share of the long-term commitments in the corporate market segment has somewhat decreased.

The yield the most liquid bond issues in this period has somewhat increased. There was no strong volatility of interest rates, and in most cases, growth yield was not more than 0.2-0.3 pp. The



leaders of growth yield from April 25 through May 20 were OAO “Mobile TeleSystems” (series 04 +2.8 percentage points), OAO AKB “Rosbank” (Series 08 +2.0 pp) and OAO “Mechel” (Series 03 +1.2 p.p.). A significant decline in the yield at the background of the overall growing trend was also shown by series 16 of OJSC “Russian Railways” bonds (-1.7 p.p.).

The yield of financial institutions securities in May has grown in general: in particular, AHML, “Bank VTB”, “Bank Zenit”, “NOMOS-Bank” demonstrated growth rates

Source: Cbonds data

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

1 the Russian Federal Financial Markets Service data.
 2 As per “Finmarket” Information agency.

for the second consecutive month. At the same time, a significant decline in the yield (by 0.7-0.8 p.p.) was recorded in the securities of OOO CB “Renaissance Capital” (Series 03) and OAO “Russian Agricultural Bank” (Series 07).

The same volatile trend was observed in the manufacturing segment. Bonds of energy companies – “Lenenergo”, “TGC-2”, “TGC-5”, “MOESK” have shown an increase in profitability, and “Mosenergo” and “TGC-1” – a significant reduction (approximately by 0.4 p.p.). In the oil and gas sector the yield of the most liquid bond issues by companies, Gazprom and Gazprom Neft has dropped down (by 0.1-0.2 p.p.).

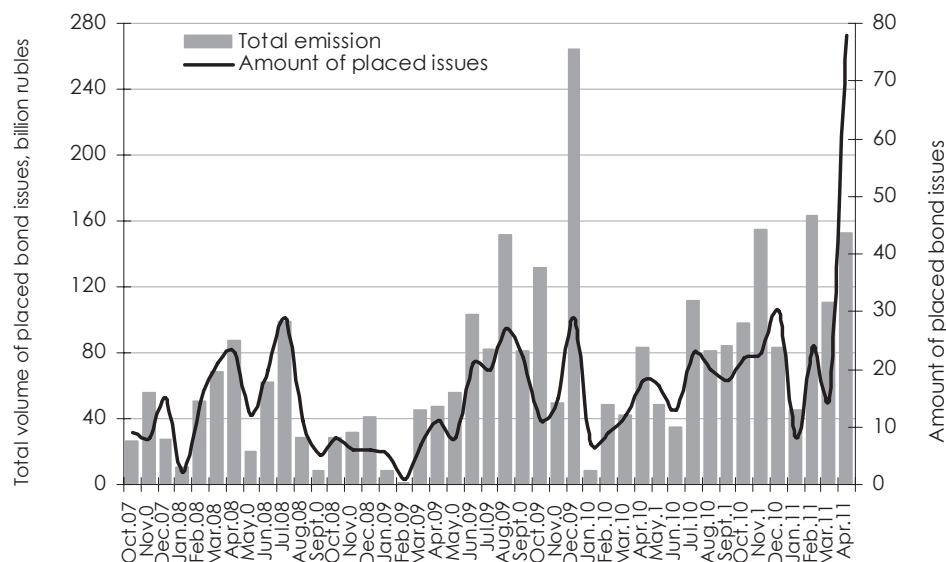
Over this month, there was registered a large number of bond issues, which nevertheless was less than the recorded April indicators.

In connection with the reduction of investment activity in the stock market, the IPO indices have fallen down significantly : from April 23 to May 24 there were placed 21 bonds issues with a total nominal value of RUR 88.4 billion (from March 25 to April 22 there were 78 emissions for the amount of 153 RUR billion) (Fig. 7). Unlike previous months, when the stock bonds were dominating in the primary market, in May there were placed only 5 issues of the stock bonds, which were registered under the simplified scheme by the emitters, represented in the stock market for a long term. The main volume of emissions was made by OAO “Oboronprom OPK” two series of bonds for the nominal value of RUR 21.1 billion, OAO “RusHydro” two series of bonds for the aggregate nominal value of RUR 20 billion, OJSC “Mortgage specialized organization GPB-Mortgage Two” two series of bonds with the nominal value of RUR 7.1 billion and OOO “Home Credit and Finance Bank” two commercial bonds for the nominal value of RUR 7 billion.

During the period under review there have been placed a lot of long-term emissions. Thus, the company “RusHydro” has first placed two debut bond loans with the maturity term of 10 years. In addition, the 10-year bond issues were placed by “Mobile TeleSystems” and “Kuzbassenergo-Finance”. The maturity of debut mortgage bonds of OAO “Mortgage specialized organization GPB-Mortgage Two” was 30 years¹.

In the period from April 23 to May 24, 2011, the Russian Federal Financial Markets Service has recognized as void and withdrawn twelve issues of bonds (from March 25 to April 22) due to non-placement of any security. Herewith, nine of the withdrawn issues were emitted by OAO “Rostelecom”².

In the period from April 23 to May 24, 17 emitters should have to repay its 19 bond debts for the total amount of nearly 26.9 billion rubles. However, five emitters has not fulfilled its obligations and announced a technical default on repayment of bond loan worth of RUR 7.8 billion (for the preceding relevant period four of the emitters failed to meet the scheduled commitments). Also in late April “Vnesheconombank” has redeemed the bond issue denominated in U.S. dollars. In June 2011 it is expected to repay 22 emissions of corporate bonds totaling to RUR 30.3 billion³.



Source: Rusbonds data

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

1 Russian Federal Financial Markets Service data.

2 Russian Federal Financial Markets Service data.

3 Rusbonds data.

REAL ECONOMY: TRENDS AND FACTORS

O.Izryadnova

According to the preliminary estimation of the Federal State Statistics Service, the index of GDP physical volume made 104.1% in the 1st quarter 2011 versus the corresponding quarter of the previous year as compared with 103.5% in the 1st quarter 2010 and 105.4% in the 4th quarter 2010. In April both consumer and investment demand was observed to expand. Retail trade turnover went up by 5% versus January-April 2010 and by 5.6% versus April 2010. Stabilization of the situation in the investments' sphere had a positive impact on the internal demand. In January-April 2011 the growth of the investments in fixed assets remained at the level of the previous year, and even increased by 2.2% versus April 2010. Despite the growth of the retail trade turnover real disposable incomes of the population reduced by 3.8% in April 2011 versus the corresponding period of the previous year, and by 3.1% over January-April 2011, which may be the evidence for the decrease in savings ratio.

In January-April 2011 the economic situation was characterized by sustention of the positive output dynamics. In the current year the positive dynamics is observed for nearly all types of economic activities. According to the preliminary estimation of the Federal State Statistics Service, the index of GDP physical volume made 104.1% in the 1st quarter 2011 versus the corresponding quarter of the previous year as compared with 103.5% in the 1st quarter 2010¹.

It is the growth of internal and external demand that remains the main factor for the economy recovery. Value volumes of foreign trade exceeded the corresponding pre-crisis figures of 2008. At the same time the trend for acceleration of the import physical volumes growth rates and slowdown of the corresponding export growth rates diminished the possibility of attaining the GDP growth of 4.2% as it was forecast by the Ministry for Economic Development.

This April both consumer and investment demand expanded. Retail trade turnover made 105.0% versus January-April 2010 and 105.6% versus April 2010, the volume of paid services rendered to population being 102.8% and 102.3%, correspondingly.

In April retail trade turnover of foodstuffs and anticipating growth of non-food goods sales as compared with foodstuffs was observed. This April retail trade turnover of non-food goods went up by 10.3% versus April 2010, whereas the volume of foodstuffs retail trade turnover increased by only 0.9%.

In January-April 2011 the situation in the investments sphere stabilized at the level of the previous year. It should be noted that the increase in investments in fixed assets by 2.2% in real terms versus April 2010 that was supported by the increase in construction materials production by 9.1%, machinery and equipment production by 5.6% as well as by the increase in the volume of construction contracts gives reasons for positive estimations of the business activity development in construction in May-December 2011. *Investment demand can be expected to reach the pre-crisis level by 2013 on condition its average annual growth rate is 6%.*

Retrospect analysis of the dynamics of the main economic indices allows revealing specific characteristics of post-crisis recovery in the industry. It should be noted that the financial crisis that started in 2008 reached its highest point in April-May 2009 when the volume of output in the basic types of economic activity contracted by 15% versus the preceding year. Graduated slowdown of the production contraction was followed by the stabilization in November-December 2009 versus the corresponding period of 2008 and dramatic acceleration of development rates in January-May 2010. Thus, the low base effect defined to a significant extent comparatively high figure of April 2010 and the specific characteristics of reserved dynamics this year (*Table 1*).

¹ According to the preliminary data of the Ministry for Economic Development, GDP growth rates in the 1st quarter 2011 was estimated to be 104.5%.

Table 1

GROWTH RATES OF MAIN ECONOMIC INDICES IN APRIL 2008-2011, AS PERCENTAGE TO THE CORRESPONDING PERIOD OF PREVIOUS YEAR

	April 2008	April 2009	April 2010	April 2011
Output volume for basic types of economic activities	109.6	85.1	107.7	102.0
Industry	105.7	85.8	110.4	104.5
Minerals extraction	102.7	97.3	104.6	101.4
Manufacturing industries	108.8	77.6	116.5	105.3
Investments in fixed assets	125.0	80.4	101.7	102.2
Workload in construction	121.8	86.5	94.5	98.1
Retail trade turnover	114.9	95.6	105.9	105.6
of foodstuffs	108.4	101.7	104.8	100.9
of non-food goods	120.4	90.2	106.9	110.3
Volume of paid services	107.2	96.2	100.7	102.3
Foreign trade turnover	149.5	54.5	147.2	134.4*
Export	148.0	52.3	149.2	129.8*
Import	152.0	58.0	130.1	142.6*
Real disposable incomes of the population	109.1	102.4	105.7	96.2
Real accrued wages	114.6	95.7	105.9	102.7
Number of the employed in the economy	101.1	97.1	99.9	101.8
Total number of unemployed	94.4	148.6	91.8	88.1

* March 2011 versus March 2010

Source: Federal State Statistics Service

Over January-April 2011 the index of industrial production made 105.5% versus the same period of 2010 and 104.5% in April 2011 versus April 2010. It was the manufacturing industries that had a prevailing influence on the dynamics and structure of post-crisis recovery of the industry. The index of manufacturing industries production made 105.3% this April versus April 2010 and 109.2% in January-April 2011 versus January-April 2010, index of extractive industries production being 101.4% and 102.8%, correspondingly.

This year it is transport vehicles and equipment production that makes the major contribution in the growth of manufacturing industries output. Automotive industry demonstrates exceptionally high growth rates taking into account production facilities created in recent years and fulfillment of industrial assemblage agreements. While the transport vehicles production increased by 1.5 times in January-April 2011 versus January-April 2010, the output of passenger cars doubled. Starting with November 2010 their output has exceeded monthly figures of 2008. Dynamic recovery of the production was determined by both the fulfillment of the government programs for the demand stimulation and the measures undertaken to modernize domestic production facilities. In 2011 the subsidies of RUR 6 billion for technical re-equipment of automotive industry are envisaged in the budget.

Recovery of industrial growth takes place against the background of the risks growth connected with the increase in production expenses due to the acceleration of prices growth. As compared with the beginning of the year industrial goods producers' prices went up by 9.1% in April 2011 (by 6.1% over the corresponding period of 2010). In April 2011 the acceleration of prices growth in industry is accounted for by the growth of process in minerals extraction by 20.5% since the beginning of the year (by 3.4% in 2010), the growth making 21.5% in fossil fuels extraction (2.5%). Manufacturing industries reacted to the changes in situation at the internal market reducing producers' prices growth rates to 104.9% versus 106.4% in April 2010. This is connected with the reserved dynamics of tariffs for freight transportation growth and producers' prices in electricity, gas and water production and distribution in the 1st quarter. However, taking into account the increase in tariffs for freight transportation by 6.3% in April 2011 as well as possible correction of prices for energy resources versus prices for oil, growth rates of prices and expenses in manufacturing industries can

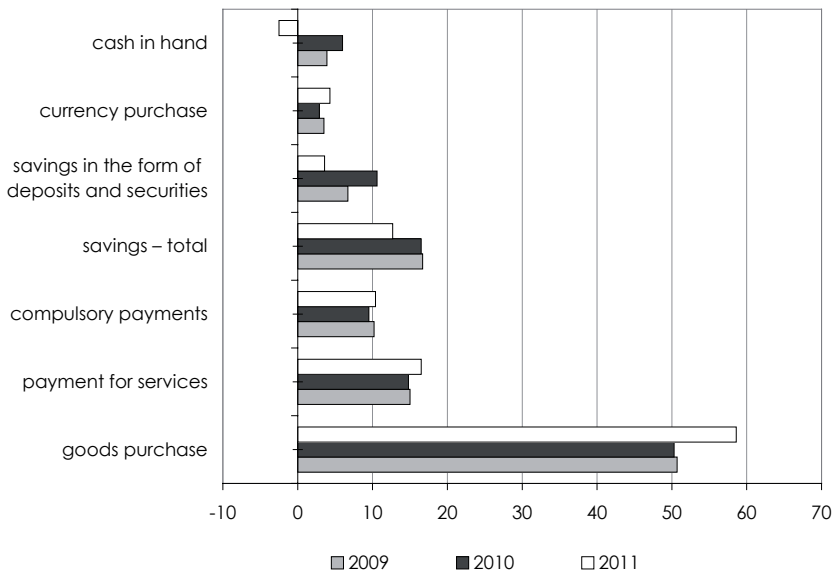


Fig. 1 Changes in Structure of Monetary Incomes of Population Use in April 2009-2011, as percentage

be expected to accelerate. Besides, recovery of the manufacturing production is accompanied by the increase in the level of wages as compared with the average Russian level but is not supported by the adequate increase in labor efficiency.

The formation of the trend towards the decrease of real disposable monetary incomes of the population as compared with the previous year is a specific feature of the beginning of 2011. According to the data of the Federal State Statistics Service, real disposable incomes of the population reduced by 3.8% in April 2011 versus the corresponding period of the previous year, and by 3.1% over January-April 2011. Real wages growth

rates are observed to slow down: over January-April 2011 wages went up by 1.8% versus 3.7% in the corresponding period of the previous year, in April – by 2.7% versus 5.9% in April 2010. Comparison with the pre-crisis level demonstrated that in April 2011 both the growth of real disposable incomes and real wages exceeded by 4.1% the figures of April 2008.

As compared with the corresponding period of 2010 in the 1st quarter 2011 the proportion of social payments expanded by 0.9 percentage point, incomes from entrepreneurial activity and property – by 0.3 percentage point, the proportion of labor remuneration (including hidden wages) reducing by 1.3 percentage point. Under the existing dynamics of the population's incomes the growth of consumer expenses is determined by the reduction of savings ratio and increase in consumer crediting. In the 1st quarter 2011 the volume of monetary incomes of the population made RUR 7155.8 billion, increasing by 6.5% as compared with the corresponding period of the previous year. The population used RUR 5598.8 billion for goods and services purchases, which is 14.1% more than in the 1st quarter 2010. Over the same period savings made RUR 1121.6 billion, which is 12.6% below the figure of the corresponding period of the previous year. It should be noted that this year the proportion of organized forms of savings in the form of deposits and securities is observed to decrease the interest for foreign currency purchase reviving.

The economy recovering after the crisis the situation at the labor market is improving. This April 69.7 million was employed in the economy, which is 0.8 million more than last April. Part-time employment reduced by approximately 5 thousand in April. According to the data of the Federal State Statistics Service monitoring of the situation at labor market the number of employees on enforced leaves because of administration, being idle and working part-time is 319 thousand as on May 3, 2011.

The total employment reduced in February and March of the current year, but in April the number of the unemployed went up by 59 thousand. At the same time as compared with last April the number of the unemployed reduced by 729 thousand and made 5411 million or 7.2% of the economically active population by the end of April. ●

RUSSIAN INDUSTRY IN APRIL 2011

S.Tsukhlo

According to the data of the Gaidar Institute surveys¹, the beginning of the 2nd quarter has definitely had negative results for the Russian industry. The demand has ceased to grow, its forecasts suffered negative correction, finished goods have been accumulating at stocks, the output and hiring growth rates slowing down, have resulted in the worsening of the financial situation at enterprises.

Demand for Industrial Goods

In April after March results which were record-breaking for crisis environment (+12 balance points) the initial demand growth rates sank to 0, i.e. the sales ceased to grow. The exclusion of seasonality has worsened April results to the absolute decrease in demand at the rate of -7 points. Such an intensive contraction of demand for industrial goods has not been observed for already 15 months (Fig. 1).

The forecasts for sales have suffered similarly radical changes. By April they dropped to +12 points according to the initial data as compared with +31 points which was registered in February 2011. Exclusion of seasonal and calendar factors has revealed the stabilization of sales forecasts at +4 points, which is also the 15-month minimum.

However, the decrease in sales and correction of their forecasts has not resulted in the changes in satisfaction with demand volumes (Fig. 2). The proportion of normal estimation of sales remained at the level of 60%, the proportion of “below the norm” responses – at the level of 38%. Such a ratio of demand estimation is maintained in the industry since August 2010.

Finished Goods Stocks

Negative dynamics of the demand has put a stop to the decrease in the volumes of the finished goods stocks in the industry. In the 2nd quarter 2011 the balance of changes in the physical volumes of stocks (not the estimations as compared with the norm) went up to +1 points as compared with -6 points in the previous two quarters. The produced goods have started to accumulate at stocks of enterprises instead of being sold. At the same time the balance of estimations has not changed and remains zero (Fig. 3), and the proportion of responses

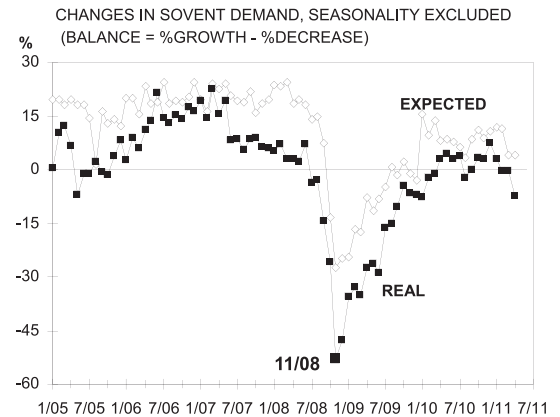


Fig. 1

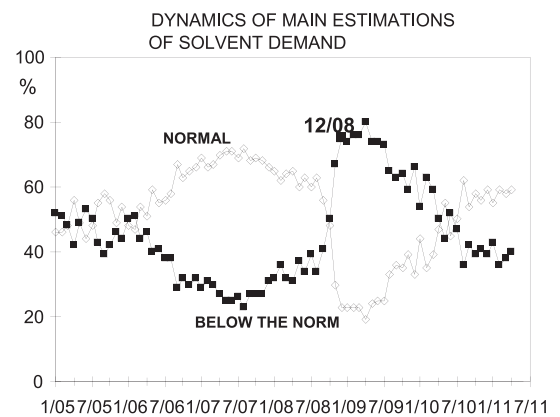


Fig. 2

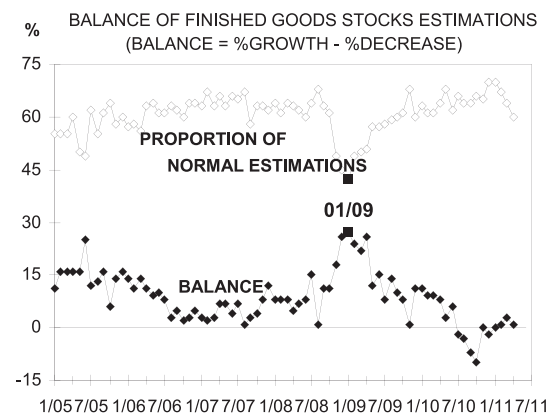


Fig. 3

1 Surveys of industrial enterprises directors have been conducted by the 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%.

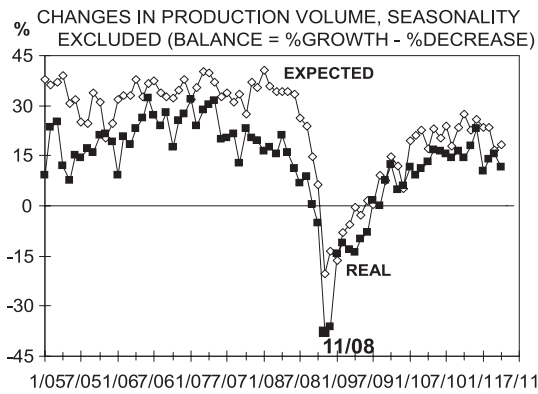


Fig. 4

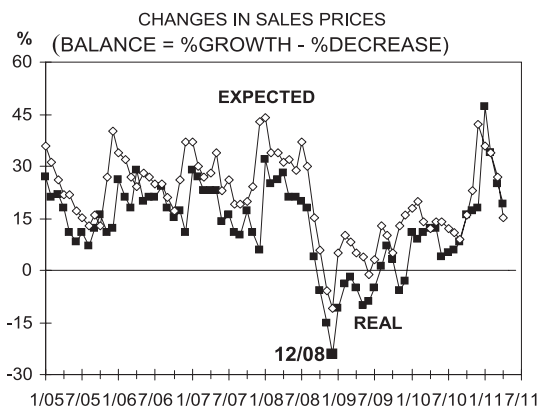


Fig. 5

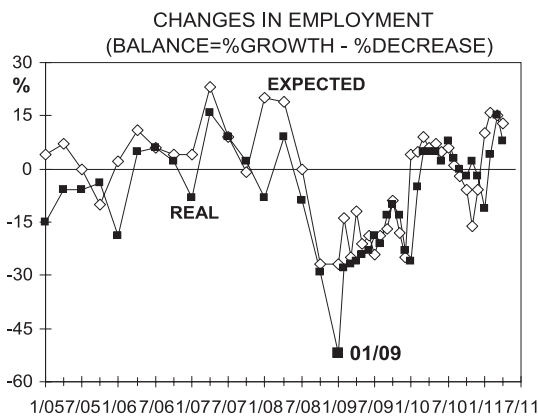


Fig. 6

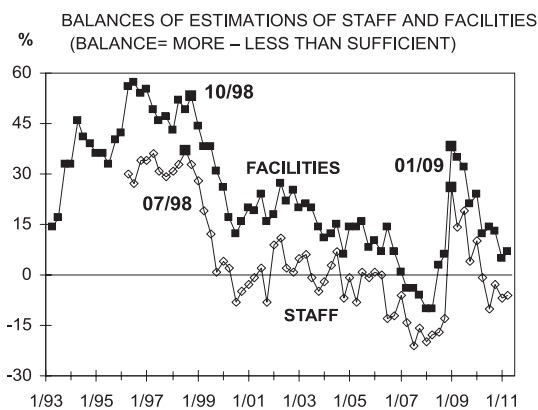


Fig. 7

“normal” has been decreasing for the third month in the row. The contraction of the normal estimations of stocks results in the growth (to approximately the same extent) of both the estimations “above” and “below the norm”. This means that a part of enterprises is toughening their policy regarding the stocks management, whereas the other is constrainedly (in case of the decrease in sales) or purposefully (in case of the growth of certainty) making them excessive. The majority of producers, however, maintain their stocks of finished goods at the normal level.

Production output

Recovery of output growth rates after January drop has ceased. In April initial data demonstrated the return to the reserved growth level of February, while exclusion of seasonality – to the low January level. As a result the output growth rates over January and April 2011 became the worst over the last 12 months (Fig. 4). Initial production plans of enterprises lost another 4 points in April upon the record for the crisis period in February 2011. Exclusion of seasonality corrected this decrease in optimism, maintaining its April value at March value.

Producers’ Prices

The latest data on real and planned producers’ prices dynamics demonstrated extinction of the inflation wave that was observed at the beginning of the year. In April the prices growth rates reduced as compared with this January by 28 points returning to the level of the 4th quarter 2010 (Fig. 5). Slowdown of prices growth was registered in all the sectors of industry, excluding metallurgy and fuel and energy sector. Price plans were subject to similar changes: as compared with December 2010 peak figures they lost 27 points. Correction of price plans towards reduction was also observed for all the sectors of industry, excluding metallurgy and fuel and energy sector.

Redundancies: Real Dynamics and Plans

In April industry reduced the hiring rates after the maximum figures of March. However, the employees are still hired and at record level for the current crisis (Fig. 6). The highest rates of increase in employees’ numbers were registered in ferrous metallurgy and production of construction materials. Forecasts for hiring that reached the crisis maximum in February-March were corrected likewise. The highest employees’ number growth rate is possible in construction materials production, foodstuffs industry and ferrous metallurgy.

It seems that enterprises in the environment of sales growth cessation try to hire the employees “for the reserve”, fearing to face (and quite reasonably so) with the lack of this resource in case the demand starts to

grow steadily (Fig. 7). For the fourth quarter in the row the shortage of staff has been observed in the industry in connection with the “expected changes in demand”. In the 2nd quarter 2011 it was registered in all the sectors of industry with the exception for the production of construction materials.

The shortage of the staff for the fifth quarter in the row holds the third place in the list of obstacles for the industrial growth (according to the enterprises). Only insufficient demand and lack of liquid funds are cited more often. Now already 32% of enterprises consider shortage of employees as an obstacle for the output growth. The crisis (2008) minimum of this obstacle citing made 14% and was registered in the 2nd and 3rd quarters of 2009. Pre-crisis and absolute maximum is equal to 46% and was registered in the 3rd quarter 2008.

Crediting of Industry

The conditions of bank crediting did not change in April. About 70% of enterprises throughout the industry have normal access to credits, in metallurgy there are 92% of such enterprises, in chemistry industry – 71%, in machine-building - 69% (Fig. 8). It is most difficult for enterprises of light industry (only 28% of enterprises has normal access to the credits) and timber industry (47%) to get the credit. The minimum average credit rate has also stabilized since the beginning of the year and makes 12.7% per annum (fig. 9). The credit rate for metallurgy sector makes 10%, for chemistry industry – 11.5%, for light industry – 14% per annum.

However, the shortage of credits has little effect on the output dynamics now. Only 5% of enterprises in the last five quarters hold that credits are an obstacle for the output growth.

Financial Situation at Enterprises

In the 2nd quarter the financial situation at the enterprises has definitely worsened. For the first time since January 2009 the balance of estimations decreased and quite considerably – from -5 to -13 points (Fig. 10). This was the result of the growth of estimations “bad” from 15% to 21%, the proportion of estimations “satisfactory” reducing from 71% to 65% (Fig. 11). At the stage of crisis overcoming the figures under consideration did not demonstrate negative dynamics. The worsening of financial situation estimations took place in all the sectors of industry, excluding fuel and energy sector and chemistry industry.

The forecasts of the financial situation did not change in the 2nd quarter and remain positive (i.e. the hopes for its improvement prevail) being the most optimistic in the current crisis (Fig. 10).

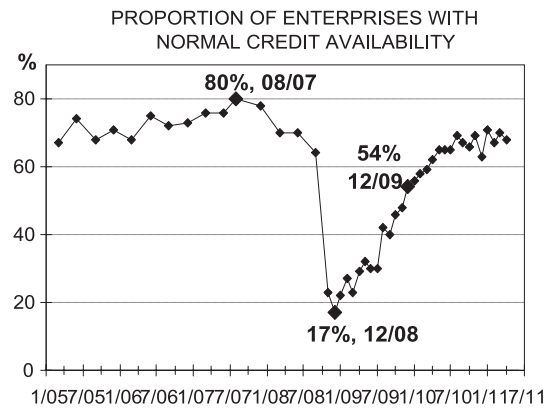


Fig. 8

DYNAMICS OF AVERAGE MINIMUM CREDIT RATE OFFERED BY BANKS FOR CREDITS IN RUBLES, %

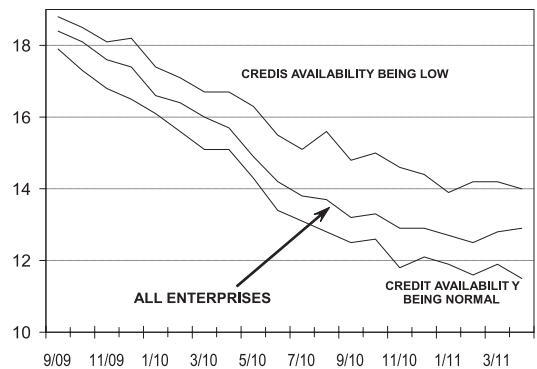


Fig. 9

BBALANCES OF ESTIMATION OF ECONOMIC SITUATION AT ENTRPRISES

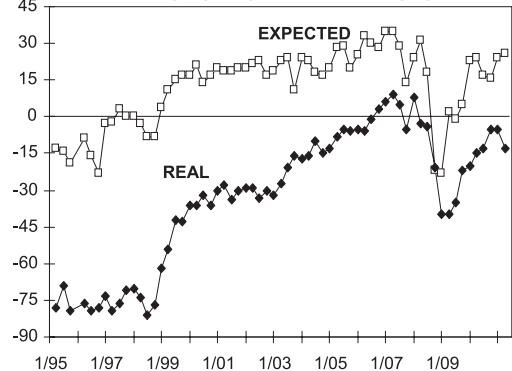


Fig. 10

ESTIMATIONS OF ECONOMIC SITUATION AT ENTERPRISES

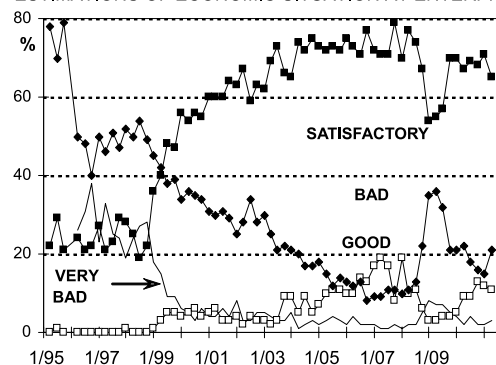


Fig. 11

THE FOREIGN TRADE

N.Volovik, K.Kharina

In the 1st quarter of 2011, in conditions where the situation on the global commodities markets was favorable to the Russian export and the Russian ruble kept appreciating further recovery of the extent of foreign trade operations took place.

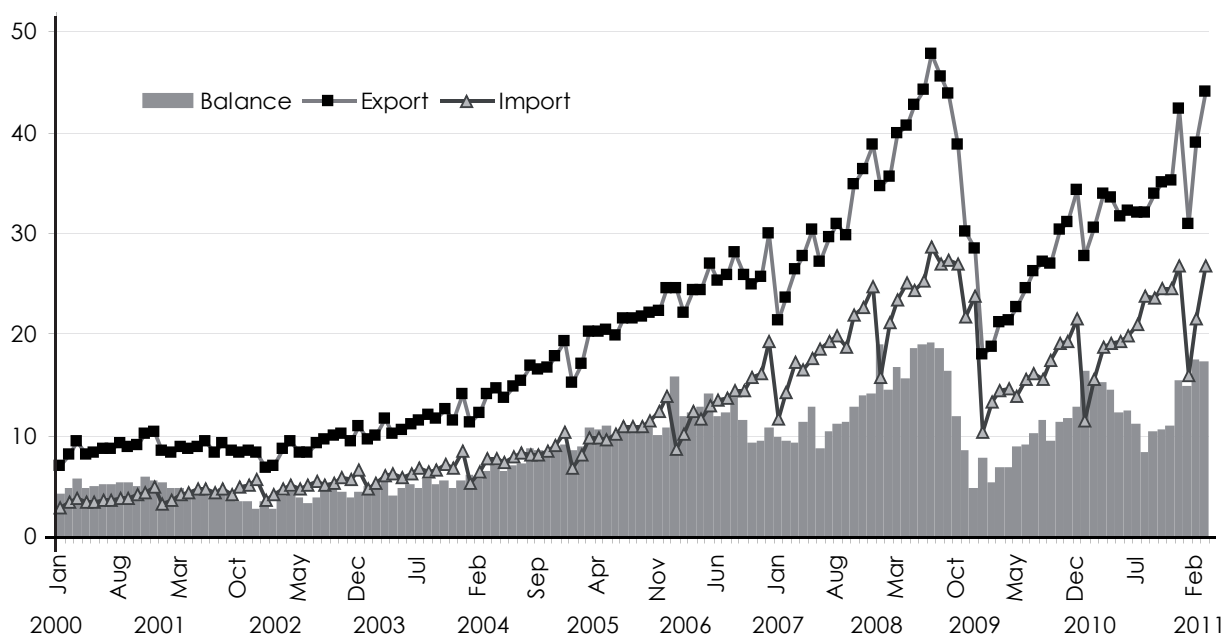
In March 2011, Russia's foreign trade turnover calculated on the basis of methods of the balance of payments amounted to USD 71 billion which is 34.4% higher than the similar index in 2010. The Russian export rose by 29.8%, while the import, by 42.6%. In March 2011, the balance of payments increased by 14% (up to USD 17.3 billion) as compared to the same period in 2010.

The growth in the value of exports is still justified by a favorable situation on the global markets of main commodities of the Russian export, primarily, the oil market. In January 2011, the average price of a barrel of OPEC oil amounted to USD 92.83, in February, to USD 100.29, in March, to USD 109.84, while in April, to USD 118.09.

After a drop to USD 108.45 a barrel on March 15, 2011, Brent oil prices started to grow again, and as a result in March the average oil price amounted to USD 114.44 a barrel and exceeded by 43.5% the similar index in 2010. In April, the average Brent oil price rose to USD 123.13 a barrel which figure is 43.7% higher than that in April last year.

In March 2011, the average Urals oil price was at the level of USD 111.25 a barrel and exceeded by 45% the 2010 index; as compared to February 2011 the oil price rose by 9.8%. In the 1st quarter of 2011, the average Urals oil price amounted to USD 102.57 a barrel as against USD 75.2 a barrel in the 1st quarter of 2010. In the 1st quarter of 2011, the oil price turned out to be higher than that in 2008 when in January-March period it was at the record-high level of USD 93.36 a barrel.

On May 5, 2011, a considerable negative adjustment of oil prices took place. The Brent oil price fell by USD 11.39 a barrel (9.4%) as compared to that of the previous day and returned to the level of March 2011. Such an adjustment was caused by fears that the demand on oil and derived energy carriers would go down. Both growth in commercial reserves of the crude oil in the USA and the weak US macroeconomic statistics contributed to formation of such sentiments. On the basis of



The source: The Central Bank of Russia

Fig. 1. The Main indices of the Russian foreign trade (billion USD)

the results of the reporting week ending on April 29, 2011, the US commercial crude oil reserves amounted to the record-high level in the past six months (366.5 million barrels). In addition to the above, on the basis of the results of the reporting week ending on April 30, 2011 the number of the new unemployed in the US was higher than expected. The number of primary applications for unemployment benefits rose to 474,000, while analysts expected that index not to exceed 410,000.

In the period of from April 15, 2011 to May 14, 2011, the average Urals oil price amounted to USD 116.23 a barrel. In accordance with Resolution No. 422 of May 26 of the Government of the Russian Federation from June 1, 2011, the export customs duty on crude oil was raised from USD 453.7 a barrel to USD 462.1 a barrel. From June 2011, the reduced rate of export customs duty on oil from a number of deposits of Western Siberia and the Northern Caspian Sea will be raised to USD 217.5 a barrel against USD 211.7 a barrel this May.

From June 2011, export duties on light oil products will be raised from USD 304 a ton to USD 309.6 a ton, while those on dark oil products, from USD 211.8 a ton to USD 215.8 a ton. From June 1, 2011, the Government of Russia set the export duty on directly distilled gasoline in the amount of USD 415.8 a ton, that is, 90% of the duty on oil. In May, the export duty on gasoline amounted to USD 408.3 a ton. Thus, a prohibitive nature of gasoline duties will prevail in June.

From July 2009, a favorable situation on the market of nonferrous metals prevailed. As a result, in the 1st quarter of 2011 prices on commercial non-ferrous metals rose as compared to those in the same period in 2010: prices on copper increased by 33.4%, while those on nickel and aluminum, by 34.8% and 15.6%, respectively.

Table 1

AVERAGE GLOBAL PRICES IN MARCH OF THE RESPECTIVE YEAR

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Oil (Brent), USD/a ton	26.9	25.5	24.1	29.1	33.6	53.7	60.9	62.05	102.3	47.42	79.8	114.44
Natural gas, USD/thousand m ³	2,828	5,200	2,996	5,757	5,267	7,234	6,123	7.25	9,655	4.03	4.65	3.97
Gasoline, USD/a gallon	0.934	0.890	0.783	1,005	1.12	1,581	1.7	1.91	2,672	1,414	2.25	2.99
Copper, USD/a ton	1779.1	1780.3	1605	1681.6	3018.0	3254.4	5103	6452.5	8421.9	3749.8	7462.8	9530.7
Aluminum, USD/a ton	1584.2	1511.2	1403.2	1393.1	1660.0	1988.6	2429	2761.7	2986.8	1335.8	2205.6	2552.6
Nickel, USD/a ton	10270	6140.3	6503.3	8402.4	13730	16190	14897	46324.8	31005.7	9696.4	22461.3	26811.7

The source: calculated on the basis of the data of the London Metal Exchange and the Intercontinental Oil Exchange (London).

After an insignificant drop in March, food prices on global markets went up again in April. In April, the index of food prices of the Food and Agricultural Organization amounted to 232 points which figure is 36% higher than the similar index of April 2010 and only 2% lower than the record level of February 2011. A drop in prices on sugar and rice contributed to some decrease in the value of the index, but global prices on practically all the other types of products still remain high.

Table 2

DYNAMICS OF AVERAGE GLOBAL PRICES ON SOME AGRICULTURAL PRODUCTS

	2007	2008	2009	2010	2011			
					January	February	March	April
Wheat, USD/a ton								
Canadian wheat, CWRS sort	300.4	454.6	300.5	312.4	440.5	474.1	432.5	460.9
American wheat, HRW sort	255.2	326.0	224.1	223.6	326.6	348.1	316.7	336.1
American wheat, SRW sort	238.6	271.5	186.0	229.7	320.4	338.8	303.1	314.9
American corn, USD/a ton	163.0	223.1	165.5	185.9	264.9	292.9	290.5	319.3
Barley, USD/a ton	172.0	200.5	128.3	158.4	195.2	196.5	202.6	208.9
Soya bean, USD/kg	384.0	523.0	437.0	450.0	572.0	570.0	553.0	556.0

Table 2, cont'd

	2007	2008	2009	2010	2011			
					January	February	March	April
Soya oil, USD/a ton	881.0	1258.0	849.0	1005.0	1374.0	1365.0	1307.0	1314.0
Thai rice, USD/a ton	326.4	650.1	555.0	488.9	516.8	524.0	492.8	484.3
Raw sugar, FOB ports of the Caribbean Sea, c/ kg	22.22	28.21	40.00	46.93	65.28	64.97	57.85	53.70

The source: The World Bank.

In the 1st quarter of 2011, surplus on the trade balance rose by 6% as compared to the same period in 2010 and amounted to USD 49.6 billion. The export of goods increased from USD 92.2 billion in the 1st quarter of 2010 to USD 114.1 billion in January-March 2011 (a 23.7% increase). The two-thirds of the export growth were ensured by an increase in contractual prices, while the one-third, by an increase in physical volumes. Growth in average contractual prices on crude oil amounted to 75.5%, while that on oil products and nonferrous metals, to 77.8% and 49%, respectively.

Late in 2010 and in the beginning of 2011, a trend of growth in the share of export to the CIS countries in the total volume of the Russian export emerged. If in the 1st quarter of 2010 that share amounted to 13.6%, in the 1st quarter of 2011 it was 17.3%. In the 1st quarter of 2011, growth in the monetary volume of the export to the far abroad was much lower than growth in exports to CIS states (18.3% and 57.6%, respectively). Such a situation can be explained by the accelerated growth in supplies of natural gas, electric power and chemical products to CIS countries.

In the 1st quarter of 2011, the import of goods increased by 41.1% as compared to the 1st quarter of 2010 and amounted to USD 64.5 billion. Almost the entire value of the increase in the imports was ensured by expansion of physical volumes of the import with an insignificant price rise. In the cost structure of the imports, there was growth in the unit weight of cars, equipment and transportation vehicles up to 44.8% as against 39.9% last year.

The import of food products and raw materials for production thereof increased by 30.8%. As compared to January-March 2010, physical volumes of supplies of fresh and frozen meat increased by 14.3%, while those of butter, sunflower oil, citrus fruits, tea and raw sugar, by 18.3%, 510%, 16%, 7.8%, and 67.8%, respectively. The volumes of purchases of fresh-frozen fish, condensed milk and coffee decreased by 30.7%, 19.4% and 3.4%, respectively.

The import of the vegetables increased by 87.6%. In the first three months of this year, 645,000 tons of potatoes were imported to Russia which figure exceeds by 740% the volume of the import in the 1st quarter of 2010 and is almost equal to the entire volume of the import in 2010 (657,000 tons). In 2009, only 374,000 tons of potatoes were imported to Russia. Such a high import volume can be explained by a poor potatoes harvest in Russia in 2010 and a temporary abolition of import duties on potatoes. In October 2010, the Commission of the Customs Union temporarily annulled (from January 1, 2011 till July 31, 2011) the import duties on potatoes. Earlier, such import duties varied from 5% to 15%.

In the 1st quarter of 2011, the import of pipes increased significantly. As compared to the 1st quarter of 2010, it grew by 160% to amount to 468,100 tons with the capacity of the domestic market being at the level of 2.8 million tons. The share of import of the above product on the domestic market amounted to 17.2%.

It is to be reminded that on the basis of the results of the antidumping probe which took place in the 2004–2005 period in respect of casing, bearing, pumping compressor, boiler, oil-and-gas pipes, as well as general-purpose hot-deformed pipes manufactured in the Ukraine and imported to the customs territory of the Russian Federation, the Government of the Russian Federation passed Resolution No. 824 of December 29, 2005 on the Measures of Protection of the Economic Interests of Russian Manufacturers of Some Types of Steel Pipes. In accordance with the above resolution, antidumping duties were introduced for the period of five years on pipes imported from the Ukraine to the customs territory of Russia.

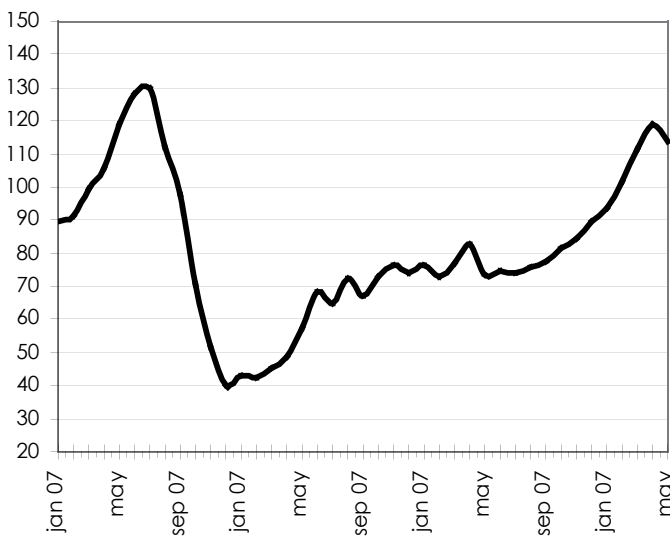
Early in February 2011, the Russian Government introduced new antidumping duties on some types of Ukrainian pipe products. Under Resolution No. 41 of January 31, 2011, import duties on casings and pumping compressor pipes amount to 18.9% and 19.9%, respectively, while those on pipes manufactured by the Interpipe Group and OAO Dnepropetrovsky Trubny Zavod, to 19.4% and 37.8%, respectively. The above duties will remain in force till March 2016. At the same time, late last year an agreement was signed on a duty-free supply by the Ukraine of 300,000 tons of pipes to Russia. In 2010, the two countries agreed on a duty-free import of the Ukrainian pipes in the volume of 260,000 tons to the Russian Federation.

Also, the Government of the Russian Federation introduced for the period of three years an antidumping duty in the amount of 26% of the customs value on steel hammered rollers for rolling mills which are produced in the Ukraine and imported to Russia. ●

THE OIL AND GAS SECTOR

Y.Bobylev

The recovery of the global economy and developments in North Africa and the Middle East have resulted in considerable growth in global oil prices which factor was behind growth in proceeds of Russian oil and gas companies and state budget revenues. In April and May, “a gasoline crisis” was observed in Russia. In some regions, there were acute shortages of gasoline and steep growth in gasoline prices. The main factor behind that crisis was a freeze on gasoline prices on the domestic market in a situation of rapid growth in global prices on oil products. As a result, the export of gasoline increased, while production and supplies thereof on the domestic market dropped. For the purpose of saturation of the domestic market, the government introduced higher export duties on gasoline.



The source: The OECD/IEA

Fig. 1. Urals oil price in the 2008–2011 period, USD/a barrel

Recovery of the global economy after the financial and economic crisis has had a determining effect on the situation on the global oil market. Higher demand in oil which was justified by higher growth rates of the global economy, particularly, in China, India and other Asian countries, quite a restrained policy by the OPEC as regards raising of production of oil by its member-states and low growth in oil production outside the OPEC zone have resulted in considerable growth in oil prices as compared to the previous year. Developments in North Africa and the Middle East which resulted in emergence of higher geopolitical risks and cuts in oil supplies from Libya could not but have a considerable impact of growth in oil prices. As a result, the price on the Russian oil on the global (European) market rose from USD 78.3 a barrel in 2010

to USD 111– USD 119 a barrel (Table. 1 and Fig. 1). Due to growth in global oil prices, prices on the Russian natural gas started to grow too (from USD 296 per thousand cubic meters in 2010 to USD 328.3 per thousand cubic meters). As a result of such growth in natural gas prices, revenues of Russian oil and gas companies and the state budget increased considerably.

Table 1

GLOBAL OIL AND NATURAL GAS PRICES IN THE 2010-2011 PERIOD, USD/A BARREL

	2010 January	2010 June	2010 December	2011 January	2011 February	2011 March	2011 April	2011 1–26 May
Brent oil price, the UK	76.2	74.9	91.4	96.5	103.8	114.6	123.5	114.4
Urals oil price, Russia	76.1	74.4	89.5	93.8	101.5	111.3	119.2	111.0
Russian natural gas price, USD/thousand cubic meters	273.0	290.2	314.3	330.8	329.0	328.3	328.3	

The source: The IMF and the OECD/IEA.

However, in 2011 growth rates of oil production in Russia decreased considerably; in January–April they amounted to 0.9% as compared to the respective period last year (Table 2). It is to be reminded that on the basis of the results of 2010 the growth rates of oil production as compared

to 2009 amounted to 2.1%. Such growth took place as a result of both placing on production of a number of new large deposits in the North of the European part of the country and Western Siberia and coming into effect of a number of such amendments to the Tax Code of the Russian Federation as were aimed at reduction of the tax burden on the oil sector, motivation of in-depth exploitation of deposits which were already in service and development of new regions of production. A drop in growth rates of the oil production can be explained primarily by objective worsening of oil production conditions. Most deposits which are currently exploited have entered the stage of a falling production, while new deposits, in most cases, are characterized by inferior mining-and-geological and geographic parameters. Development of such deposits requires higher capital, maintenance and transportation costs. In such a situation, more urgent actions as regards development of new oil deposits, including additional tax incentives measures are required.

Table 2

PRODUCTION OF OIL, OIL PRODUCTS AND NATURAL GAS IN THE 2006–2011 PERIOD,
% OF THE PREVIOUS YEAR

	2006	2007	2008	2009	2010	2011 January–April
Oil, including gas condensate	102.1	102.1	99.3	101.2	102.1	100.9
Primary crude oil distillation	105.7	103.8	103.2	99.6	105.5	103.0
Automobile gasoline	107.4	102.1	101.8	100.5	100.5	99.7
Diesel fuel	107.0	103.4	104.1	97.7	104.2	102.7
Residual oil	104.5	105.2	101.9	100.8	108.5	104.5
Natural gas	102.4	99.2	101.7	87.9	111.4	100.7

The source: The Rosstat.

In April-May, such an unusual phenomenon for Russia as a “gasoline crisis” broke out in some parts of the country and caused acute shortages of gasoline. Such a situation was a result of growth in export of gasoline and reduction in gasoline supplies to the domestic market. For the purpose of limitation of the export and saturation of the domestic market, in May the export duties on gasoline were raised by 44%, that is, from 67% of the export duty on oil to 90%. In addition to the above, large oil companies entered into commitment to refrain from export gasoline supplies in May. However, some individual evidence of the gasoline crisis could still be observed in May. For example, acute shortages of gasoline took place in the Republic of Tuva where gasoline prices at independent gas filling stations which were not a part of vertically integrated oil companies amounted on average to RUR 50 a liter in May (while Russia’s average gasoline price was RUR 24.8 a liter).

In our view, the main factor behind the gasoline crisis was the incorrect pricing policy by the government, that is, freezing of gasoline prices on the domestic market. In January 2011, as a result of growth in global prices and excise duties domestic prices on oil products rose as well. However, as early as the beginning of February oil companies received in “a manual mode” unambiguous instructions from the government to reduce prices on gasoline and diesel fuel and, as a result, those prices went down. In February, March and April, retail gasoline prices were below the January level and only somewhat higher than in December 2010, while producers’ prices were below than in December 2010 (*Table 3 and Fig. 2*).

Table 3

PRICES ON AUTOMOBILE GASOLINE IN RUSSIA IN THE 2010–2011 PERIOD, RUR/ A LITER

	2010 December	2011 January	2011 February	2011 March	2011 April	2011 23 May
Consumer prices on automobile gasoline: AI-92 (AI-93 and other)	23.42	24.25	23.66	23.42	23.63	25.01
AI-95 and higher	25.29	26.11	25.60	25.42	25.56	26.88
Producers’ price: AI-92	12.33	11.48	11.98	11.56	12.21	

The source: The Rosstat.

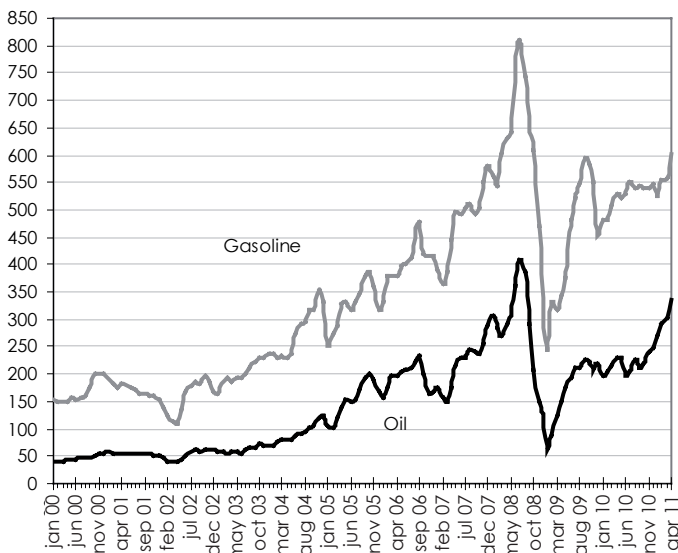
It is to be noted that in the meantime prices on oil and oil products kept growing fast. Urals oil prices on the European market rose from USD 89.5 a barrel in December 2010 to USD 119.2 a barrel in April or by 33%. Gasoline prices on the European market (without taking into account indirect taxes) rose in the same period from Euro 0.566 a liter to Euro 0.738 a liter or by 30% (Table 4). In Russia, in April domestic gasoline prices (producers' prices) were 1% lower than in December, while retail prices on AI-92 gasoline rose by the mere 0.5% (it is to be noted that in the same period growth in consumer prices on goods and services amounted to 4.3%). As a result, it became more profitable to export gasoline than supply it to the domestic market and, consequently, oil companies increased export supplies of gasoline. According to the Rosstat's data, in the 1st quarter of 2011 the export of automobile gasoline increased by 9.3% as compared to the same period last year with the share of export in gasoline production rising to 14.7%.

Table 4

PRICES ON AI-95 AUTOMOBILE GASOLINE IN GERMANY, EURO/ A LITER

	2010 December	2011 March	2011 April
Consumer price	1.453	1.587	1.658
Taxes on consumers	0.887	0.908	0.920
Price exempt from taxes	0.566	0.679	0.738

The source: The OECD/IEA.



The source: calculated on the basis of the Rosstat's data
 Fig. 2. Producers' prices on oil and automobile gasoline in USD terms in the 2000–2011 period, USD/a ton

At the same time, as a result of the price control some changes took place in the production structure in favor of other oil products in respect of which there was no price control introduced. It concerned primarily residual oil and directly distilled gasoline. On the contrary, production of automobile gasoline decreased (Table 5). In January-April 2011, production of gasoline amounted to 99.7% as compared to the same period in 2010, while in April 2011 it was 96.4% as against April 2010. Introduction of new technological standards in respect of fuel had a certain effect on that situation. As regards automobile gasoline, in Russia the Euro-3 standard was introduced from January 1, 2011. As a result, gasoline of the 2nd grade (that is, gasoline of a lower grade) ceased to be produced. At the same time, for technical reasons some oil companies failed to ensure substitution of production of that gasoline by production of gasoline of the 3rd grade, which situation affected the general supply of gasoline.

Table 5

 PRODUCTION OF MAIN TYPES OF OIL PRODUCTS IN JANUARY-FEBRUARY 2011,
 % OF JANUARY-APRIL 2010

	2011 January-April
Primary crude oil distillation	103.0
Automobile gasoline	99.7
Diesel fuel	102.7
Residual oil	104.5
Directly distilled gasoline	106.5

The source: The Rosstat

Thus, the government's pricing policy on the oil market failed to take into account a number of important factors and as a result "a gasoline crisis" broke out. In May, administrative pressure on prices was weakened and gasoline prices rose significantly. According to the Rosstat's data, by May 23, 2011 consumer price on AI-92 gasoline amounted to RUR 25 a liter, that is, a 6% increase as against the level of April 2011 (it is to be noted that gasoline prices rose by 6.5% as against the level of December 2010).

As gasoline shortages could be still observed in some regions, for the purpose of saturation of the domestic market the government passed a decision to preserve in June restrictive export duties on gasoline in the amount of 90% of the export oil duty. It is to be noted that the above duty was also applied to directly distilled gasoline. It is expected that both weakening of the administrative pressure on prices and limitation of gasoline export will help balance the market. ●

STATE BUDGET

E.Fomina

In May the government has informed of the amount of additional expenditures for 2011 (about RUR 420 billion), which primarily will be addressed at social issues. This extension of expenditure commitments was possible thanks to the good prices for energy sources. However, any additional expenditure can threaten the fiscal balance in future. As of May 1, the federal budget was executed with a surplus of about 1 per cent of GDP. The current favorable dynamics of budget revenues urged the revision of the official forecast of the federal budget deficit for 2011 in general to 0.6-0.8 per cent of GDP (in the budget law its deficit is fixed at 3.6 per cent of GDP).

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

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

Analysis of the main parameters of the expanded government budget execution in the I Quarter 2011

In May 2001, the preliminary results of execution of the extended government budget are summarized for the I quarter of this year. The volume of the revenues of the *budget of the expanded government* has increased against the level of the relevant period of 2010 by 2 percentage points of GDP¹. Herewith, the expenditure part of the budget in relative terms has been reduced by 2.7 p.p. of GDP, whereas in absolute terms expenditures have grown by approximately RUR 355 bn. As a result, the budget of the expanded government has been executed with a surplus of 7.1 per cent of GDP, which is by 4.6 p.p. of GDP higher than in the relevant period of 2010 (*Table 1*).

Table 1

EXECUTION OF THE BUDGETS OF ALL GOVERNMENT LEVELS IN TERMS OF REVENUE AND EXPENDITURES IN JANUARY-MARCH 2010-2011

	January-March 2011		January-March 2010		Change, against GDP, p.p.
	RUR, bn	% of GDP	RUR, bn	% of GDP	
Federal budget					
Revenues	2 392.8	20.8	1 954.9	20.4	+0.4
Expenditures	2 214.7	19.2	2 199.5	23.0	-3.8
Deficit (-) /Surplus (+)	178.0	+1.5	-244.6	-2.6	+4.1
Consolidated budgets of the RF Subjects					
Revenues	1 640.2	14.2	1 391.0	14.5	-0.3
Expenditures	1 239.7	10.8	1 111.7	11.6	-0.8
Deficit (-) /Surplus (+)	+400.4	+3.5	+279.3	+2.9	+0.6
The budget of expanded government					
Revenues	4 392.5	38.1	3 463.2	36.2	+1.9
Expenditures	3 575.5	31.0	3 220.8	33.7	-2.7

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

Table 1, cont'd

	January-March 2011		January-March 2010		Change, against GDP, p.p.
	RUR, bn	% of GDP	RUR, bn	% of GDP	
Deficit (-) /Surplus (+)	+817.0	+7.1*	+242.4	+2.5	+4.6
For reference: GDR, UR bn.	11 530.00		9 571.9		

* A significant surplus of the budget of the expanded government as against the surplus of the federal budget and budgets of the RF Subjects can be explained by the change since 2001 in the procedure for crediting of funds to extra-budgetary funds, bypassing the federal budget as it was done before.

Source: The Ministry of Finance of the Russian Federation, assessments of Gaidar Institute

Within four months of this year grants received from the federal budget to regional budgets have reached RUR 578 billion, which amounts to 23 per cent of all revenues of regional budgets¹. We would like to recall that the Government is currently reducing financial assistance from the federal budget, thereby stimulating the regions for the effective expenditure of funds, when they are limited. Each region is recommended to approve its own program to improve the efficiency of budget spending, and accept this document is a step toward to a targeted program for budgeting principles. To date, out of 83 RF Subjects, only 23 approved a similar program².

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

Revenue from mineral extraction tax (MET) and income from foreign economic activity over January-March 2011 increased by 0.3 percentage points of GDP for each of those taxes against the relevant period of preceding year. The basic grounds for higher tax collection level in both, absolute and relative terms were provided by the growth of global oil prices against the relevant period of 2010 (USD 106 per barrel against USD 77 per barrel). With further increase in oil prices, there is a danger of excessive inflow of oil dollars to the economy, the negative effect is associated with increased attachment of the economy to commodity exports, as well as inflation fluctuations.

Table 2

THE DYNAMICS OF THE BASIC TAX REVENUES TO THE BUDGET OF THE EXPANDED GOVERNMENT OF THE RUSSIAN FEDERATION IN JANUARY-MARCH 2010–2011, PER CENT OF GDP

	January- March 2011	January- March 2010	Change, p.p. of GDP
Level of tax burden (1+2+3)	35.5	33.1	+2.4
1. Revenues from taxes (1), including:	21.5	21.1	+0.4
Corporate profits tax	4.9	4.0	+0.9
Single social tax	3.5	3.8	-0.3
VAT	6.3	6.4	-0.1
Excise duties	1.1	1.1	0.0
Severance tax	3.8	3.5	+0.3
2. Insurance contributions for compulsory social insurance	6.3	4.8	+1.5
3. Revenues from foreign economic activity	7.7	7.2	+0.5

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

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

The revenue from *corporate profit tax* in the expanded government budget within the first Quarter of 2011 as compared with the relevant period of 2010 has increased by 0.9 percentage points of GDP, which was based on the growth of the tax base. Thus, in January-March of the current year the real sector has received the financial surplus in the amount of RUR 1,980.2 bn, which is by 33 per cent higher than its value for the corresponding period in 2010, whereas the share of profitable organizations in the

1 <http://www.minfin.ru/ru/press/speech/index.php?id4=12691>

2 <http://bujet.ru/article/125334.php>

total number of organizations in comparison with the relevant period of preceding year increased by 0.2 percentage points and amounted to about 61 per cent¹. *Personal income tax* revenue to the budget of expanded government in relative terms amounted to 3.5 per cent of GDP, which is by 0.3 percentage points of GDP lower than in the corresponding period of 2010. In nominal terms, revenue growth in January-March 2011 was about 10 per cent and was associated with the expansion of the tax base: the dynamics of an average monthly gross wage demonstrates growth against the level of 2010 both, in nominal and in real terms (by 11.2 per cent and by 1.6 per cent, respectively)².

The volume of *VAT* proceeds to the expanded government budget for the 1st quarter has decreased in relative terms by 0.1 percentage points of GDP in nominal terms, growth in income tax amounted to 18.5 per cent. According to the Federal Tax Service of Russia for January-March 2011 by 4.5 per cent decline in the number of applications for *VAT* refunds at the level of 2010³. To a large extent that dynamics was associated with the adoption of legislative measures to eliminate the «gray» schemes in the *VAT* assessment and payment.

In general, it can be noted that the level of the *tax burden* on the economy in January-March 2011 has increased by 2.4 percentage points of GDP as compared with the same period in 2010 and reached 35.5 per cent of GDP. In the medium term, the sources of increasing the tax burden on the economy could be: growth of excise tax rates on pure alcohol and tobacco, the severance tax on gas (proposed to be increased 2-fold for the companies-holders of the gas business), the growth in property tax in terms of physical entities real estate, changes in depreciation rates (it is proposed to return to the rate of 10 per cent instead of the current 30 per cent currently). In general, additional budget revenues in 2012-2014 can reach 1.9, and the majority of them will be formed by increasing the excise duty on alcohol and the severance tax on natural gas⁴.

Against the background of increased revenues of the budget of expanded government, relative level of expenditures also demonstrates an explicit reduction: budget expenditures decreased by 2.6 percentage points of GDP as compared with the relevant period of 2010 (*Table 3*).

Table 3

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

	January-March 2011		January-March 2010		Change, p.p. of GDP
	RUR bn	% of GDP	RUR bn.	% of GDP	
Expenditures, total:	3 575.5	31.0	3 220.8	33.6	–2.6
Including					
Federal issues	231.6	2.0	297.0	3.1	–1.1
Contributions to the service of federal and municipal debt	94.5	0.8	86.6	0.9	–0.1
National defense	262.3	2.3	273.4	2.9	–0.6
National defense and law enforcement	290.5	2.5	279.8	2.9	–0.4
National Economy	347.7	3.0	376.1	3.9	–0.9
Housing and public utilities	140.5	1.2	111.5	1.2	0.0
Environmental protection	4.2	0.04	4.1	0.04	0.0
Education	374.8	3.3	335.0	3.5	–0.2
Culture, cinematography and mass media*	65.3	0.6	56.8	0.6	0.0
Health care and sports**	344.9	3.0	295.3	3.1	–0.1
Social policy	1 419.1	12.3	1 191.8	12.5	–0.2

*, ** In the functional classification of budget expenditures for 2011 there were changes: the article “Culture, “Film Industry”, “Media” and “Healthcare” and “Physical Culture and Sport” are submitted as separate budget lines.

Source: RF Treasury, Gaidar Institute estimates.

1 According to the Federal State Statistics Service “On the financial performance of organizations in the I Quarter 2011”

2 http://www.gks.ru/bgd/free/B11_00/IssWWW.exe/Stg/dk01/5-0.htm

3 <http://www.minfin.ru/ru/press/speech/index.php?id4=12581>

4 <http://www.rg.ru/2011/03/29/budget.html>

In varying degrees of reduction in relative terms, all budget lines of expanded government were reduced. The worst decline in public expenditures was based on the reduced funding for «Federal issues», which has reduced by 1.1 p.p. GDP. Also reduction of budget expenditures is noted in the lines “National Economy”, “National Defense”, of “National Defense and Law Enforcement”, - by 0.9-0.4 percentage points of GDP for each budget line. The amount of funding for social expenditures of government budget is in general consistent with the level of 2010.

In May 2011 the Government has informed of the plans for a massive cost-cutting for «energy-source block». In general, in 2012-2014, their reduction perhaps by RUR 1.5 billion, including the reduction of the number of troops by 15 per cent, as well as reduction of the costs of defense contracts¹. In addition, it is expected to slowdown the cost of supporting economic industries and the cost of investments². Optimization of public expenditures is related to the government desire to balance the budget system without increasing the cost above the planned parameters.

RF federal budget execution within January-April 2011

According to the tentative estimates of the RF Ministry of Finance, the federal budget execution within 4 months of 2011, budget revenues amounted to 21.3 per cent of GDP, which is by 1.3 percentage points of GDP exceeds the indicator of the relevant period of 2010 (See Table 4). In absolute terms, the growth of federal budget revenues amounted to RUR 720 bn. One can note the reduction of “diversification” of tax sources. The major revenue share of the federal budget is contributed by the proceeds from only two taxes: oil and gas and VAT³.

In January-April 2011 revenues from oil and gas asset management funds for 2010 were enrolled in the budget in the amount of RUR 54.1 billion. The total volume of oil and gas revenues in January-April 2011 amounted to 10.1 per cent of GDP, which is by 1.3 percentage points of GDP higher than the values for the same period in the last year.

In general, in a favorable foreign economic situation the Russian government found a compromise between spending and saving in the distribution of surplus incomes. In 2011 the following concept was adopted: surplus non-oil revenues will be fully spent, and oil and gas surplus revenues will be directed to the Reserve Fund, again creating a «safety cushion». An exception will be the use of oil and gas revenues as a contribution to the created by the Government Russian Sovereign Investment Fund.

Table 4

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

	January-April 2011		January-April 2010		Budget execution in % versus 2011 year estimates.	Change	
	RUR, bn	% GDP	RUR, bn	% GDP		RUR, bn	% GDP
Revenues, including:	3 340.0	21.3	2 618.3	20.0	37.8	+721.7	+1.3
Oil and gas	1 580.6	10.1	1149.4	8.8	38.6	+431.2	+1.3
Contributions to the Reserve Fund and National Welfare Fund (Stabilization Fund)	0.0	0.0	26.5	0.2	–	–26.5	–0.2
Revenues, including:	3 206.0	20.4	3 030.5	23.1	30.1	+175.5	–3.4
Interest expenditures	91.8	0.7	77.4	0.6	23.6	+14.4	+0.1
Non-interest expenditures	3 114.1	19.9	2 953.1	22.5	30,3	+161,0	–2,6
Deficit / Surplus of the federal budget	+134.0	+0.9	–412.3	–3.1	7,4	+546,3	+4,0
Non-oil deficit	–1 446.6	–9.2	–1 561.6	–11.9	24,5	+115,0	+2,7
GDP estimates	15 682.0		13 115.9				

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

1 <http://bujet.ru/article/133021.php>

2 <http://www.kommersant.ru/doc/1647085>

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

Preliminary estimates of the *federal budget execution in terms of expenditures* for January-April 2011 indicate a significant decrease in their volume - by 3.4 percentage points of GDP against the value of four months of 2010, which is mainly based on the low rate of the budget expenditures.

In general, in 2011, the federal budget expenditures may increase by RUR 420 bn¹(growth about 4 per cent against the initial value, specified in the Law. Additional funding is provided, as stated by the government, to «achieve strategic objectives». In particular, about RUR 128 bn will be spent on solving social problems: first, the indexation of labor pensions at the end of the year due to the excess of the planned rate of inflation. About RUR 55 bn are planned to be allocated to the support of the RF Subjects and other RUR13 bn – for the implementation of activities in agroindustrial complex.

According to tentative results, within four months of 2011, the federal budget was executed with a surplus of 0.9 per cent of GDP against the deficit of 3.1 per cent of GDP in the same period of 2010; the volume of non-oil deficit has significantly declined - by 2.7 percentage points of GDP as compared with the previous year and amounted to 9.2 per cent of GDP. In general, in 2011 the value of the federal budget deficit is fixed in the budget law at 3.6 per cent of GDP (with the price of oil at USD 75 per barrel.) However, the favorable conditions of the global energy market led to a significant correction to the official estimates of the deficit value to 0.6-0.8 percent of GDP².

As of May 1, 2011, the Reserve Fund amounted to RUR 745.7 billion (RUR 775.2 bn on January 1, 2011); the volume of the National Welfare Fund has reduced to RUR 2.5946 trillion (RUR 2695.5 bn on January 1, 2011).

Since 2012 when additional revenues were allocated in the oil and gas funds (the Reserve Fund and National Welfare Fund (NWF) the mechanism of cut-off price will activated again. According to preliminary assessments the Ministry of Finance of Russia, cut-off price will vary in the range of USD 75-90 per barrel in depending on the level of expenditures³. New budgetary rules on the funds replenishment will be developed by the Ministry of Finance of Russia in the coming months. ●

1 <http://lenta.ru/economy/2003/10/15/budget/>

2 <http://bujet.ru/article/133021.php>

3 <http://www.minfin.ru/ru/press/speech/index.php?id4=12570>

THE STANDARD OF LIVING OF THE POPULATION

S.Misikhina

In the 1st quarter 2011, the households' real disposable cash income was lower than that in the 1st quarter of 2010 though the difference was not great and amounted to less than 3%. The growth of that index in April could not have a positive effect on the situation. In the 1st quarter, the index of inequality was lower than that in the same period last year.

In January 2011, **the households' real disposable cash income** fell by 50% as compared to December 2010 which situation can be explained by seasonal fluctuations of the annual dynamics of cash incomes. Pay out of the so-called 13th salary, annual bonuses and other payments justified in December 2010 the largest monthly average growth in the value of that index during the year, that is, 39.1%. Discernible growth of 28% in households' real disposable income in February and preservation of that level in March failed to make up for the January drop in the value of that index: in the 1st quarter of 2011 the households' real disposable income fell by 25% as compared to that in the 4th quarter of 2010. Such a drop resulted in a situation where in the 1st quarter of 2011 the households' real disposable income was less than that in the 1st quarter of 2010, though the difference was insignificant and amounted to 2.8%. Growth in the index value in April was insufficient to have a positive effect on the situation: in January-April 2011 the households' real disposable cash income was 3.1% lower than that in the same period in 2010.

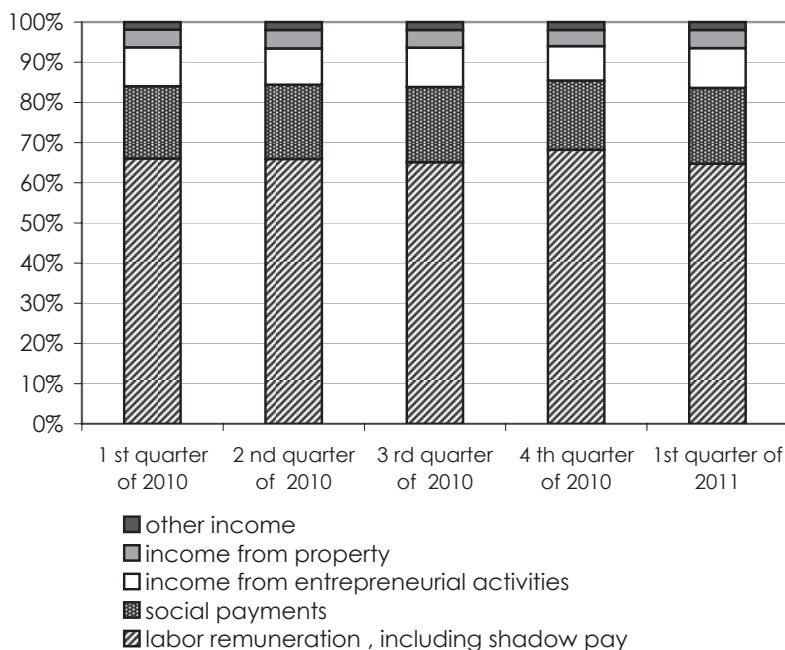
In April 2011, the main types of households' cash income were as follows:

- Households' average cash income: RUR 19,900;
- Average wages and salaries accrued: RUR 22,600.
- Average pension granted: RUR 8,200.¹

In the 1st quarter of 2011, the structure of the households' cash income underwent a number of changes as compared to that in 2010. On the one side, the unit weight of the income received from entrepreneurial activities, property and social payments increased, while the share of labor remuneration decreased (See Fig. 1).

The dynamics of income inequality. In the 1st quarter of 2011, the decrease in inequality as compared to that in 2010 was more discernible than in 2009 (Table 1). In the 1st quarter of 2011, indices of inequality were lower than those in the same period in 2010:

- 0.398 against 0.403 as regards the index of income concentration (the Gini coefficient),
- 14.0 against 14.5 as regards the ratio between the incomes of 10% of the most well-to-do households and 10% of the least well-to-do households (funds coefficient).



The source: The Rosstat data.

Fig. 1. The structure of households' cash income in 2010 and the 1st quarter of 2011.

¹ The data for the period of March.

A decrease in the values of inequality indices in the 1st quarter of 2011 as compared to the 1st quarter of 2010 was determined both by a small growth of 0.1 percentage points per quintile in the share of income which the first four quintiles of households account for and a decrease of 0.4 percentage points in the share of income which 20% of the most well-to-do households account for (46.2% in the 1st quarter of 2010 and 45.8% in the 1st quarter of 2011).

Table 1

DISTRIBUTION OF THE TOTAL VOLUME OF HOUSEHOLDS' CASH INCOME, %

	2009	2010			2011	
	Year	1st quarter	1 st half-year	9 months	Year	1 st quarter
Cash income – total		100	100	100	100	100
Including those by 20 % groups of households:						
The first group (with the lowest income)	5.1	5.5	5.3	5.3	5.1	5.6
The second group	9.8	10.3	10.1	10	9.7	10.4
The third group	14.8	15.3	15.1	15	14.8	15.4
The fourth group	22.5	22.7	22.6	22.6	22.5	22.8
The fifth group (with the highest income)	47.8	46.2	46.9	47.1	47.9	45.8
Index of income concentration (the Gini coefficient)	0.422	0.403	0.411	0.414	0.423	0.398
The ratio of incomes between 10% of the most well-to-do households and 10% of the least well-to-do-households (funds coefficient), by factor	16.7	14.5	15.4	15.8	16.8	14.0

The source: The Rosstat data.

RUSSIAN BANKING SECTOR

S.Borisov

Record high financial results of the Russian banking sector in the first quarter of 2011 was associated with a decrease in the value of the resource base and the stabilization of the dynamics of lending rates. The most were high-yielding were corporate lending operations.

Table 1

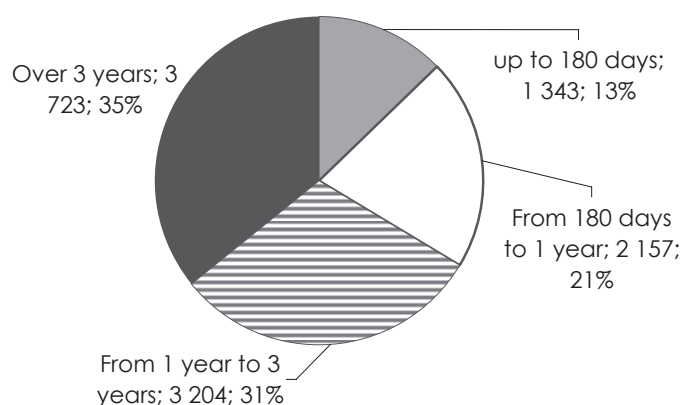
MAIN INDICATORS OF THE RUSIAN BANKING SYSTEM, RUR, BN.

	As of 01.02.2010	As of 01.01.2011	As of 01.02.2011		
			Nominal	Growth since the start of the year, %	Year-on- year Growth, %
Assets	29 284.2	33 804.6	34 009.4	0.6	16.1
Loans to non-financial organizations	12 424.0	14 062.9	14 368.6	2.2	15.7
Loans to private individuals	3 536.3	4 084.8	4 192.8	2.6	18.6
Loans to banks	2 779.5	2 921.1	2 983.1	2.1	7.3
Investments in bonds	3 885.6	4 419.9	4 483.8	1.4	15.4
Deposits with the RF CENTRAL BANK	685.9	325.7	312.3	-4.1	-54.5
Banks' deposits	3 097.6	3 754.9	3 613.2	-3.8	16.6
Corporate deposits	5 275.1	6 035.6	5 994.0	-0.7	13.6
Private deposits	7 797.7	9 818.0	10 018.0	2.0	28.5
Impairment reserves	2 144.2	2 192.0	2 217.5	1.2	3.4
Profit (in the respective year)	116.7	573.4	214.3		83.6

Source: the Bank of Russia

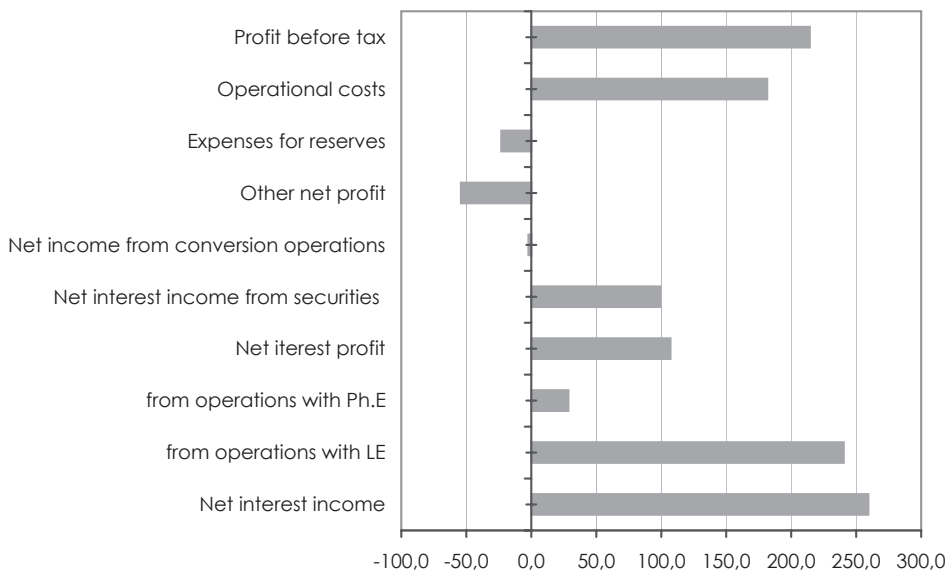
Despite a slowdown in the monthly growth rate of banking system assets in March to 0.4% from 2% in February, for the first time since the beginning of the year, corporate lending, as well as loans to individuals, was growing at the same time reducing the amount of banks' investments in securities. According to the RF Central Bank, the balances of loans to non-financial institutions in March have grown by RUR 182 billion, providing a 2.2% having increased since the beginning of the year by 0.5 p.p. In the structure of loans to non-financial institutions by maturity (Fig. 1), the maximum weight in the portfolio since February 2010 to February 2011 retained loans with maturities

over 1 year. As of March 1, their share in the portfolio for a total of 67%, an increase over January-February, a total of 1.3 percentage points. According to the report of the integrated RF Central Bank report on income and profit of the RF banking sector, the system has received during the first three months of 2011 a profit in the amount of RUR 214 billion, which is over 84% higher than the result of the same period of the last year. Herewith, the return on equity of the banking system increased



Source: the Bank of Russia.

Fig. 1. The structure RUR credits to legal entities in terms of maturity, %



Source: the Bank of Russia

Fig. 2. Gains and losses of the RF banking sector in the first quarter of 2011, RUR bln.

from 12.5% at the end of 2010 to 14.6% in the I quarter of 2011. The enlarged structure of the profit and loss account of the RF banking system is shown in *Fig. 2*.

The main factors which influenced the record volume of banking sector profit in the first quarter were an increase in net interest income (NII), net profit from conversion operations, as well as significant cost reduction for the formation of reserves for possible loan losses. Let's consider the key revenue sources in more detail.

Volume of the banking system NII of Russia for January-March amounted to 269 billion rubles. In this case, the share of NII loans to legal entities amounted to RUR 240.4 billion and the interest income from lending to households was equal to RUR 28.6 billion. Reduction of the cost attracted by banks, allowed the majority of lending institutions to maintain and even expand margins in lending to the real sector, as well as population. The share of population in the total amount of attracted funds (excluding interbank loans) in the first quarter, did not fall below 47%. Herewith, the weighted average interest rate on ruble deposits of the population up to one year, their share in total volume of ruble-denominated deposits of which to individuals as of March 1 was equal to 36%, has declined in January-February 2011¹ from 4,9% to 4,4%. In the same period, the weighted average cost of retail deposits in rubles with maturity over a year was stable and amounted to 5.6%. Resources attracted by commercial banks from non-financial corporations, have somewhat grown in January-February. Thus, the weighted average rate on deposits of legal entities in rubles with maturity up to one year in this period increased from 2.5% to 2.6%, while the funds of companies in the national currency, borrowed for more than a year, rose from 6.4% in December 2010 up to 7% in February 2010. With the reducing cost of the attracted funds, the average weighted credit interest rate in 2011 has not been dropping at an accelerated pace, typical for the second half of last year. Thus, as compared with December 2010, the average weighted interest rate on Ruble credits to legal entities for less than 1 year decreased by 0.4 percentage points (for comparison, from September to December 2010 it fell by 0,6 percentage points), while the ruble loans for more than a year, even grew by 0.4 percentage points. In lending to the population average rate for Ruble loans up to one year in January and February rose by 0.3 percentage points and was 25% for loans over the year grew by 0.7 percentage points to 17,5%.

The growth of interest margin to a greater degree has influenced the interest income from bank system interest from crediting of non-financial corporations. As of March 1, the share of credits to legal entities in the total loans to customers (including interbanking loans) was 63.4% (RUR 14,369 billion). On the contrary, despite the relatively high value of banks' interest margins on the loans to individuals, retail banking in Russia has little effect on the profitability of the banking sector due to the relatively low share of the portfolio of loans to individuals in the total amount of funds placed by banks - 18.4% as of March 1, 2011.

The volume of the net interest income, earned by the banks for three months in 2011, made RUR 107 billion. Fee and commission incomes of credit institutions consist of two main components: credit and noncredit commissions. Unfortunately, official statistics published by the RF Central Bank, does not allow accurately to assess an individual contribution of each specified commission

1 Bulletin of Banking Statistics, the data with a delay of 1 month.

income. However, one can confidently assert, that a wave of cancellations commissions for arranging loans that took place in the banking sector in the retail business, significantly increased the weight of all non-credit commissions in the aggregate result. If a credit interest is largely a consequence of the sale of credit product to the client, the growth of non-credit fee income expresses a primarily line of the additional banking products and services development.

Another significant reason for the impressive financial results of the Russian banking system in the first quarter of 2011 were relatively small expenditures on creation of reserves for possible loan losses. According to the RF Central Bank, for the period from January to March, the banks have spent on the establishment of reserves RUR 23.1 billion. For comparison, during the same period of the last year, the change in bank reserves redundant system was RUR 93.6 billion, and RUR 234 billion for 2010 overall. Slowing growth in expenditures on the reserves in 2011 is primarily due to recovering the quality of loan portfolio and the financial status of borrowers in the corporate and retail segments. Banking statistics for March showed a decrease in the share of overdue loans in the portfolio of loans to legal entities from 5.3% to 5.1% in the portfolio of loans to individuals – from 7.1% to 6.9%. In addition, the loan portfolio, 30 largest Russian banks for January-March 2011 in terms of quality categories, the share of standard loans increased by 3.6 percentage points and reached the maximum value from January 2010 – 49.6%.

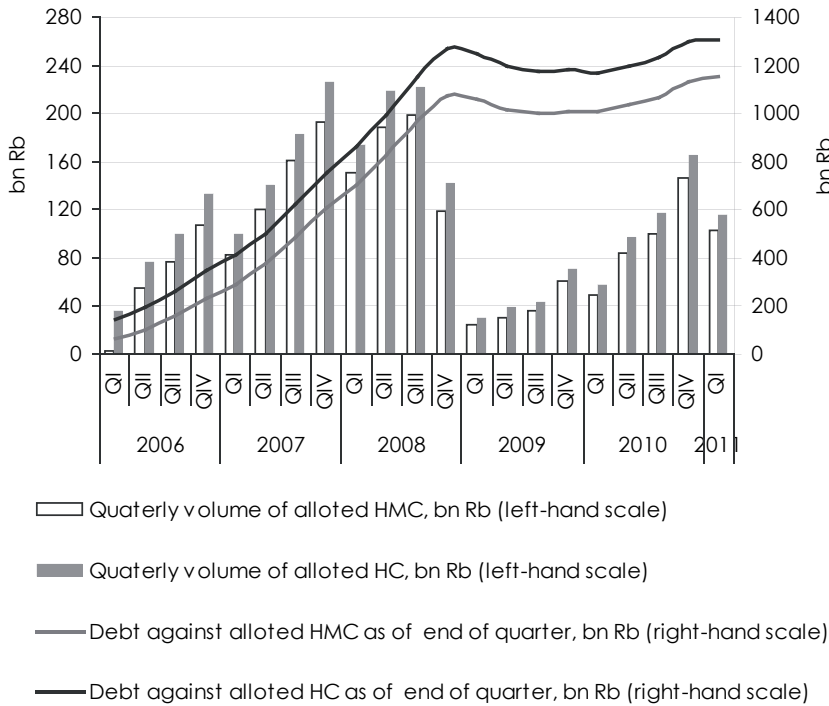
One should highlight the income from securities transactions received by the banking sector. According to the Bank of Russia, the amount of net income from securities transactions in the first quarter of 2011 reached RUR 99 billion. Investments in debt securities of corporate emitters are still widely used by the banks as a less risky alternative to traditional lending. Within January-March, investments in the bonds denominated in nominal terms, have increased by RUR 64 billion. Income from investments in equity securities of the Russian emitters also provided a significant contribution to the growth of the financial results of credit institutions in the first quarter.

The most significant developments in the banking sector in January-February were:

- HSBC, after the bank Barclays has decided to discontinue its operations to serve retail customers in Russia;
- From May 3, the refinancing and interest rates for individual operations of the Bank of Russia increased by 0.25 percentage points. The refinancing rate increased to 8.25% per annum. As noted by the RF Central Bank, the decision was made due to the persistently of high level of inflation expectations, exceeding the inflation target for the current year;
- The Board of Directors of TransCreditBank has approved an offer of VTB to buy the remaining share in TransCreditBank in the amount of 56.8%, based on the assessment of each share at RUR 21. Thus, for this portion VTB will pay about 27.3 billion rubles;
- VTB24, Transcreditbank and Bank of Moscow will consolidate ATM networks in the II quarter of 2011, which should result in an appearance of a powerful competitor to Sberbank in this segment of the banking market;
- The Bank of Russia will hold a concomitant survey of current expenditures of individual credit institutions for 2011. Credit institutions, included in the list, should no later than March 1, 2012 submit to the territorial branches of Bank of Russia reports on the operating costs (material costs and services of third-party organizations). ●

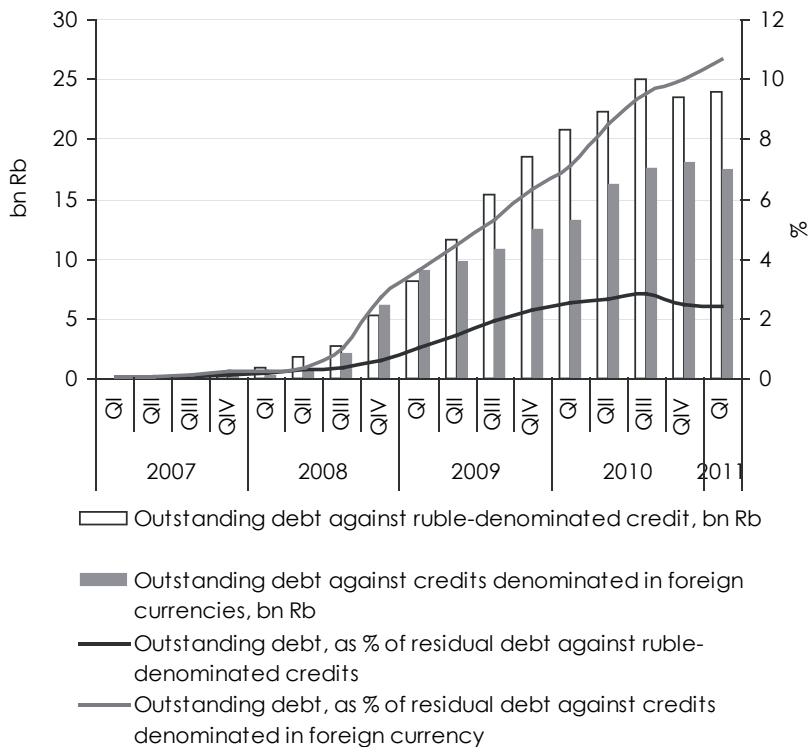
HOUSING MORTGAGE IN THE RF

G.Zadonsky



Source: RF Central Bank.

Fig. 1. Quarterly dynamics of allotted credits



Source: RF Central Bank.

Fig. 2. Changes in outstanding debt against housing mortgage credits, as of end of quarter

In Q I 2011, the volume of allotted housing mortgage credits (103.24 bn Rb) became nearly as high as its pre-crisis level (though still below it). The share of outstanding Rb-denominated debt against housing mortgage credits in Q I 2011 relative to the sum of residual debt declined to 2.42 %. However, in March 2011 the sum of debt against defaulted credits increased – both in terms of its total volume and share in the total sum of debt – from 4.63 % to 5.89 %.

According to data published by RF CB, in Q I 2011 credit institutions issued a total of 91,736 housing credits (HC) (denominated in rubles and foreign currencies) in the amount of 115.68 bn Rb, including 74,224 housing mortgage credits (HMC) in the amount of 103.24 bn Rb (Fig. 1). The total sum of 73,662 Rb-denominated housing mortgage credits was 100.34 bn Rb. Residual debt against housing mortgage credits continues to be on the rise, and so as of 1 April 2011 it amounted to 1.152 trillion Rb, including 0.988 trillion Rb against Rb-denominated credits. The volume of housing mortgage credits allotted in Q I 2011 was by 2.11 times higher than the same index for the period of Q I 2010 (48.96 bn Rb), and by more than four times higher than that for Q I 2009, but still 31.5 % lower than in Q I 2008 (Fig. 1).

According to data published by the RF CB, the amount of outstanding debt against housing mortgage credits as of 1 April 2011 was 41.45 bn Rb (23.93 bn Rb against Rb-denominated credits and 17.53 bn Rb against credits denominated in foreign currencies) (Fig. 2). The sum of

total outstanding debt as of the end of Q I 2011 was 0.43 % less than that as of 1 January 2011. At the same time, outstanding debt against Rb-denominated HMC in terms of volume somewhat increased by comparison with the end of Q VI 2010, while in terms of per cent share of residual debt it dropped from 2.48 % as of 1 January 2011 to 2.42 % as of 1 April 2011. Outstanding debt against HMC denominated in foreign currencies over the same period declined in terms of volume, while in terms of per cent share of residual debt it increased from 10.03 % to 10.70 % (Fig. 2).

According to data published by the RF CB, the amount of outstanding debt against HMC in March 2011 declined from 982.69 bn Rb as of 1 March to 961.35 bn Rb as of 1 April, and in terms of share in total debt – from 86.67 % to 83.43 % (Table 1). Over the same period the sum of debt against defaulted HMC (i.e., credits with payments in arrears for over 180 days) increased from 52.50 bn Rb to 67.87 bn Rb, and in terms of per cent share of total debt it increased from 4.63 % to 5.89 % (Table 1).

Table 1

DEBT AGAINST HOUSING MORTGAGE CREDIT BROKEN UP BY PERIOD OF DELAY
IN PAYMENT, FOR 2011

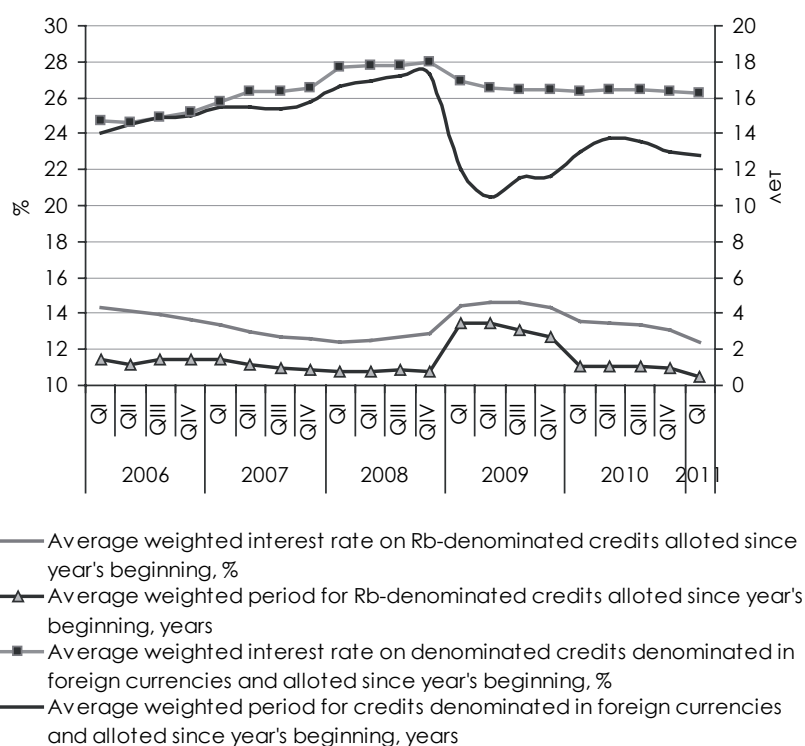
	Total amount of debt against HMC	Including							
		less payments in arrears		with payments in arrears between 1 and 90 days		with payments in arrears between 91 and 180 days		with payments in arrears for over 180 days	
		in mln Rb	as % *	in mln Rb	as % *	in mln Rb	as % *	in mln Rb	as % *
1 Jan	1,129,373	991,928	87.83	66,859	5.92	12,875	1.14	57,711	5.11
1 Feb	1,127,493	977,085	86.66	84,562	7.50	12,290	1.09	53,556	4.75
1 Mar.	1,133,825	982,686	86.67	86,738	7.65	11,905	1.05	52,496	4.63
1 Apr	1,152,287	961,353	83.43	105,549	9.16	17,515	1.52	67,870	5.89

*) - as % of total amount of debt.

Source: RF CB.

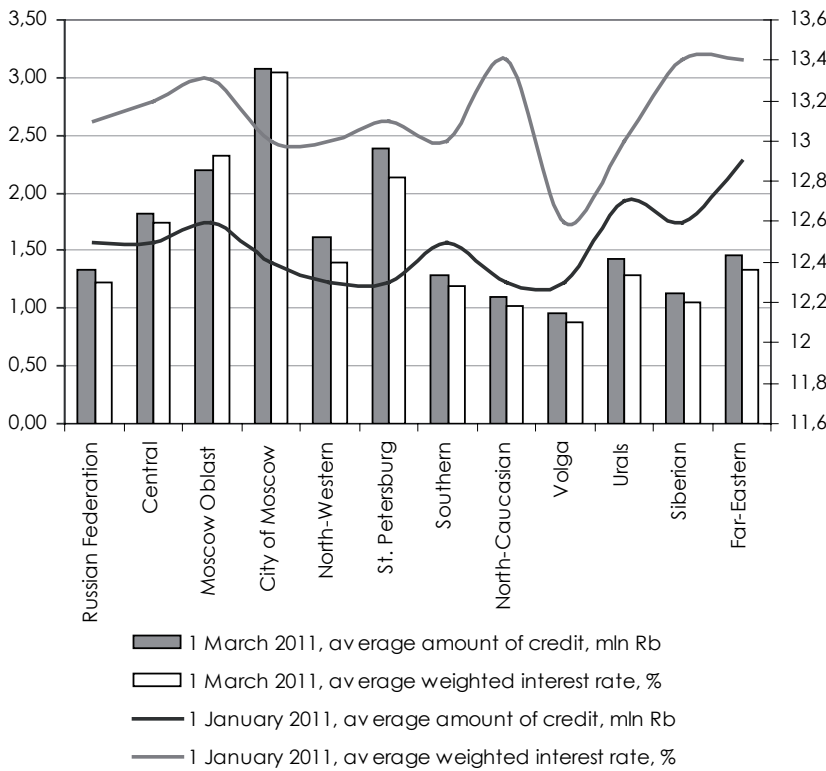
As reported by the RF CB, in Q I 2011, the average weighted rate on HMC (denominated both in rubles and foreign currencies) issued since the year's beginning continued to display a downward trend (Fig. 3). The average weighted rate in 1 Q 2011 with regard to Rb-denominated credits dropped by 0.5 p.p. to 12.4 %, and with regard to credits denominated in foreign currencies – by the same 0.5 p.p. to 10.5 % (Fig. 3). In 1 Q 2011, the average weighted rate on Rb-denominated HMC refinanced by the Agency for Housing Mortgage Crediting (AHMC) since the year's beginning rose by 0.55 p.p. relatively to the AHMC's rate for the year 2010 and thus amounted to 11.71 % (the AHMC's average weighted rate for 2010 was 11.16 %).

As of 1 March 2011, the average credit amount for Rb-denominated HMC allotted since the year's



Source: RF CB's data.

Fig. 3. Average weighted data on housing mortgage credits allotted since year's beginning



Source: RF CB's data.

Fig. 4. Average weighted data on Rb-denominated housing mortgage credits allotted since year's beginning, by federal district

beginning had increased since 1 January 2011 everywhere (Fig. 4) except in Moscow Oblast. The average credit amount across the Russian Federation as of 1 March 2011 was 1.34 mln Rb, thus having risen on 1 January 2011 by 9.5%. The biggest credits as of 1 March 2011 were allotted in Moscow (3.07 mln Rb), the smallest – in the Volga Federal District (0.96 mln Rb). The same district demonstrated the lowest rate on HMC (Fig. 4) both as of 1 January 2011 (12.6%) and as of 1 March 2011 (12.3%).

Over Q I 2011, the AHMC refinanced 5,602 mortgages in the total amount of 5.69 bn Rb, which is by 40.4% less in quantitative and by 37.7% in money terms than the same indices for Q I 2010. In April 2011, the AHMC refinanced 2376 mortgages in the amount of 2.45 bn Rb, which is also by 38.7% less than the volume of refinancing registered in April 2010.

According to data published by the *Rusipoteka* analytical web portal, the example of Sberbank – which in 2010 fully abolished any commission on the issuance of housing mortgage credits – was followed by Rosselkhozbank, Barclays Bank, HSBC, and Intesa Bank. This year, they were joined by *Vozrozhdenie*, MDM Bank, *Otkrytie* (with regard to some of its programs), Raiffeisenbank, and *Uralsib*. As stated by *Insurance Company AIZhK* (the insurance arm of the Agency for Housing Mortgage Lending), the cost of insurance against the risks associated with borrowers' liability for failure to fulfill or improper fulfillment of their obligations under credit agreements is gradually declining. ●

AN ANALYSIS OF THE INITIATIVE DESIGNED TO INCREASED THE LIST OF ONE-COMPANY TOWNS EARMARKED FOR TARGETED STATE ASSISTANCE IN 2011

A.Alaev

In April 2011, Russia's authorities announced that the list of the one-company towns entitled to priority state assistance should be further expanded¹. Thereby, that list will be increased for the second time since July 2009. It will include 50 one-company towns – twice as much as originally envisaged.

The necessity to render assistance to one-company towns and to prevent a sharp fall in the standards of living of their residents was first mentioned in the RF President's Address to the Federal Assembly on 12 November 2009. The President offered two methods for resolving the existing problem. The first method consists in developing special socio-economic programs designed to create new jobs and to additionally stimulate private investments in one-company towns. If a given one-company town can offer no sound economic prospects, the second method should be applied, that is, proper conditions should be created for resettling the population to regions with more favorable living and working conditions that will be capable of absorbing additional work force².

In order to achieve this aim, the RF Government had, first of all, to perform the following two tasks:

1. to establish criteria for placing settlements into the category of one-company towns;
2. to compose a general list of mono-specialized towns containing an analysis of their socio-economic situations, including the towns most severely hit by the current financial crisis, and to assess their prospects for further development.

The common feature typical of all one-company towns is the presence of one dominant or city-forming enterprise (or a group of enterprises interconnected within the framework of a single production chain). Therefore the issues of company-town functioning are closely interlinked with those of the development of city-forming enterprises.

In June 2009, the specially created Interdepartmental Task Force on the Issues of Mitigating the Negative Impact of the Financial Crisis on the Socio-Economic Development of Mono-Specialized Towns in RF Subjects approved, on the basis of the legislatively established definition of a city-forming organization³, the following basic criteria for placing settlements into the category of mono-specialized settlements:

1. The existence of an enterprise or several enterprises functioning within the framework of a single production and technological process, which provides principal employment to more than 25 percent of the economically active population of that settlement;
2. The existence, in a settlement, of an enterprise or several enterprises functioning within the framework of a single production and technological process that account for more than 50 percent of that settlement's industrial production volume.
3. The share of taxes and revenues transferred to the budget of a municipal formation by the enterprise or several enterprises functioning within the framework of a single production and technological process and situated in a given settlement should amount to no less than 20 percent of the total volume of taxes and revenues transferred to the budget of the municipal formation by all the organizations and enterprises operating therein.

1 <http://www.prime-tass.ru/news/0/%7B803AA708-D6F4-4C40-B07F-5F20E2637123%7D.uif>. – In 2011, another 15 one-company towns will be included in the priority list of targeted state assistance recipients – A. Zhukov.

2 <http://news.kremlin.ru/transcripts/5979> – The Official Website of the President of the Russian Federation.

3 In accordance with Item 1 of Article 169, of Federal Law, of 26 October 2002, No 127-FZ 'On Insolvency (Bankruptcy)', city-forming organizations should be deemed to be legal entities whose employees account for no less than 25 percent of the working population of the corresponding settlement.

In accordance with these criteria, the RF Ministry of Regional Development composed a general list of Russia's one-company towns covering 335 settlements (among them 226 settlements with more than 10 thousand inhabitants, including 12 closed territorial units), including 110 to 120 urban settlements, 2 villages and 1 *stanitsa* (large Cossack village)¹. It should be noted that, according to a study carried out by the Independent Institute for Social Policy (IISP), Russia has approximately 150 one-company towns (which account for about 8 percent of Russia's total population and for 11 percent of her urban population), which is 3 times less than the official estimates issued by the RF Ministry of Regional Development². At the same time, the Scientific and Educational Foundation *Expert Institute* believes that Russia has 332 one-company towns and 467 problem-ridden one-company urban settlements³.

Thus, at present, Russia has no strict and unambiguous criteria for defining settlement mono-specialization. For example, the IISP did not take into account, in its estimates, the closed towns operated by the RF Ministry of Defense and Russia's atomic agency (the closed administrative and territorial units), or the towns dominated by the existing or previously existing monopolies (Open-End JSC *Gazprom*, Russia's JSC *UES*, etc.) which are, in fact, state structures functioning at the expense of the national budget⁴.

The sectoral structure of Russian mono-specialized formations is indicative of the predominance of the following sectors: the timber-processing industry (20 percent); machine building (17 percent); the food industry (14 percent); the fuel industry (11 percent); and ferrous and non-ferrous metallurgy (6 percent). At the same time, the biggest companies predominant in the economy of one-company towns are as follows: *Rusal* (13 towns, 815 thousand inhabitants); Open-End JSC *AvtoVaz* (1 town, 705 thousand inhabitants); Open-End JSC *Evrax Group S. A.* (8 towns, 696 thousand inhabitants); Open-End JSC *UGMK* (the Urals Mining and Metallurgical Company) (12 towns, 666 thousand inhabitants); and Open-End JSC *Tatneft* (8 towns, 633 thousand inhabitants)⁵.

Under the current economic crisis conditions, the RF Government decided to urgently compose a list of those mono-specialized towns that were most heavily hit by unemployment and so should receive priority assistance at the expense of the federal budget.

For these purposes, by the decisions of First Deputy Chairman of the RF Government Igor Shuvalov, of 2 February 2010, No 1419p-P16, and of 30 November 2009, No 5787p-P16, a special Task Force for One-company Town Modernization under the Government Commission for Economic Development and Integration was formed.

However, the Government Commission for Economic Development and Integration failed to develop any formalized concept of rendering assistance to one-company towns, including well-substantiated economic plans and thoroughly elaborated mechanism for distributing budget funding between them. One of the possible reasons for this failure was the necessity to provide state assistance on an emergency basis in order to prevent social explosions in some of the one-company towns, e.g. to resort to extraordinary assistance measures like those taken in June 2009 in the town of Pikalevo. The Government Commission considered the list of one-company towns composed by the bodies of state authority of RF subjects, the Task Force for One-company Town

1 The list of 335 one-company towns was approved by the Government Commission for Economic Development and Integration (the minutes of meeting, of 22 December 2009, No 25).

2 Zubarevich N. V., *Regiony Rossii: neravenstvo, krizis, modernizatsiia* [Russia's Regions: The Inequality, Crisis, and Modernization]. Moscow: Nezavisimyi Institut Sotsial'noi Politiki [Independent Institute for Social Policy], 2010. P. 86.

3 *Monoprofil'nye goroda i gradoobrazuiushchie predpriiatiia: obzorny doklad* [The Mono-Specialized Towns and City-Forming Enterprises: A Review Report] Ed. by I. V. Lipsits. Moscow: Khroniker Publishing House, 2000.

4 The IISP's typology addresses only those towns where, in the medium-term perspective, the emergence of external shocks and the development of market relations may result in social upheavals, because the owner of the enterprises situated in a one-company town is a business entity that can stop production in the event of a sharp deterioration of the economic situation, and this will inevitably lead to a rise in social tensions. The RF Ministry of Regional Development considers a broader list of one-company towns, including those of them where a steep drop in federal budget revenues or de-monopolization (privatization with a subsequent optimization of production) of a number of spheres of the economy may result in a decline of living standards and a rise in unemployment. We believe that both approaches have the right to exist. However, it should be noted that any one-company town, in absence of appropriate institutions capable of facilitating its adaptation to changes in the sectoral structure of the economy, will sooner or later develop some grave problems.

5 <http://monogorod.org/> – according to the Institute for Regional Policy.

Modernization at the Government Commission for Promoting the Stable Development of Russian Economy, and the RF Ministry of Regional Development. As a result of the combined efforts of these state agencies, there emerged a list of 27 towns (with the total population of 2,862 thousand). Kemerovo, Cheliabinsk, Jaroslav and Nizhnii Novgorod oblasts, Maritime (Primorskii) Krai, and the Republic of Tatarstan were represented in the list by 2 one-company towns each, while Sverdlovsk Oblast was represented by three one-company towns. At the same time, the town of Sarapul (the Republic of Udmurtia) and the town of Budennovsk (Stavropol Krai) were not included in the list, although they had been recommended for inclusion by the RF Ministry of Regional Development.

The total volume of financial resources earmarked for assistance to one-company towns was determined in the minutes of the RF Government's meeting of 30 December 2009, No 42, *The Main Directions of the Anti-Crisis Measures of the Government of the Russian Federation for the Year 2010*. It amounted to 22 bn Rb. It was planned that out of that sum, 10 billion rubles would be allocated in the form of subsidies, and another 10 billion rubles would be transferred to the regions as credits. The maximum sum of subsidies allocated to RF subjects for the purpose of implementing the municipal programs for developing small and medium-size enterprise in one-company towns was not to exceed 400 mln Rb per year per RF subject, including:

- a) the sum allocated to the municipal program of a one-company town with up to 50 thousand inhabitants – no more than 80 mln Rb.;
- b) the sum allocated to the municipal program of a one-company town with 50 to 300 thousand inhabitants – no more than 150 mln Rb.;
- c) the sum allocated to the municipal program of a one-company town with more than 300 thousand inhabitants – no more than 300 mln Rb.

It was planned that 2 bn Rb would be additionally spent on activities within the framework of programs such as grants, micro-financing, construction of business incubators, educational programs and industrial parks¹. The authorities also planned that another 5 bn Rb would be spent under the aegis of the Fund for Reforming the Housing and Utilities Sector.

However, the actual volume of the funds allocated to one-company towns in 2010 was by 16.1 percent lower than the initially planned volume. It amounted to only 22.665 bn Rb². Moreover, the allocated budget funds were unevenly distributed over the course of the financial year. Thus, as of 16 September 2010, only 246 mln Rb (or 2.5 percent of the funds planned for allocation) had been allocated in the form of credits from the budget, and only 642 mln Rb (or 6.4 percent) had been allocated in the form of dotations³. As of that date, only three towns (or 11 percent of those included in the approved list) were fund recipients: Nizhnii Tagil (Sverdlovsk Oblast), Togliatti (Samara Oblast) and Sokol (Vologda Oblast). The remaining 32 one-company towns would receive funding only at the end of 2010. Moreover, it was only in Q 4 2009 that the authorities actually made the decision to render financial assistance to yet another 10 towns that were not included in the initial list: Kamskie Poliany (Tatarstan), Naberezhnye Chelny (Tatarstan), Pavlovo (Nizhnii Novgorod Oblast), Viatskie Poliany (Kirov Oblast), Prokop'evsk (Kemerovo Oblast), Kamensk Ural'skii (Sverdlovsk Oblast), Leninsk Kuznetskii (Kemerovo Oblast), Sineluki (Voronezh Oblast), Satka and Pikalevo. In 2010, 5.6 bn Rb was allocated to the programs of these towns (4.6 bn Rb in the form of dotations from the budget and 1 bn Rb in the form of credits from the budget). As a result, by the end of 2010, financial assistance had been granted to 35 one-company towns.

One of the unsolved problems is the persistingly low quality of the investment programs of municipal formations or their total absence. It results from the municipal bodies' failure to attract qualified and competent personnel and from the somewhat inflated demands of the federal authorities. As of 14 February 2011, 71 municipal formations (out of 335) failed to map out comprehensive plans for their development, thus lagging by one year behind the deadlines set

1 The amount of financial assistance and the directions of financing were determined by the Minutes of the Meeting Conducted by First Deputy Chairman of the Russian Federation Igor Shuvalov, of 18 March 2010, No ISH-P13-11pr.

2 <http://www.minregion.ru>. – According to the report On the Results of the State Assistance Rendered to One-Company Towns.

3 <http://www.minfin.ru/ru/press/speech/index.php?id4=10647>. – Anton Siluanov's remarks to news agencies. In the nearest future, ten one-company towns of the RF will receive 5.6 bn Rb for investment projects.

for them by the federal authorities¹. According to the RF Ministry of Finance, this situation had emerged through the fault of the leadership of one-company towns, who had failed to find their own or additionally attracted sources of initial investments, thus making it impossible for federal funding to be granted to them².

The main reasons for budgetary credits having been radically cut in 2010 by comparison with the planned figures were the requirements and mechanisms for budget allocations established by legislation.

Thus, in order to receive funds from the federal budget, a one-company town should comply with several requirements. Firstly, it must undergo the general selection process based on a mandatory number of established parameters (two main parameters and one additional parameter). Secondly, it must then undergo the additional selection process carried out by a special government commission. Thirdly, it must devise its own program of socio-economic development, which must primarily be focused, instead of maintaining jobs at the inefficient city-forming enterprises, on restructuring these enterprises, creating alternative jobs, and diversifying the economy of one-company towns, including through the formation of individual programs designed to promote the development of small businesses (the creation of technoparks and business incubators with the help of budget funding, etc.)³.

The latter two conditions (which are interlinked) require separate consideration. The experience of 2010 indicates that by no means all of the one-company towns are satisfied with the results of the general federal selection process. Thus, the authorities of the Republic of Karelia announced that five Karelian towns were excluded from the federal list of mono-specialized settlements earmarked as candidates for receiving federal budget assistance (the Federal Commission of the RF Ministry of Regional Development has not yet approved this decision). The one-company towns in question are Pindushi, Nadvoritsy, Lakhdenpokhia, Pudozh and Viartsilia⁴.

One of the reasons for their exclusion was that those towns had very low chances of obtaining federal assistance in a situation of an ongoing fierce competition between towns; the second reason is the conditions for its obtainment. In order to obtain funds from the federal budget, a town must devise a comprehensive program of its development, envisaging the implementation of relatively expensive projects in each of the settlements, which is rather difficult for a small city - bearing in mind that part of the funds should be allocated from the regional and local budgets. Moreover, the subjects of the Federation have their own vision of urban development that may differ from that of the RF Ministry of Regional Development⁵.

Yet another obstacle which has proved to be very serious for many mono-specialized formations is the procedure for budget fund allocation whose mechanism still remains incomplete. First of all, the funding of projects is carried out with the help of a development institution – the Bank for Development and External Economic Affairs⁶ - whose functions are determined by the Memorandum on the Financial Policy of the State Corporation 'Bank for Development and External Economic Affairs (Vneshekonombank)' approved by Decision of the Government of the Russian Federation, No 1007-p, of 27 July 2007.

1 <http://президент.рф/выступления/10331>. – The Official Website of the President of the Russian Federation. The authorities' meeting on the issues of employment, 14 February 2011.

2 http://www.memoid.ru/node/Minfinu_nadoelo_kreditovat_monogoroda. – The prospects of one-company towns in contemporary Russia.

3 See Section 2.2.4. The Main Directions of the Anti-Crisis Measures of the RF Government for the Year 2010.

4 <http://www.eg-online.ru/article/131188/> – *Proshche i desheve otkazat'sia ot pomoshchi* [It is simpler and cheaper to get by without assistance]. *Ekonomika i Zhizn* [Economics and Life]. No 9379.

5 Thus, in the event of the Russian Frontier program being implemented, the settlement of Viartsilia, Murmansk Oblast, plans to open a crossing point which will enable it to create new jobs for local residents. The development of this settlement in accordance with the RF Ministry of Regional Development's project envisages the creation of new jobs requiring qualifications different from those possessed by the local population. The local authorities believe that the chances to get federal assistance are small, and that it would not be feasible, from the point of view of economic effectiveness, to spend more than 1 mn Rb on the comprehensive development of plans for implementing a 2 bn Rb project in a settlement with only 3 thousand residents.

6 <http://www.veb.ru/ru/about/normpr/mem/> – Directive of the Government of the Russian Federation, No 1007-r, of 27 July 2007, *The Memorandum on the Financial Policy of the State Corporation 'Bank for Development and External Economic Affairs (Vneshekonombank)*.

In accordance with Item 11 of this Memorandum, funding should be granted only to the investment projects with payback periods of over 5 years and with the overall value of more than 2 bn Rb¹. It is apparent that the development of such projects is difficult for small settlements and for those populated localities that do not have their own budget funds for attracting highly qualified specialists in the field of project activities. Well aware of these difficulties, the RF Ministry of Regional Development made an attempt, in 2010, to devise a sample solution for such towns, but this work was not completed due to the extremely high degree of diversification of towns and to the differences in the approaches to solving their problems. Unification of approaches to solving the problems of one-company towns also contradicts the international experience accumulated in this field.

Moreover, one-company towns are also faced with the problem of devising development programs or the so-called modernization investment plans (MIPs). Firstly, some towns are plagued by disagreements between their local administration and the owners of the city-forming enterprises with regard to the plans of territorial development. Secondly, these towns lack professionals capable of devising development projects that will be compatible with the requirements set by the Credit Commission of Vneshekonombank. Thirdly, according to the RF Ministry of Regional Development, 76 percent of one-company towns are small settlements poorly financed from the budget. For such towns, the resolution of current issues is a higher priority than the devising of medium- and long-term plans of development, whose implementation requires financial resources and additional state guarantees. Fourthly, in the course of devising development plans it is necessary to get engaged in numerous time-consuming conciliation procedures involving various agencies; the number of these procedures varies from region to region.

In all likelihood, further assistance to mono-specialized formations will be carried out through the implementation of regional and federal programs of assistance to small and medium-sized businesses, and through the selective construction of new enterprises with the help of *Vneshekonombank*.

At the federal level, there exist several approaches towards further development of the policy of rendering assistance to mono-specialized towns. Thus, the RF Ministry of Finance has decided that the funding of one-company towns should be discontinued, and the carryover of the non-spent budget funds (4.3 bn Rb) to the year 2011 be rejected. In this connection, the authorities developed a draft resolution of the RF Government entitled *On the Introduction of Alterations in Resolution of the Government of the Russian Federation, of 26 May 2009, No 453 'On the Approval of the Rules for the Allocation (or Usage or Return) of Budgetary Credits from the Federal Budget to Subjects of the Russian Federation for the Year 2010'*, which envisaged that the allocation of budgetary credits to mono-specialized towns could be abolished. However, this project was then stopped in its tracks, and so RF Government Resolution No 453 remains valid in its 2010 wording, which envisages that budgetary credits may be granted to one-company towns. Nevertheless, the previously existing forms of funding (budgetary credits and dotations) have not survived in the 2011–2013 federal budget. The authorities have decided to replace the previous methods for assisting one-company towns by a new special fund whose resources may be spent only in emergency situations (like that in June 2009 in the town of Pikalevo). The resources of this fund for 2011 amount to 30 bn Rb. The fund is aimed at achieving two goals: to prevent large-scale inefficient spending of budget resources in time of economic growth and to maintain financial reserves for resolving crisis situations “in a manual mode” when the economic situation deteriorates. This approach appears to be well fitted for balancing the budget on a current basis, but it cannot bring about an adequate solution to the problems of one-company towns.

The RF Ministry of Economic Development has announced² that the federal center will no longer make unilateral efforts to help one-company towns out of the crisis, and that it would like to place the responsibility for any corresponding initiative on the governors, thus reducing its competence to the granting of tax preferences to problem-ridden settlements and other such issues.

1 According to the report *On the Results of the State Assistance Rendered to One-Company Towns*, out of the 200 investment projects for the modernization of one-company towns selected by Vneshekonombank in 2010, 16 are currently being implemented, 50 have been approved for financing, while the rest of them are being examined by experts.

2 <http://www.forumkuban.ru/> – The IX International Investment Forum in Sochi.

In response to the RF Ministry of Finance's decision to discontinue direct budget assistance to one-company towns, the RF Ministry of Regional Development has announced the creation of regional development centers designed to carry out the selection of promising business projects both at the place of their origin and at the Ministry's project offices. Financial assistance to these projects will be carried out through a revolver fund¹ financed from the budget (0.5–1 bn Rb) and off-budget investments (up to 60 mn Rb). In 2011, public funding will be granted with priority to infrastructure projects and projects in the housing and utilities sector and the electric power industry. ●

1 A revolver fund is the totality of financial resources intended for specific capital investments designed to produce an economic effect. The idea of revolver fund consists in accumulating financial resources for the purpose of carrying out investments in projects at the expense of the finance flows produced by the previous investments with relatively short pay-back periods. Continual reinvestment in projects with short pay-back periods accumulates new resources due to the cash flows coming to the fund.

NATIONAL RESEARCH UNIVERSITIES' DEVELOPMENT PROGRAMS: A REVIEW OF THE FIRST TWO YEARS

I.Dezhina

In the spring of 2011 the Ministry of Education and Science of the Russian Federation initiated performance measurement of the universities which in 2009–2010 were granted the status of national research university. Neither marked leaders nor outsiders were revealed among the universities after analysis of the performance thereof. Issues are evident both at the federal (problems with defining objectives, the adopted system of indicators designed to measure the performance of the universities) and university levels (problems with system-based adherence to the set mission).

Since 2009, the Government of the Russian Federation initiated a large-scale support to selected universities through a special status of national research university (NRU) to be granted on a competitive basis. Twenty nine state universities became research universities in the period between 2009 and 2010, of which 14 universities began to implement development programs in 2009.

The status of research university is granted for a period of 10 years, and the federal government provides financing of the development programs of such universities within the first five years. Every university laid down its development program and set quantitative values for goal achievement indicators. The composition of the indicators was determined by the Ministry of Education and Science of the Russian Federation with the participation of a series of universities and includes 22 indicators for the following five groups¹:

- success in the field of education;
- effectiveness in the field of research and innovations;
- development of the human resource potential;
- worldwide recognition;
- financial stability.

The NRUs can be financed by the government subject to a co-financing of 20%. The universities are allowed to spend budget resources to pay for the following five items: purchase of training and research equipment, provision of advanced training of trainers (professors) and researchers employed at higher education institutions, development of training programs, development of information resources, as well as enhancement of the system of management of quality of education and scientific research². In spite of the fact that the NRU must increase their research level, they may not spent the allocated money to finance R&D, support research units and group, as well as make extra payment to postgraduates. However, no well-defined tasks were set for the NRUs, and the government failed in general to lay down goals of the initiative to the universities. The goals were interpreted in different statements of public officials, namely to increase the level of Russian universities so that some of them can eventually be ranked among the top-500 universities in the world; prepare high-quality professionals for the national economy; develop the science for economic development of the country. There is no way, however, to elaborate any methods to achieve ill-defined goals. Therefore, under the circumstances, the universities began to work by focusing primarily on the approved system of indicators in order to achieve the relevant quantitative values thereof.

The development programs of the NRUs³ were checked for implementation in the spring of 2011, with emphasis being placed on the first 14 universities which had more time to achieve any visible

1 The Order of the Ministry of Education and Science of the Russian Federation No. 279 dd. July 29, 2009.

2 The Order of the Government of the Russian Federation dd. July 13, 2009, No. 550 “On the Competitive Selection of the Development Programs of the Universities which are Granted the Status of “National Research University”, and the Provision on Competitive Selection of the Development Programs of the Universities which are Granted the Status of “National Research University”. <http://mon.gov.ru/dok/prav/obr/5556>

3 A special Expert Committee was set up to measure the performance of the National Research Institutions (under the Order of the Ministry of Education and Science of the Russian Federation dd. February 4, 2011, No. 167 “On the Committee for Assessment of the Effectiveness of Implementation of the Programs of the National Research Universities”).

results. The check was intended to assess implementation of the development programs announced by the universities, both objective and subjective topic issues, as well as adequacy of the applicable system of indicators for the assessment of the performance of the NRUs.

It was revealed that the NRUs prepared their reporting materials in such a way that they failed to allow one to assess the qualitative performance of the development programs. In most cases, the NRUs' reports contained self-assessment of the effectiveness which is of declarative nature and not supported by convincing argumentation. Most of the NRUs still employ old methods and know-how. Though extra financing allowed all of the universities which were granted the status of national research university to further develop their best practices, models and schemes, no brand new inventions were reported in most cases. Such a result is based on both external reasons and conditions inside the universities. Specifics and terms of budget allocations for the development programs can be referred to serious external reasons. In 2009 budget allocations were transferred with serious delays, not until the end of the year. In 2010, a new issue emerged: while in 2009 financing was made by estimate, in 2010 it was made as part of the Federal Special Program "Scientific and Research and Educational Manpower in Russia" for a period of 2009 – 2013, under the budget item "Miscellaneous", which resulted in extra tax expenses incurred by the universities.

Nevertheless, successful practices began to appear at the universities within a relatively short period of time of the work on the development programs. For example, the National Research University of Information Technologies, Mechanics and Optics (University ITMO) developed attractive solutions in the field of HR management; innovative activities are successful – a relatively big number of small innovative companies was set up. The National University of Science and Technology "MISIS" has a tailor-made educational process based on partnership with foreign institutions and Russian employers. The National Research University Higher School of Economics (NRU HSE) has already gained experience in different fields. There is no way, however, this practice can be applied on a large-scale basis, because of educational specifics (social sciences) and a specific financial situation (the NRU HSE is financed with federal budget allocations which are much bigger in size as compared to other NRUs). There are potentially effective measures such as establishment of full-day postgraduate training at the NRU HSE, recruitment of teaching personnel in the international labor market, opening of research laboratories in cooperation with foreign centers, provision of extra payment for conducting and publishing research works in other countries.

However, not all of the innovations are indisputable. For example, application of the "Chinese Model" for extra payment of "bonuses" to researches who publish articles with a high impact factor in foreign journals has not yet resulted in increase in the number of scientific publications. Furthermore, the universities' personnel have found themselves under pressure, because they are supposed to publish their works not only abroad but also in top-rated scientific journals which require publications of a strict profile. This leads to the need to adhere to a single "methodological pattern", thereby restricting appearance of new, original research trends and methods. It turns out that this approach has a potentially inherited defect which is likely to manifest itself in the long-term period.

Since the concept of research university implies active development in the field of science, it is important to assess the recent changes in terms of how the teaching personnel are involved in the research process. A series of the research universities exceed the country average value of this indicator. For example, up to 70% of the teaching personnel at the Saint-Petersburg State Mining University are involved in the research process; 45% of the teaching personnel are involved in some or another research projects at the NRU HSE against less than an average value of 20% at higher education institutions in Russia. However, the objective is not only to increase the number of teaching personnel involved in the research process, but also change volumes and quality of the same. So far, the number of scientific articles indexed in foreign and Russian databanks accounts for an average of 0.7 per research and educational employee in a group of 14 universities (an average of 0.58 for all of the 29 universities), i.e. less than one article per employee annually. The leader is the Moscow Institute of Physics and Technology and the National Research Tomsk Polytechnic University where the personnel publish more than one article per research and educational employee.

The second relevant aspect, which distinguishes the NRUs from other higher education institutions, is international cooperation in the field of education and research, engagement of human resources (both teaching staff and students) from foreign countries. In this respect, the first 14 NRUs show no good results and fail to meet the worldwide recognized “standards” which are typical of research universities worldwide. According to the reports made by the NRUs, they believe that they can attain successful international cooperation mainly through provision of onsite training in foreign countries, reciprocal visits, participation at conferences, publication of research results in foreign countries, participation in a series of projects, which also includes the EC Framework Program, and participation in seldom joint research works. No well-balanced system of international relations has been established at the NRUs to date, a small number of universities have begun to change their approach to the English language teaching. The prospects of increasing the number of foreign students from non-CIS countries are illusionary, and invitation of foreign specialists is a luxury which only can be afforded by a few of the universities which have enough money as well as skilled personnel which are able to surmount multiple bureaucratic obstacles related to engagement of foreign personnel.

In the meantime, the analysis of the performance of the NRUs’ programs revealed no losing universities. There are well-founded reasons for failure to provide reports on a series of target values which are not indicative of bad performance of a higher education institution, because if the institution failed to achieve the target indicators’ planned values, this is by no means the evidence of “failure”. Furthermore, it is unwise to absolutize the selected system of indicators in making any managerial decisions, due to primordial imperfection of the former. In addition, unification of the indicators regardless of the profile of a higher education institution can’t be considered as undisputable solution. There is no way medical universities, universities of technology, and classic universities can be compared by applying a single standard, otherwise quantitative data should be thoroughly interpreted based on a fair knowledge of the specifics pertaining to each specific university.

In addition, it should be noted that every NRU set on its own threshold values of the indicators. In some cases they were found to be underestimated and therefore easy to be achieved. From this perspective, it is the requirements for such indicators as the number of postgraduates from third-party institutions, volumes of R&D per research and educational employee, publication activity that should be raised in the first place.

In addition, the assessment revealed that the top managers of the universities neither had well-defined objectives nor understood further steps of the government in developing the system of national research universities. Logically, the following questions arise: whether it is possible to revise the indicators and values thereof; whether the government NRU policy would change if a university changes its legal status; whether variable external conditions (e.g., changes in statutory regulations) would be taken into account in measuring the performance of the NRUs.

Hence, today, both the federal government and the NRUs have no system-based sense of goals and trends in further development of elite universities, thereby creating numerous “areas of uncertainty”. This has an adverse effect both on daily operation of the universities and the possibility to develop long-term operations plans. ●

ASSESSMENT OF BUDGET INVESTMENT EFFECTIVENESS

A.Kireeva

Assessment of budget investment effectiveness is one of the most challenging issues in the investment legislation. To date, no uniform approach has been established to assess effectiveness of spending of budget resources.

General requirements to efficient spending of budget resources are set forth in article 34 of the Budget Code of the Russian Federation under which the principle of efficiency and effectiveness of budget expenditures means that in developing and executing budgets, budget participants must rely, within the scope of budget authorities, upon the need to achieve planned results by spending the least funds or achieving the best result under a specific size of budget financing. Consequently, the concept of effectiveness of with regard to budget expenditures is of estimating nature which allows different approaches to be applied towards assessment of the effectiveness of specific types of budget allocations focused on investments.

There are *two basic approaches* towards enhancing effectiveness of budget resources:

- detail regulation of the procedure for spending of budget funds;
- no detailed regulation of the procedure for spending of budget funds, but simultaneous introduction of strict rules and responsibility for low quality of performance results.

The foregoing approaches can't be applied together in most cases. Where recipients of budget resources observe a procedure which is subject to a strict regulation under the law, the recipients can't be responsible for the final result. For example, the results of implementation of national projects revealed that the state faced a few cases of totally ineffective spending of budget resources in spite of the fact that all the procedures (adopting and developing special-purpose programs as part of national projects, placing of orders, etc.) were formally observed.

In addition, apart from "common" violations in the field of accounting as well as violations in undertaking expenditures which subsequently were not recognized as dedicated expenditures, and failures to observe the procedure for executing documents of budget support recipients, there is a series of violations related to flat misuse by recipients of aid, as well as violations which shows ineffective application of subsidies allocated from the federal budget. *Ineffective spending of funds in implementing the "Health" National Priority Project* Illustrative can be illustrated with the following examples¹.

1. The equipment of a series of medical institutions was purchased at unreasonably high prices. For example, a medical institution in Moscow purchased a U/S unit whose price doubled the mid-market price of the same equipment, according to the invoice, sales slip and budget accounting data. Hence a total of RUB 300 thousand of budget funds were spent ineffectively.

2. A medical institution was equipped with a mobile photofluorography office with a digital photofluorography unit priced at RUB 4633,2 thousand, which became unserviceable more than 20 times since installation, because of computer malfunctioning and lock of the door.

3. Diagnostic equipment, namely stationary U/S units priced at RUB 1472 thousand, 2-workplace X-ray stationary units with linear tomography and mammographs at a total price of RUB 4126 thousand, were delivered, put into operation but stood idle due to a lack of processing machines and materials at a series of municipal medical institutions.

¹ See, e.g., Y.A. Vasilyeva, Audit and Inspection of State-Financed Institutions. What Accountants Should Know? / Audar Press, 2009. 240; T. Silvestrova, The Results of Inspection of the Implementation of the "Agro-Industrial Sector Development" National Priority Project. "State-Financed Institutions: Auditing Business and Financial Performance", 2009, No. 10] ; The Results of Inspection of the Implementation of the "Health National Priority Project. "State-Financed Institutions: Auditing Business and Financial Performance", 2009, No. 9; T.V. Obukhova. Housing and Utilities: Accounting and Financial Violations in Implementing National Projects. "Housing and Utilities: Accounting and Taxation", 2009, No. 9, etc.

4. Enzyme multiplied immunoassay equipment which came with a set of laboratory equipment priced at RUB 893,3 thousand, stood idle due to a lack of trained specialists at a series of municipal medical institutions in the Tula Region.

5. Equipment priced at RUB 1838 thousand stood idle for more than one year due to a lack of premises at a municipal medical institution in the Sverdlovsk Region.

6. The Audit Division under the Presidential Executive Office of the Russian Federation revealed that mediators were paid more than a half of RUB 7,5 billion allocated for the purchase of 170 tomography units for a series of medical institutions.

The major violations were committed in the Rostov Region, where the price of the manufacturer of tomography units, General Electric, equaled to RUB 34,5 million, but the British mediator supplied the equipment to Russia at a price of RUB 71,7 million, whereas the Russian importer sold it at a price of RUB 90,39 million to the Rostov Region under a contract with the public authorities. The markup totaled 262% or RUB 55,9 million per unit of equipment.

7. Audit of spending of the funds allocated to a state-financed medical institution as part of the “Health” National Priority Project revealed that every day during a year the institution purchased and used 100 pieces of batteries at a total price of RUB 1200 to operate its tomography units. Hence the medical institution spent a total of RUB 438 thousand of budget funds during a year¹.

Technical advisors made a search into the matter of replacing the batteries with cells (rechargeable cells) and made a conclusion that technical specifications of cells with 500 rechargeable cycles allow for such a replacement which eventually could have saved a total of RUB 344 thousand of budget funds per year, RUB 688 thousand per two years.

Though procedures for spending of program-based allocations were observed in full, the budget resources were spent much less effectively than they could be in all of the foregoing cases.

The second approach to assessment of effectiveness of budget expenditures implies, conversely, that if it is the results that are first to be monitored, recipients of budget resources must be operationally free in selecting methods to achieve the result. For example, OAO ROSNANO, as development institution, is assigned to develop, based on relevant budget allocations, nanotech industry in the Russian Federation. ROSNANO’s top managers mostly bear a political responsibility as well as run risk of losing the reputation of qualified managers, but they are entitled to select supported projects and distribute the budget allocations among the projects.

It appears that the two examined approaches must be combined according to the types of investment-related expenditures towards which they are applied. At the same time, it should be kept in mind that it is difficult to apply both approaches at a time. Application of the first approach can be efficient:

- in the field of budgeted financing;
- and/or for purchasing bulk goods, works and services to which quality standard requirements may be introduced.

Effectiveness of budget investments in fixed assets of public agencies and state-financed institutions should be controlled through regulation of the procedure, i.e. inspection of how the requirements established by the procurement legislation (in accordance with the procedures established by the Federal Law No. 94-FZ) are observed.

Effectiveness of development institutions as well as legal entities whose establishment was sponsored by the state should be monitored by introducing ultimate result requirements.

There are no statutory requirements to effectiveness of investment-related budget expenditures which are effected without applying the government procurement procedure. The same problem is encountered in allocating investment-related subsidies to state-financed and standalone institutions and making contributions to charter capitals of legal entities, including development institutions.

The following types of spending of investment-related budget resources are suggested to be recognized effective:

- without violating the applicable laws and in compliance with the goals and objectives set by a relevant public, long-term or departmental program or any other regulation;

1 M. Andrianov. Ineffective Spending of Budget Funds. Thought-Provoking Information // “State-Financed Institutions: Auditing Business and Financial Performance”, 2010, No. 3, pp. 34 – 42.

– ensure achievement of immediate and ultimate results (in terms of quantity and/or quality), provided that the size of spending is equal to or less than the originally planned size, as well as goods, works and services are purchased for state needs at prices which are less than or equal to mid-market prices;

– ensures introduction of innovative technologies.

A list of cases in which investment-related budget expenditures can be recognized ineffective, should be compiled on the basis of the documents issued by fiscal control agencies (the Federal Service of Financial and Budgetary Oversight and the Accounts Chamber of the Russian Federation). The list should be made public, because it should be frequently updated based on audits and arbitration disputes.

Hence, from the technical and legal point of view, the approach to the assessment of effectiveness of investment-related budget expenditures must be similar to the approach which is applied to cases when unreasonable tax advantages are revealed. ●

AN OVERVIEW OF ECONOMIC LEGISLATION

I.Tolmacheva

In May 2010, the following alterations were introduced in legislation: the new Federal Law ‘On Licensing of Some Types of Activity’ was adopted.

On 4 May, Federal Law No 99-FZ “On Licensing of Some Types of Activity” was adopted. It is to come into force from 3 November 2011 (with the exception of certain provisions); the Law of 8 August 2001, No 128-FZ, “On Licensing of Some Types of Activity”, will thus no longer be in force.

The closed list of licensed types of activity new Law has been substantially reduced. In this connection, many of the licensed types of activity, which in accordance with the existing Law required applying for different specific licenses, in the new Law have been pooled into more generalized licensed types of activity. Besides, the new Law envisages a single indefinite (without a time limit) license period, and, importantly, it implies that after its coming into force the previously issued licenses shall on the basis of a licensee’s application become indefinite (Parts 3, 4 of Article 22 of the Law).

The exhaustive list of licensed types of activity will consist of 49 items. The exactly specified list of types of work and services that will require issuance of a license must be brought in conformity with the corresponding provisions concerning the licensing of specific types of activity (Part 2 of Article 12 Law). The elaboration and approval of such provisions falls within the powers of the RF Government.

The force of the Law is not extended to the following areas:

- 1) the use of nuclear power;
- 2) production and turnover of ethyl alcohol, alcohol and alcohol-containing products;
- 3) activity relating to the protection of state secrets;
- 4) the activity of credit institutions;
- 5) activity involving the organization of trade on exchanges, operation of exchange intermediaries and brokers;
- 6) professional types of activity on the securities market;
- 7) the activity of joint-stock investment funds; activity involving the management of joint-stock investment funds, share investment funds and independent pension funds;
- 8) the activity of the specialized depositaries of investment funds, share investment funds and independent pension funds;
- 9) the activity of independent pension funds relating to pension provision and pension insurance;
- 10) clearing activity;
- 11) insurance activity.

The licensing of the aforesaid types of activity is regulated by separate federal laws.

Some specific features of licensing may be established by other federal laws with regard to the following types of activity: rendering of communications services, television and (or) radio broadcasting; private detective (investigation) and private security services; educational activity (except that pursued by private educational establishments in the territory of Skolkovo Innovation Center). The licensing of some types of activity that are not specified in the new Law shall be terminated from the moment of its coming into force (Part 1 of Article 22 of the Law).

A license, in accordance with the new Law, is understood as a special permission for the exercise, by a legal entity or an individual entrepreneur, of a specific type of activity (performance of work or rendering of services that correspond to a given type of licensed activity). Such a permission must be confirmed by a document issued by a licensing body on a paper carrier. That document may also be presented in an electronic form (with an electronic signature), if the applicant submits a special request to this effect.

An applicant for a license may receive it only if the former complies with the established licensing requirements.

The licensing requirements may include the following ones:

- the possession, by an applicant for a license or a licensee, of movable or immovable objects necessary for the exercise of a given licensed activity (if those objects comply with the established criteria), the availability of workers complying with the established criteria, and the existence of a system of production control necessary for the exercise of that type of licensed activity;

- the compliance of an applicant for a license or a licensee with the requirements established by federal laws with regard to a legal entity's organizational legal form, the size of a charter capital, and the absence of debts against obligations to third parties;

- special requirements relating to the organization of the rendering of communications services, television and (or) radio broadcasting; private detective (investigation) and private security services, as well as educational activity.

The licensing requirements shall be established by the provisions concerning the licensing of specific types of licensed activity (Part 1 of Article 8 of the Law).

The license received by a licensee in accordance with Part 4 of Article 9 of the new Law shall be effective without a time limit. At present, under a general rule, licenses are issued for a period of five years (Article 8 of Law No 128-FZ).

In addition, the new Law envisages the creation of an open and generally accessible information resource that will contain information from the register of licenses, the provisions concerning the licensing of specific types of activity, technical regulations and other normative legal acts of the Russian Federation establishing the mandatory requirements to licensed types of activity (Article 21 of the Law). The information concerning licenses will be open, and the information on specific licenses will be made available to any persons desiring such information within five working days from the receipt of a corresponding application. ●

AN OVERVIEW OF THE RF GOVERNMENT'S MEETINGS IN MAY 2011

M.Goldin

At its meetings in May, the Presidium of the RF Government considered, among other things, the Draft Federal Law 'On the Introduction of Alterations in Some Legislative Acts of the Russian Federation in the Part of Applying Valuation Standards' and the issue of the introduction of the regulatory impact assessment institute. Also, Chairman of the RF Government Vladimir Putin conducted government meetings on tax policy issues in the part of transfer pricing and taxation in the gas industry.

At its meeting on **17 May 2011**, the RF Government discussed the Draft Federal Law “*On the Introduction of Alterations in Some Legislative Acts of the Russian Federation in the Part of Applying Valuation Standards*”.

The Draft Federal Law was introduced by the RF Ministry of Economic Development. In accordance with Article 18 of the Federal Law “*On Valuation Activities in the Russian Federation*” (in its wording of 28 December 2010, No 431-FZ), the discretion to devise and approve valuation standards, previously vested in the RF Government, should be distributed between the RF Ministry of Economic Development, the National Council for Valuation Activities and the self-regulatory organizations of valuers. At the same time, the Draft Federal Law established that the requirements dealing with the procedure for the conduct of valuation and the procedure for the carrying out of valuation activities should be determined by the standards of valuation activities, including the federal valuation standards (devised by the National Council for Evaluation Activities and approved by the RF Ministry of Economic Development) and the standards and rules of valuation activities (devised and approved by the self-regulatory organizations of valuers).

The Draft Law is aimed at bringing the norms of a number of laws into line with Article 18 of the Federal Law “*On Valuation Activities in the Russian Federation*”.

At its meeting on **26 May 2011**, the RF Government considered the issue of the introduction and further development of the regulatory impact assessment institute in the norm-making activities of the RF Government and the federal bodies of executive authority. The RF Ministry of Economic Development's representative addressed the meeting with a report on that issue.

Generally, the term “*regulatory impact assessment*” means the procedure for revealing and assessing the possible advantages, disadvantages and effects of a new or already existing state regulation.

The decision that regulatory impact assessment instruments should be used in the norm-making activities of the RF Government and the federal bodies of executive authority was adopted in May 2010.

In order to develop this institute in the Russian Federation, the mandatory responsibility to carry out regulatory impact assessment at the early stage of a draft normative legal act's development (in the course of feasibility studies and alternative analysis) will be vested in the federal body that is developing the draft law. The RF Ministry of Economic Development will preserve its powers to draw conclusions with regard to draft normative legal acts, including on the issue of whether or not the developer has observed the procedure for regulatory impact assessment, as well as with regard to the completeness and objectivity of this assessment. This initiative will be introduced into practice step by step.

Also, the RF Ministry of Economic Development should form an information database and devise sample approaches to assessing the impact of the most widely used measures of state regulation usually selected by law developers (mandatory liability insurance, mandatory self-regulation, licensing and accreditation, etc.). These database and sample approaches will simplify the task of assessing the expected costs and advantages of regulation.

It is planned that the sphere of application of the regulatory impact assessment institute will be expanded within the framework of this institute's further development. It is planned that regulatory impact assessment will be extended to other draft laws in the event that they interfere with the interests of subjects of entrepreneurial activity.

In May, Chairman of the RF Government Vladimir Putin conducted two government meetings on tax policy issues.

On **18 May 2011**, at the government meeting on the issue of tax legislation in the part of transfer pricing, Chairman of the RF Government Vladimir Putin, the RF Ministry of Finance and the Russian Union of Industrialists and Entrepreneurs reached an agreement on the new wording of the draft law on the introduction of alterations in the RF Tax Code in the part of transfer pricing.

In conclusion, the meeting took the decision that, in order to become an in-full-effect document, the draft law will require a certain "period of transition". Thus, in 2012, transactions between Russian organizations will be subject to control in the event of the total sum of such transactions exceeding 3 bn Rb; by 2014, this threshold will be decreased to 1 bn Rb. A two-year "period of transition" will also be established in the part of special tax regimes (in particular, for the period of transition, the threshold for transactions where one of the parties is a Common Economic Zone resident will be increased to 1 bn Rb). Also, if in the course of tax verifications the tax authorities should expose some cases of transfer pricing for 2012–2013, a moratorium on the use of fines in the amount of 40 percent of the non-paid tax will be introduced.

The meeting made the decision that the draft law on transfer pricing should be adopted simultaneously with the draft law on consolidated groups of taxpayers.

On **27 May 2011**, Chairman of the RF Government Vladimir Putin conducted a government meeting on the issue of taxation in the gas industry. The meeting was carried out within the framework of preparing the 2012–2014 budgets. In the course of the meeting Vladimir Putin noted that, from 1 January onwards, for the first time in five years, the mineral extraction tax on natural gas was increased by 61 percent. At the same time, the zero rate was preserved for regions without infrastructure (the so-called difficult-to-access regions) and for the projects of building liquefied natural gas enterprises. Among other things, the meeting was devoted to the issue of keeping a proper balance between the necessity for the State to implement its social liabilities at the expense of budget revenue and the need to implement the investment programs of gas companies. ●

A REVIEW OF TAXATION REGULATORY DOCUMENTS ISSUED IN THE PERIOD OF APRIL AND MAY 2011

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1. One more phenomenon should be highlighted in continuation of the analysis of trends in the field of taxation and mandatory payments which was made in the previous review. The phenomenon refers to a specific group of payments which is defined as payment for public services, i.e. the services provided by the state, namely payment for works or services which under the applicable legislation the taxpayer must purchase from an authorized person and pay for running a business. These services include due diligence, surveys, etc. Paid public services are intended to ensure observation of certain rules and regulations applicable to different types of activities in the society. The state empowers itself and authorized public entities to provide such services on a mandatory payment basis.

It is uncontroversial that rules and regulations applicable to specific types of business should be subject to regulation (namely sanitary and epidemiological requirements, and requirements to nuclear facilities safety insurance, and requirements and rules established by the urban planning law, etc.), as well as independent control of the observation thereof should be provided. The question is how to select entities which would provide such services. In theory, the state, being entitled to establish and collect taxes (mandatory non-refundable payments) payable to the budget, must provide public services free of charge. Introduction of mandatory payment for public services is a form of contingent tax liability whose size is not linked to the size of marginal tax burden on businesses, and expenses on payment are forcibly included into the price of goods (works, services) taxpayers – manufacturers of goods (works, services).

Non-competitive delegation of powers to state unitary enterprises or public institutions would establish state monopoly on respective services and purposefully assign specific public agencies or subordinate entities to collect mandatory payments.

Once hidden taxes begin to take a form of artificial public service monopoly, the factor of monopoly price is triggered. Being the monopolist in the public services market, public agencies or their authorized entities (like any other monopolist) would be very much drawn to higher monopoly price. Therefore, if public services become payable, the level of burden on taxpayers would tend to grow uncontrollably, faster than growth in the market price index. This is a clear evidence of the development of contingent tax liability which is not governed by the principles of market tax system, (equity, neutrality to types of taxpayers' revenues, legal status, and territorial quality) with the possibility to arbitrary change the burden on businesses.

If the aforementioned services, which the society recognizes as essential, would be provided within the scope of market regulation, i.e. an entity would be entitled to provide such services on a competitive basis, such paid services would be provided within the scope of market relations. This would allow market conditions to influence the size of payment while the payment itself would be classified as a taxable sale revenue for the commercial provider. As it follows from the case under review, a relevant service would be provided at a market rather than monopoly price.

It should be noted, like we already did in our previous reviews, that the decisions which have recently been made in the field of economy are very controversial. On the one hand, Federal Law dd. 4.05.2011, No. 99-FZ was adopted, which allows for major shortening of the list of licensable types of activity, i.e. the activity which is subject to a special permit (issue of licenses is taxable in the form of a state due). Revocation of any type of licenses means elimination of administrative restraints and expansion of the competitive market sector as well as release of the tax burden due to abolishment of the state due.

On the other hand, the quantity of activities subject to a direct state monopoly on the provision of paid services is increasing. The Order of the Government of the Russian Federation dd. 6.05.2011,

No. 352, approved a list of services “which are indispensable and mandatory for the provision of public services by federal executive authorities and provided by organizations participating in the provision of public services”. A positive aspect about this is a summary list of paid public services which was compiled within the framework of the Order. The preamble of the previously effective Order of the Government of the Russian Federation dd. 2.12.2009, No. 984 contained a list of regulatory documents which establish one or another paid public services which are governed by special regulations and regulatory documents rather than the Order. The list was unified by the Order of the Government of the Russian Federation dd. 6.05.2011, No. 352. Meet with approval should be the fact that control of the size of payment for public services was assigned to the sole ministry – the Federal Antimonopoly Service of the Russian Federation – as opposed to the previously applicable arrangement. Since the Federal Antimonopoly Service (represented by the Federal Tariff Service) controls tariffs of natural monopolies, we can witness convergence of methods of control of prices set by natural monopolies and payment for public services.

In spite of an attempt to unify the list of public paid services within the framework of the Order of the Government of the Russian Federation dd. 6.05.2011, No. 352, the list doesn't prevent introduction of other mandatory payments. For instance, the mandatory payment in compensation for damage inflicted by heavy-duty (more than 12 tons) motor vehicles on public federal motor roads, introduced by the Federal Law dd. November 8, 2007, No. 257-FZ, as amended by the Federal Law dd. 06.04.2011, No. 68-FZ), which was mentioned in the previous review, was not included into the aforementioned unified list.

The currently applicable judicial system doesn't prevent the establishment of new mandatory payments or paid public services outside the scope of the Tax Code of the Russian Federation. If a provision appears in the law on that the Government of the Russian Federation or government authorities of the constituent territories of the Russian Federation should establish a procedure for relevant mandatory payment, it would be sufficient for judicial authorities to recognize that the establishment of such a payment is legitimate.

The Constitutional Court of the Russian Federation provided explanations, in particular that decisions of the Government of the Russian Federation are based on the powers which are vested by the Constitution of the Russian Federation (the Order of the Constitutional Court of the Russian Federation dd. 17.06.1998, No. 22-P refers to the articles of the Constitution of the Russian Federation: 71 “и”, 110, part 1, 114 “г”, 115, part 1) rather than federal laws. However, since the principle of division of powers (article 10 of the Constitution of the Russian Federation) reads that composition of budget revenues and expenditures is to traditionally be determined by statutory regulation, mandatory payments to the budget system may be made subject to permission from the federal law-maker (see the Ruling of the Constitutional Court of the Russian Federation dd. 19.01.2005, No. 40-O).

Following is a series of fundamental differences between the schemes of imposition of taxes as part of the Tax Code of the Russian Federation and pseudo-taxes as mandatory payment for public services. First, the tax burden as part of the Tax Code of the Russian Federation is allowed to be changed only from the beginning of a new fiscal year, thus allowing for maximum transparency in assessing compliance of the sources of budget revenues with appropriation of the same. Second, the Tax Code of the Russian Federation and the Budget Code of the Russian Federation determine a strict relationship between making decisions on changes in the existing tax system and the federal budget's obligation to compensate regional and local budgets for revenues which are not derived as a result of the decisions made. Third, article 3 of the Tax Code of the Russian Federation reads explicitly that taxpayer's actual playability (c. 1) must be taken into account in establishing taxes and dues, taxes and dues may not be of discriminating nature (c. 2), must be economically substantiated and can't be arbitrary (c. 3), taxes and dues which violate the single economic space, in particular limit, directly or indirectly, free movement of goods (works, services, financial resources) within the territory of the Russian Federation or otherwise restrict or impede legal economic activity of individuals and legal entities must not be established. Unfortunately, these rules are not applied to mandatory payments introduced by non-tax laws. To legitimate a special-purpose mandatory payment, it would be suffice to include a provision into the industry-specific law on that the procedure and amount of the payment is to be established in accordance

with the procedure established by the Government of the Russian Federation or local government authorities. This allows the Government of the Russian Federation and/or government authorities of the constituent territories of the Russian Federation and local government authorities to change the burden on manufacturers within a year outside the scope of the Tax Code of the Russian Federation and the Budget Code of the Russian Federation and exclusively on the basis of their own decisions. In our opinion, such an approach is exposed to serious adverse affects.

Following is an illustration of the foregoing. The Federal Law dd. 21.04.2011, No. 69-FZ introduced amendments to the Federal Law dd. 6.10.1999, No. 184-FZ “On General Principles of Organization of Legislative (Representative) and Executive Government Authorities of the Constituent Territories of the Russian Federation” under which the government authorities of a constituent territory of the Russian Federation are entitled to set up and ensure functioning of paid parking lots (parking spaces). If effect, it means introduction of a local tax on the right to have (park) motor vehicles on the territory of a constituent territory of the Russian Federation. As opposed to the land tax which can be established according to the common principles applicable on the entire territory of the Russian Federation and regulated by the Tax Code of the Russian Federation, the rules for payment and size of a parking charge will be governed by regional interests and decisions of regional authorities.

During the tax and budget reforms which were carried out early in the 2000s, one of the most serious issues was to prevent dissipation of Russia as the single economic space, which was only achieved through introduction of a single tax system and legal distribution of sources (by type and share) at the levels of the budget system. In our opinion, reluctance to apply such an approach, which also manifests itself as expansion of all kinds of paid services provided by public agencies at different levels which are not governed by the principles of free competitive market or beyond the scope of the tax regulation whose principles are established in the Tax Code of the Russian Federation, may eventually lead to territorial disunity and create difficulties for free economic activity on the entire territory of the Russian Federation.

2. As part of practical work with the documents issued by the Customs Union (hereinafter referred to as the CU), the Ministry of Finance of the Russian Federation, the Federal Tax Service of the Russian Federation and the Federal Customs Service of the Russian Federation prepared a few letters which contain technical recommendations on how Russian taxpayers can use the CU's documents.

2.1. The Letter of the Federal Tax Service of the Russian Federation dd. 10 May 2011, No. AC-4-2/7439@ explains the procedure for filling out an application for export of goods and paying indirect taxes. Where no invoices are provided for by the internal documents of a CU member country, it is more than sufficient for Russian taxpayers to specify the particulars of any other document provided for by the legislation of a relevant CU member country, which must contain the price of imported goods. Paragraph 15 of the Application (which specify the VAT taxation base, including for goods (works, services) exempt from taxation) must be filled out on a mandatory basis.

2.2. The Letters of the Ministry of Finance of the Russian Federation dd. April 14, 2011, No. 03-07-06/110, the Ministry of Finance of the Russian Federation and Federal Tax Service of the Russian Federation dd. April 28, 2011, No. AC-4-3/6961@ explain the procedure for confirming the right to exemption from excises in exporting excisable goods from the Russian Federation to the CU member countries. Under the CU, the procedure for exemption from VAT and excises in exporting goods from the Russian Federation to a CU member country is regulated by clause 1, article 1 upon presentation of the documents provided for by clause 2, article 1 of the Protocol for **the Collection of Indirect Taxes and the Mechanism for Ensuring their Payment During the Import and Export of Goods within the Customs Union**” dated 11.02.2009 (as amended and restated on 18.06.2010), which was ratified by the Federal Law of May 19, 2010, No. 98-FZ. The aforementioned Protocol confirms that the national legislation must be applied in such a case.

2.3. The Letters of the Ministry of Finance of the Russian Federation dd. April 8, 2011, No. 03-07-06/97, the Ministry of Finance of the Russian Federation and the Federal Tax Service of the Russian Federation dd. April 30, 2011, No. AC-4-3/7112 explain a common procedure for confirming exemption from excises on goods which were previously exported to CU member countries, if they

were subsequently moved from the territory of the Customs Union. The Ministry of Finance of the Russian Federation approved that all excisable goods (not only oil products) must be governed by the provisions of paragraph 3, clause 7, article 198 of the Tax Code of the Russian Federation under which within 180 days from the day of sale of goods a Russian tax authority is to be provided with a customs declaration (or a copy thereof) for the goods which contains only customs stamps affixed by the Russian customs authority which performed customs clearance of these exported goods. Actual export of goods via the territory of other CU member countries (i.e. confirmation of the export from the CU customs territory) is to be confirmed by a tax authority by directing a relevant query to the Orenburg or Smolensk Customs.

2.4. The Letter of the Federal Customs Service of the Russian Federation dd. April 29, 2011, No. 01-11/19942, explained the procedures for confirming and refunding overpaid customs payments.

The fact of overpayment of customs duties, taxes can be confirmed by making amendments to the declaration on goods based on the decision of a customs authority, in which case the amount of payable customs payments is to be adjusted as well.

Upon presentation of a court-issued order of enforcement to a customs authority, which is res judicata and binds the customs authority to refund, the refund can be made without the payer having to specify the revised amounts of customs duties, taxes and submit an application for refund. It means that the Federal Customs Service of the Russian Federation doesn't consider the amounts, which are refundable under the order of enforcement, as refund of overpaid duties, taxes, because these amounts already incorporate all the liabilities which the court decided to take into account. In our opinion, this position of the Federal Customs Service of the Russian Federation is disputable, and legal cases concerning classification of this type of payments are very likely to be filed in courts.

3. The Letter of the Federal Tax Service of the Russian Federation dd. April 22, 2011, No. KE-4-3/6526@ provided explanations on the issues referred to taxation of apartment owners partnerships (AOPs). In particular, the Federal Tax Service of the Russian Federation places emphasis on the fact that under the simplified tax system (STS) the composition of revenues excludes the items listed in article 251 of the Tax Code of the Russian Federation. Under the article, when AOPs, which apply the STS, determine the tax base, they may not consider entrance fees, membership fees, donations, as well as contributions to the creation of provisions for repairs, overhaul of the common property which are performed by the members of such AOPs.

Other payments made to an AOP by its members will be included into taxable revenues on the basis of the subject-matter of agreements concluded between the AOP and the members. If the AOP enters in its own name (i.e. is not acting as mediator between the members and the providers) into agreements with providers of works (services), the amounts paid by the members to finance this activity constitute revenues from sale of works (services) AOPs. If the amount of a tax assessed according to the general procedure appears to be less than the amount of the assessed minimum tax, the AOP, which applies the STS, would become obliged to pay a minimum tax accounting for 1% of the tax base determined with the STS.

Where an AOP on behalf and for the account of its members enters into agreements with providers of works (services) (i.e. is acting as mediator), the AOP's taxable revenue would include commission, agency or any similar fee.

4. Under the Letter of the Ministry of Finance of the Russian Federation and the Federal Tax Service of the Russian Federation dd. March 25, 2011, No. KE-3-3/926, compensation for hotel and travelling expenses must not be included into the income of an individual who is invited by an organization to participate in a conference (seminar). In concluding a civil law contract (contract agreement) for works and services as part of a seminar (conference), the amount of compensation for the expenses incurred by such a participant under the contract must not be included into the tax base of the participant, as provided for by clause 2, article 709 of the Tax Code of the Russian Federation. The remuneration, which is provided for by clause 2, article 709, is subject to personal income tax.

5. A very interesting solution was revealed, which taxpayers use to avoid VAT on advance payments. Instead of advance payments (prepayment, down payment), they use so-called security deposits which the payee transfers to the seller's account. Such a situation was explained, in particular in the Order of the Federal Antimonopoly Service of the Moscow Federal District dd. 27.04.2011, No. KA-A40/3679-11, which reads that security deposits constitute a form of security of a deal, and there is no reasons to consider them advanced or down payment. However, in executing a deal which includes security deposits rather than advance payments, the buyer, in our opinion, is exposed to risk, because the buyer closes a deal which is not secured by counter obligations, and the buyer would not have grounds to demand from the seller to complete the deal.

6. The fact that the Tax Code of the Russian Federation includes different tax treatments often leads to uncertainty which may arise during investigation into the possibility of applying one or another tax treatment. In such cases taxpayers apply to the Ministry of Finance of the Russian Federation for explanation or file a legal action in a court.

For instance, the general profit tax treatment and the single tax on imputed earnings (STIE) differ totally. The list of payable taxes and the level of the tax burden in these cases differ totally. Wrong selection of a taxation scheme may result in material financial losses for taxpayers and the treasury, because a decision which leads to decrease in regional and local budget revenues may subsequently make the federal budget obliged to compensate them for lost revenues.

An example of disputable situation is given in the letters of the Ministry of Finance of the Russian Federation dd. April 12, 2011, No. 03-11-06/3/44, dd. 22.04.2011, No. 03-11-09/29, the Ministry of Finance of the Russian Federation and the Federal Tax Service of the Russian Federation dd. May 10, 2011, No. KE-4-3/7455@, which provided explanations about taxation of sale of goods which a third party manufactured for the taxpayer of the raw materials supplied by the taxpayer (hereinafter referred to as sale of goods manufactured of customer-supplied raw materials). The point is that wholesale trade doesn't fall within the scope of the STIE, whereas sale of goods manufactured of customer-supplied raw materials is subject to the general profit tax treatment.

It should be noted that the Ministry of Finance of the Russian Federation and the Federal Tax Service of the Russian Federation previously took a stand on that transfer of raw materials for processing was considered as a part of the manufacturing process performed by the taxpayer. The foregoing public agencies took a different stand which was in line with a series of judicial authorities' opinion (the Ruling of the Presidium of the Supreme Commercial Court of the Russian Federation dd. 14.10.2008, No. 6693/08, the Federal Antimonopoly Service of the Volga Federal District dd. 08.05.2009 with regard to case No. A12-12331/2008, the Federal Antimonopoly Service of the Central Federal District dd. 20.05.2009 with the regard to case No. A14-5951/2008/132/33, the Federal Antimonopoly Service of the West Siberian District dd. 12.02.2009, No. F04-7936/2008 (18119-A27-29) etc.) on that manufacturing of customer-supplied raw materials must not be regarded as taxpayer's in-house manufacturing.

In our opinion, the issue remains to be resolved, because the taxpayer sells raw materials. The taxpayer transfers rather than sell raw materials to the counteragent, in other words, the owner remains the same and no assets are deducted on the balance sheet. The taxpayer remains the manufacturer and books eligible costs which under the accounting rules must be included into the price of products, regardless of the fact that they are manufactured through outsourcing (i.e. counteragent). Court rulings failed to explain how taxpayers should recognize related expenses, if any, namely interest, if raw materials, which were transferred for processing, were purchased against a credit; costs on payment for public utility services, if the counteragent processed raw materials on the customer's territory, etc. In our opinion, the stand taken by judicial authorities should be supported by more reasoned explanations, because it affects interests of the budgets of the constituent territories of the Russian Federation and local budgets. ●