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RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES 07'2010

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BASIC DEVELOPMENTS AND TRENDS IN JULY 2010

July was full of political events. Alexander Lukashenko, under pressure from Moscow has signed the documents of the Customs Union, which started formally to operate, though the contradictions among its participants still exist. Kremlin continued its attacks against the “old-time” Governors who belonged to the political elite of the 1990’s: after Menteymir Shaimiev, the President of Tatarstan, were forced to retire Murtaza Rakhimov, Bashkortostan President, who ruled since 1991, Nikolay Fyodorov, who governed Chuvashia since 1994, and Sergey Katanandov, Head of Karelia Republic since 1998.

Resignations demonstrate first of all a growing confidence of Moscow in its ability to keep the situation in the country under control. The policy of the federal center in this case is systemic: the replacement of republican leaders is called upon not only to solve some specific socio-economic problems of the regions, but to increase the actual control of the center over the regional economic and political life, and reduce the autonomy of local governments. In the case of Chuvashia the model of “succession” was implemented - the former leader played a key role in appointing a new Governor; in two other cases the decisive role in selecting candidates was played by external forces and the replacement in leadership will result in a serious redistribution of spheres of influence in those regions.

In July, amendments to the Law on the Federal Security Service were approved by Parliament and signed by the President. The amendments, negatively estimated by human rights’ defenders and the international community, actually legitimize the practice of extrajudicial preventive detentions of political activists and allow the Federal Security Service of Russia to restrict the rights (including constitutional ones) of citizens in administrative proceedings without a charge. A number of scandals and the lack of progress in human rights and constitutional norms defense, as well as in the development of civil society led to the resignation of Ella Pamfilova, Chairman of the Council for Human Rights and Civil Society Development in late July.

* * *

The main trend of the global markets, which has affected the dynamics of the financial markets in Russia in July was Euro systematic strengthening. After declining in the last week of June, Euro strengthened during the month to the level of USD 1.22 per Euro as of June 30 and to USD 1.3 per Euro on July 29. After declining in the last week of June, during the month Euro strengthened to the level of USD 1.22 per Euro as of June 30 and to USD 1.3 per Euro on July 29. This trend has affected not only the changes in the Russian national currency (depreciation of dollar against ruble from RUR 30.74 to 30.26 and Euro upgrading from RUR 38.2 to 39.33), but also the growth and stabilization of oil prices at the level of USD 74-77.5 per barrel (ICE. Brent), and traditionally - the dynamics of the Russian stock market. RTS and MICEX synchronously responded to the stronger dollar and lower oil prices by the drop in the indices at the end of June (RTS index has decreased from 1457 to 1288 points, MICEX index - from 1400 to 1254 points), but then within the month, at the background of weakening dollar, the indices have gradually returned to the previous maximum reached in mid-June.

In July foreign currency and gold reserves of the Central Bank have shown a marked increase after two and a half months of stagnation and fluctuations within the range of USD 454-461 billion. As a result, on July 23 they reached the amount of USD 469.1 billion, what makes 77% of the pre-crisis maximum (USD 598.1 billion), whereas the pre-crisis minimum was USD 376.1 billion, noted on March 13, 2009 (63% of the maximum value).

During the period from July 1 to 26, 2010 consumer price index made 0.4% (against 104.7% at the beginning of the year); over the same period of 2009 the CPI was 0.5%, and the total for

the month was 0.6%. Therefore, in annual terms inflation rate continued to decline (by 5.7% on July 26), but in August one can expect a reverse trend. This is due to the fact that in the past year, beginning from August, inflation was sustained at the zero level for three months. However, the drought that happened this summer in the European territory of Russia can hinder the traditional seasonal reduction in food prices, but on the contrary can provoke their growth. Reduced harvest of grain, vegetables and fodder will boost prices for milk and meat. Meanwhile, the share of foodstuffs in the consumption basket is about 40%, and therefore, altering the balance of the food market will provide a direct impact on the overall consumer price index. A. Klepach, Deputy Head of the Ministry of Economic Development already noted that year-end inflation may slightly exceed the official estimates. It may be noted also, that the June inflation rate in Russia (0.4%) was the highest among 37 countries, taken for comparison by the Statistical Service (the same level of inflation was only in Estonia and Latvia).

By the end of June the monetary base (in broad definition) increased as compared with May by 5.6% to RUR 7.2441 billion. In total for the first six months of 2010 it increased by 12%. Suspension of excessive reserves of commercial banks growth in May proved to be episodic, in June they increased by 13.5%. In view of the accumulated excessive liquidity in the banking system, interbank rates continued to decline, having reached 2.6% in June, but in July they showed a tendency to some increase. For the third consecutive month economy lending by the banking sector is growing; according to assessments of the Central Bank management, loans to non-financial sector in June increased by 2.1% as compared with the previous month (by 1.9% in May), and by 1.5% to individuals (1% in May). This allows the bank of Russia to suspend the policy of lowering interest rates, as well as to continue cutting down anti-crisis measures to support the banking sector.

* * *

Published in July key indicators of socio-economic development for the first six months of 2010 allow to compare them with similar data of the last year (the peak of the crisis) and to assess the level of post-crisis economic recovery. Thus, the GDP for the first six months of 2009 amounted to 89.9% of the first six months of 2008 level (pre-crisis maximum), and for the first six months of 2010 – 104.2% against the level of the first six months of 2009. Thus, GDP of the first six months of 2010 amounted to 93.6% from the pre-crisis level. Real disposable income reached 107% of the pre-crisis level, while the real wages rose much more modestly, having reached 101.5% against the first six months of 2008 level. The retail trade turnover of the first six months has also exceeded the pre-crisis level (100.9%). Rapid recovery of foreign trade has regained only a half the crisis gap in this sector: in the first six months of 2010 foreign trade turnover amounted to 78.5% against the first half of 2008 (as compared with 55.8% in the first six months of 2009). Industrial output reached 94.4% against the pre-crisis level, as compared with the downfall to 85.7% in the first half of 2009. Thus, industry has regained 60% of its crisis reduction. Similar recovery rates are demonstrated in the dynamics of cargo turnover: in the first six months of the current year it amounted to 92.6% against the level of the first half of 2008, while in the first half of 2009 (at the peak of the crisis) it was 82.5% of the pre-crisis value.

The most serious is the situation in the investment sector. Due to the extremely optimistic tentative estimates of the Russian Statistical Service, investment activity in the second quarter of 2010 has grown by 5.3% as compared with the level of the same period in 2009. Basing on the results of the six months, one can speak of the termination in the decline of investments: as of the first six months performance, investments in the fixed assets amounted to 80.4% versus the pre-crisis level (against 79.4% in the first half of 2009). However, even in the I quarter of 2010 there was still a decline in this area: 78.8% against the level of the I quarter of 2008, whereas in the first quarter of 2009 investments amounted to 82.7% against the pre-crisis level. In the construction industry the decline continues: in the first half of the year the construction scope amounted to 78.2% of the level of the first six months of 2008 (versus 80.7% in the first half of 2009). Here, however, tentative estimates for the II quarter of 2010 demonstrate a possible opposite trend: the scope of construction works in the II quarter of 2010 amounted to 99.9% as compared with the second quarter of 2009, while commissioning of the residential housing has demonstrated growth already by 7.5% against the relevant period of 2009,

while in the first quarter an intensive decline to 91.7% was noted as compared with the first quarter of 2009.

Positive dynamics in the industry in the second quarter (growth by 10.9% against the same period in 2009) is largely based on the development of the processing industry (an increase by 14.3%). However, estimating the growth in manufacturing sector, it should be borne in mind that we are dealing with the effect of base: in the second quarter of 2009, the recovery in the manufacturing sector has not started yet. In total, the output in processing industry as per the first six months made 88.8% of the pre-crisis level (as compared with 77.7% in the first half of 2009), which corresponds to the average recovery rates in the industry.

The volume of the raw materials industry has exceeded the pre-crisis level, having reached within the first six months 101.7% versus the level of the first half of 2008. Strong growth in machinery and equipment (121% versus the first half of 2009) should also be considered in the context of the effect of the base and the depth of the crisis: as per the first quarter results, the volume of production in this sector amounted to 72.4% against the pre-crisis level (59.7% in the first half of 2009). IEP industrial surveys demonstrated some deterioration in assessments of demand by the middle of summer: again the majority of heads of businesses are evaluating the demand as "below normal", and the minority of them evaluate it as "normal", while in early summer the situation was reversed. Herewith, the estimates of the output rate in June were steadily upgrading, and no decline is planned in any of the branches in July-August. According to estimates of enterprises, price growth for products in June has stopped, which is apparently correlated with the deterioration of the current estimates of demand (according to the Russian Statistical Service, producer prices decreased in June by 3.1%, while in previous months their growth was about 3% per month). However, the companies expect a renewed growth of prices in July and August. The average credit interest rate for all groups of enterprises continued to decline, with the most intense decrease in June for small enterprises; as a result, the level of differentiation depending on the size of business has somewhat reduced: large companies (with more than 1000 employees) can obtain credits borrow at the rate of 12.6 % (the average rate in May was 12.9%), medium-sized businesses (250-500 employees). – at 14.7%, and small businesses (1-250 people). - at 15.9% (17.1 % before). ●

POLITICAL AND ECONOMIC RESULTS OF JULY 2010

S.Zhavoronkov

In the month of July was finally adopted the President's draft law on police, which has strengthened responsibility of the Ministry for Internal Affairs officers for their offenses, and at the same time expanding the powers of the Federal Security Service of Russia (FSB) In particular, the FSB officers are allowed to give warnings to citizens on their unlawful actions, the breach of which is punishable by 15 days of administrative arrest. We'll see later the extent of danger of this law. In the Government, arguments about the privatization of national property became more acute, although only non-controlling shares of large state enterprises were under discussion. Meanwhile, the supporters of privatization have did not succeed to reach any definite decisions. M. Rakhimov, the Head of Bashkortostan, one of the most popular regional leaders has resigned from his post, and it seems, in contrast to Tatarstan, there will be no succession in this region. .

The State Duma and the Federal Council have approved draft law, introducing amendments to the effective Law "On Militia". According to it, the Ministry of Internal Affairs shall not employ former convicts, people with expired terms of criminal records and the participants of the criminal cases closed for the lapse of time or for a reconciliation of the parties. The above requirements are applicable to both, newcomers in the service, and acting police officers. Herewith, there are remarkable exceptions from the case: the cessation of prosecution under an amnesty, the closure of the case because of his sincere repentance and serious crimes against the person - the intentional infliction of physical harm, assault, defamation, without aggravating circumstances and the offense, if the victim has withdrawn the requirement for attracting the employee to criminal liability - all these circumstances do not prevent work with the Ministry of Internal Affairs. Besides, a crime of a MIA officer will not serve as an aggravating circumstance.

However, it is interesting, that the Federal Council rejected the draft law submitted by the President of Russia and accepted by the State Duma on the recruitment of police officers. According to the draft law, it was assumed that the potential employees had to undergo tests for alcohol and drug dependence, as well as psychological investigation. In addition, recruits were to get references from the working police staff members. However, the draft law concerned not all police officers, but only the list of them referred to the competence of the RF Minister of Internal Affairs.

Anyway, Dmitry Medvedev promised before the end of the year to submit to the parliament a new version of the draft law "On Militia" and related laws, so the final state of the reform of the Ministry of Internal Affairs will be clear later. As to the already adopted laws, in general, they can be assessed as positive, but insufficient. Even disregarding the essence of the reform of the Ministry of Internal Affairs, it is clear that it would be desirable to introduce the same reform provisions with respect to all employees of law enforcement agencies.

The Parliament has adopted and the President of Russia signed amendments to the law on the FSB, as well as to the Code of Administrative Offences, the adoption of which in the first reading has caused a serious scandal a month ago. The essence of this law is that the FSB is allowed to issue warnings to the citizens that their actions, according to the Service understanding, could lead to the law offences. If citizens would do not obey, a lawful order or request of the FSB officer order, they face fines ranging from RUR 500 to 1 thousand or administrative detention for up to 15 days. We'll see in practice the real harm of this law enforcement practice, but now it looks rather scary. There were no special events in political sphere. E. Pamfilova, the Head of the Presidential Council on Civil Society Development, who was regularly speaking in favor of human rights respect has retired. However, the real weight of this event was very low, it was not monitored in the last two years.

In early July, the event occurred, that reminded the Cold War - in Vienna, there was an exchange of a group of Russian citizens detained in the US, for a similar group of Russian nationals

convicted in Russia. Ten spies exposed in the US, were exchanged for four individuals convicted of espionage, including J. Sutyagin, a young scientist recognized as the world's political prisoner, who was convicted 10 years ago.

In early July, three Heads of the Russian republics - the political long-livers have resigned: M. Rakhimov, Bashkortostan Leader, who ruled since 1991, N. Fyodorov, who governed Chuvashia since 1994, and S. Katanandov, Head of Karelia. In poor, but very stable in all respects Chuvashia, in place of Fedorov was appointed one of his successors, Deputy Prime Minister M. Ignatiev, in place of Katanandov, who was accused of a variety of faults - from political instability in the country (riots took place in the republic on a national basis in Kondopoga) to economic autarky and isolation, the former member of the Federation Council of the Republic, a native of St. Petersburg Business A. Nelidov was appointed.

But most interesting is the situation in Bashkortostan, whose leader as early as in the 90 years was a symbol of regional separatism, and was carefully building its own, separate from the Russia legal framework, taking advantage of the fact that Moscow has failed to include basic economic infrastructure of Bashkortostan in the list of voucher privatization, carried out in 1992-1994, so the vouchers remained the property of the republic. In the 2000s, Rakhimov not only did not lose influence, but also expanded it by transferred the main objects of the national fuel and energy industry to the business structures of his son Ural. Moscow did not dare to resolve this conflict through enforcement, and there began a prolonged litigation in regard to the fuel and energy industry, which ended with the resale of assets to B. Yevtushenkov's business structures. Immunity Rakhimov has largely been associated with fears of the complex ethnic situation in the country, populated by Russians, Tatars and Bashkirs in almost equal proportions (although many felt that it was Rakhimov action, who created ethnocracy in a multinational republic, promotes the rise of those problems.) R. Khamitov, appointed to the post of the new Head of the republic, in the 90-ies and the beginning 2000s worked in the republican government, was recently working in "InterRAO". Khamitov made a statement that he intends to temporarily manage the government, as Prime Minister R. Sarbaev has resigned, while Rakhimov has been appointed to the representative position of Adviser of Bashkortostan Presidential on volunteer basis. Judging by Khamitov's declarations, his task is radically to "mop up" the Republican government of old personnel in view of the new interests of those who appointed him. Surprisingly, the change of power in the republic, as many people expected, did not provoke any disaster - local elite interest to get adapted to the new appointments, and only later, if they fail in it, we one can expect some resistance.

In the economic sphere, July was marked by three important subjects: formation of the Customs Union of Russia, Belarus and Kazakhstan, the discussion in the Government of the basic indicators of the federal budget for 2011 and up to 2013, and in this relation, discussion on the possible privatization of the state property.

On July 5 the ratification on the part of Belarussia the Customs Code of the Customs Union of three countries was announced (the other two have done this before). Russia has refused to make concessions and cancel export duties on oil and petroleum products from the July, which Belarus was insisting on. As a result, export duties will remain unchanged before formation of the Single Economic Space (CES) - presumably, to 2012. However, Russia has declared a possibility of more rapid formation of the EEA, if there are appropriate conditions. The threat of the restoration of the customs border has worked - the bulk of Byelorussian export is made to Russia.. Gazprom, however, had to make concessions in the dialogue about raising gas prices for Belarus, and on the contrary, reduce the rates for pumping gas through Belarus to Russia (the current agreement valid before 2011 provides for annual adjustments). As a result, Gazprom even has indebtedness to Byelorussians in the amount of USD 32 million. To resolve this issue, the Belarus intention to take gas, relying on the position of force, persuaded the Russian side. On top of economic controversies, a public spat has been raised after the film "God daddy" was demonstrated on the Russian NV, accusing Lukashenko of committing serious crimes, in particular, contract murders, and on Belarusian TV - an interview of Mikhail Saakhashvili with his view on the war in 2008.

The Russian government has approved the main indicators of the federal budget for 2011 and the planning period to 2013. Its revenues for the year are assumed to be at the level of 17.4 per

cent, 16.5 per cent and 16.1 per cent of GDP, respectively, while expenditures are expected to make 20.9 per cent, 19.6 per cent and 19 per cent of GDP. Therefore, the budget deficit in the next three years will reach 3.6 per cent, 3.1 per cent and 2.9 per cent of GDP, respectively. It will be funded from the Reserve Fund and foreign loans. The budget is execution implies to increase the cost of the federal targeted program (FTP) in 2011 by 19%, the growth of basic pensions by 9 per cent and military spending (to 2013) by 60 per cent. The expenses for the state administration will be reduced, although not much, as well as for public utilities, education, healthcare.

Extensive discussions took place about the proposal on privatization program for non-controlling packages of the major Russian companies. Proposals made by the Ministry of Finance and Ministry of Economic Development originally were rather optimistic – within three years it was proposed to sell shares in state companies for 600-800 billion rubles, including those of Sberbank, VTB, Transneft, Rosneft, Sovekomflota, Russian Railways, FGC, RusHydro and others. However, as a result of debates, Minister of Finance Alexei Kudrin acknowledged that Russian Railways, AHML and Rosneft in the nearest years will be excluded from the privatization list, and considerably smaller businesses will replace them- such as Rosspirtprom and Rosagroleasing. However, one cannot guarantee that the return to privatization happens at all - it was promised by the First Vice-Premier Shuvalov a year ago, but there are no visible effects so far.

It is unclear in what scope the Government's proposal to increase the fuel excise and mineral extraction tax will be approved, but now the government has already rejected the idea to increase excise taxes on strong alcohol.

In July, however, the largest deal since 2008 was announced: Lukoil confirmed redemption at ConocoPhillips first 7.6 per cent of its shares for 3.44 billion dollars in this year, and buy the balance of the 20 per cent package inclusive before 2011. We would like to recall that in 2004-2005, the deal to sell state-owned Lukoil shares became the last major privatization transaction. The background of the sale were mainly economic reasons - ConocoPhillips is implementing a program of selling its assets all around the world, but one cannot neglect that the company had previously regarded this asset as a very important one its sale was not discussed. However, Lukoil, remains a private company, in which the major shareholder is V.Alekperov and his entourage.

In July, the gunmen made a diversion to the Baksan hydroelectric power station in Kabardino-Balkaria - killing two police officers guarding it, they blew up two of the three generating units. The power of this old station is rather low - 25 MW, energy consumers have not suffered from the attack, there was no threat of flooding of human settlements, but the station suffered damages amounting to at least USD 50 million. There were new attacks of the railway, the nodes and communication towers in Dagestan. In the North Caucasus Islamic underground, thus, begins to focus not only on the fight against security forces and suspected of supporting the effective government, but also to sabotage with the aim to destabilize the situation on the one hand, and the strengthening of racketeering entrepreneurs and government officials on the other. In any case, the diversion revealed the weak points in the life support system (e.g., it is found out that at such objects as hydropower plants, there is no video surveillance, and there were only two security guards there), though there was no deficit in the local law enforcement agencies neither in terms of human resources, nor in their powers. ●

INFLATION AND CREDIT AND MONETARY POLICY

N.Luksha

In June, inflation has slowed down again: CPI as of the month results amounted to 0.4 per cent. Three weeks of July have added 0.3 per cent more to the annual inflation. Thus, from the beginning of the year to July 19 inflation reached 4.7 per cent as compared with 7.9 per cent over the relevant period of 2009. In June and early July international reserves of Russia have grown up, having reached by July 16 USD 469.3 billion. For the first time since the beginning of the year, in June, the real effective ruble rate has declined (by–0.3 per cent). In June the Central Bank has suspended the policy of mitigating interest rate: the refinancing rate remained unchanged. The Bank of Russia continued to restrain anti–crisis measures: on July 1, 2010 the regulator announced the suspension from October 1 the issue of unsecured loans for over 5 weeks, and since January 1, 2011 – for all timeframes.

In June, inflation decelerated by 0.1 percentage points as compared to May of this year and amounted to 0.4 per cent. The gap between the monthly inflation rate again reached 1.5 times (0.4 per cent versus 0.6 per cent a year earlier) (see Fig. 1). Like in the previous month, the largest contribution to growth in prices has been made by more expensive food products (0.5 per cent).

The behavior of prices for food products in June has been largely copying the dynamics of the preceding month. The greatest upward rates again were observed in fruit and vegetable products, the price increase of which amounted to 4.6 per cent. However, due to the gradual saturation of the consumer market of fruit and vegetables with the new crop, the price growth has slowed down. Prices were growing for alcoholic beverages, meat and poultry, respectively, by 0.4 per cent and 0.9 per cent. Due to the sharp upsurge in the cost of buckwheat (by 8.9 per cent), there was no longer price reduction for cereals and beans, the increase in their prices was 2.1 per cent. However, the majority of the food products under review showed a decrease in prices. The maximum fall in prices, like in May, was observed in the eggs, which became cheaper by 11 per cent.

In June the rate of growth of prices for commercial services has not changed, reaching 0.4 per cent. During the mass summer holidays there continued to grow prices for tourism and recreation services: health resort services rose by 4.8 per cent, foreign tours – by 1.9 per cent, passenger transport – by 1.3 per cent. However, education and insurance services grew cheaper (–0.1 per cent).

The rate of increase in prices for industrial goods in June has slowed down by half to 0.2 per cent. This was due to five times slower growth in prices for petrol (0.3 per cent) and almost two–fold – for tobacco products (0.8 per cent). In June, prices for audio and TV commodities continued to decline (–0.5 per cent), for pharmaceuticals (–0.4 per cent), as well as for electrical and other household appliances (–0.1).

As of nineteen days of June of this year, monthly inflation has reached the lowest rate of the month according to the estimates of the Ministry for Economic Development and Trade. From the beginning of July prices have grown by 0.3 per cent, while in June of 2009 that growth made 0.4 per cent. According to the forecast of the Ministry for Economic Development and Trade, in July inflation should decrease to 0.3–0.4 per cent as compared with 0.6 per cent of 2009¹.

However, in the last month of summer and the first month of autumn, apparently, one cannot expect the seasonal reduction in price of food. In view of abnormally hot summer, which will reduce the likelihood of deflation and the summer increase the risk of acceleration of inflation since the beginning of autumn of the drought to the European territory of Russia, upgrading grain, vegetables and fodder prices. The rise in prices of the latter will urge price growth for milk and meat. Because the CPI in our country is very sensitive to changes in food prices, the weight of which in the consumer basket is about 40 per cent, the growth of food prices may boost the of general inflation rate

1 Reurets News (<http://slon.ru/news/425521/>), 21.07.2010.

for the year. As a result, it may slightly exceed the official forecast (currently 6–7 per cent), as in late July was noted by A. Klepach, Deputy of Ministry for Economic Development and Trade¹.

The basic CPI of consumer price index² in June 2010 has made 0.2 per cent (versus 0.3 per cent in the relevant period of 2009).

As of June results, the monetary base (in broad definition) has increased by 5.6 per cent as compared with May results and amounted to RUR 7,244.1 bn. In general in the first six months of 2010 it has grown by 12 per cent. Cash in circulation with regard to the fund balances in credit

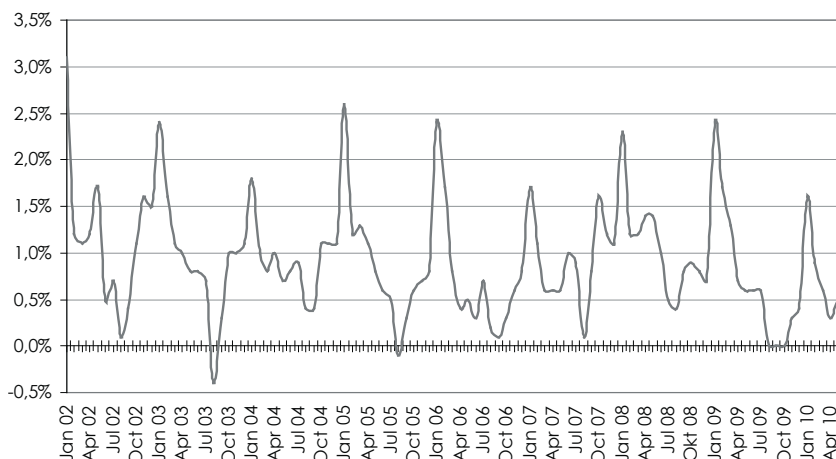
organizations on July 1 has reached RUR 4.8 trillion (+2.4 per cent), correspondent accounts of credit organizations with the Bank of Russia made RUR 603.6 billion (increased by 11.9 per cent), mandatory reserves made RUR 175.5 billion (+2.9 per cent), deposits of the banks with the Bank of Russia made RUR 637 bn (+7.7 per cent), the value of shares of the Bank of Russia with credit organizations made RUR 999.8 bn (+18.6 per cent).

In June, the excessive reserves of commercial banks³ have resumed their growth, having reached by the month result RUR 2.2404 trillion. Thus, they increased by 266.4 billion rubles, or 13.5 per cent. Because of the accumulated excessive liquidity in the banking system, interbank rates continued to decline, reaching 2.6 per cent in June.

Crediting of economy is growing on the part of the banking sector for the third consecutive month. According to G. Melikyan, First Deputy Chairman of the RF Central Bank, loans to non-financial sector in June increased by 2.1 per cent⁴ as compared with the previous month (for comparison: in May – by 1.9 per cent), and to individuals – by 1.5 per cent⁵ (in May – by 1 per cent). Only one bank spoils the statistics on the banking sector, International Industrial Bank. If it were not for the problems of the bank with the return of unsecured loan securities, in June, the amount of delay for the banking sector in general could be negative. Since the beginning of the year the «delay» for the total loan portfolio grew by 24.1 per cent, while 23.1 per cent of it was due to the International Industrial Bank⁶.

In June the growth of the volume of cash in circulation by 2.4 per cent with the simultaneous increase of mandatory reserves by 2.9 per cent urged the extension of monetary base in narrow definition (cash plus mandatory reserves)⁷ by 2.4 per cent to RUR 5003.6 bn (see Fig. 2).

In June, for the first time since December of the last year the real effective ruble rate has decreased; the decline made 0.3 per cent. Accordingly, the index of the real effective exchange rate has decreased as well: as of the month result, it made 144.09⁸ (See Fig. 3).



Source: RF Statistical Service.

Fig. 1. The Basic Growth Rate of the CPI in 2002 - 2010 (per cent per month).

1 «Inflation should be assessed in autumn». // RBKdaily, 20.07.2010, p. 2.

2 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

3 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.

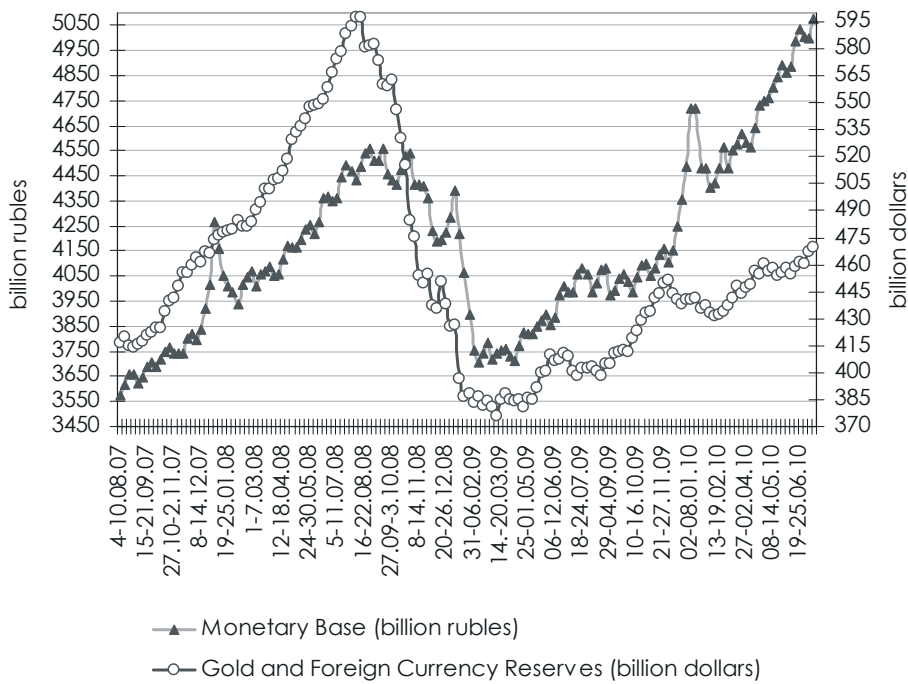
4 RIA News (http://rian.ru/trend/_banks_july_02072010/), 23.07.2010.

5 RBK News (<http://www.rbcdaily.ru/2010/07/13/finance/494006>), 13.07.2010.

6 Ditto.

7 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.

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



Source: RF Central Bank.

Fig. 2. Changes in the Monetary Base and in the Gold and Foreign Currency Reserves in 2007 – 2010

dollar rate to the speech of B. Bernanke, FRS Head with the six-month report to the Congress, where he disclosed the slow-down of the US economic growth and noted the generally vague prospects for the future.

In late June and in July, the Euro continued to strengthen. Nervous investors' mood was calmed down after the successful placement of state bonds of Spain, Greece and Portugal, the establishment of the EC crisis fund, purchase troubled debt securities of the European Central Bank and new promises to cut down government spending in the EU countries. In addition, positive impact over Euro rate was made by the information on the acceleration of growth in services and manufacturing. Strengthening of European currency against ruble contributed to the weakening of dollar against Euro in Forex market. On July 20 Euro rate to the dollar has updated its maximum of three months, having grown above 1.3 dollars per Euro. Therefore, in July rate of Euro rate to the ruble has strengthened by 2.4 per cent, amounting by July 25 to 39.13 rubles. As a result, in July, the value of the two-currency basket¹ reduced to RUR 34.32 (–0.1 per cent).

At a regular meeting of the Board of Directors of the Central Bank on June 30, 2010 it was decided to leave unchanged the refinancing rate and other key interest rates as the RF Central Bank. We would like to remind that on May 31 the refinancing rate was set at 7.75 per cent per annum, and before it was lowered four times since the beginning of the year. Therefore, the Bank of Russia has suspended the policy of mitigating interest rates, started in April 2009

The reasons for maintaining rates unchanged, as stated in a press release of the RF Central Bank was confident restoration of the credit markets and reduced inflation. The press release also states that the Bank of Russia, probably in the next few months will leave unchanged the current level of interest rates. In our view, further lowering of the rates would be inappropriate, because this may accelerate inflation.

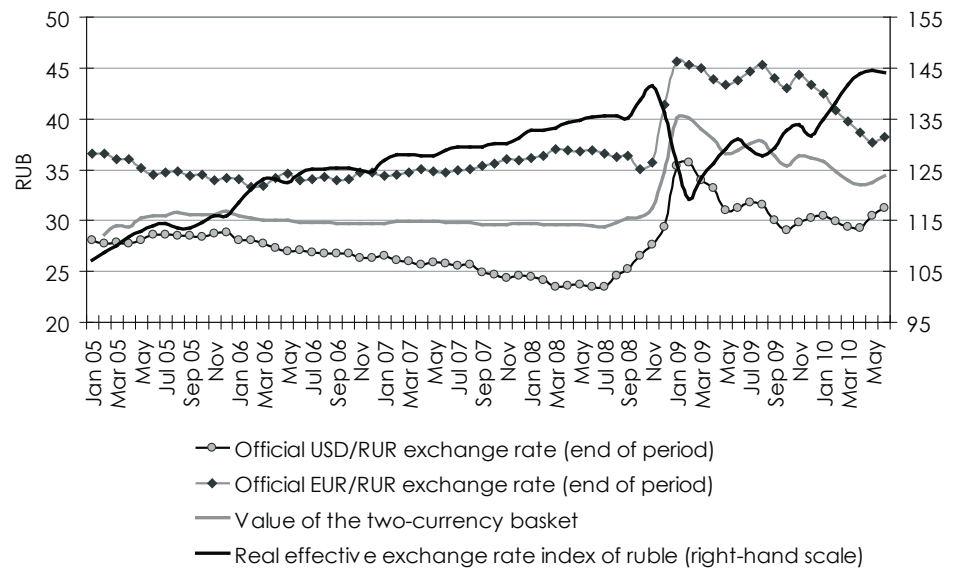
Central Bank continues to reduce anti-crisis measures. On July 1, 2010 the Bank of Russia has announced the suspension from October 1 auctions for providing loans to organizations without collateral for more than 5 weeks, and since January 1, 2011 – for all terms. This mechanism

¹ Two-currency basket is the RF Central Bank operational indicator in its foreign currency policy. Currently the share of EURO in the currency basket makes 45 per cent, USD – 55 per cent

During the last decade of June the dollar was strengthening. However, since the beginning of July the dollar began to decline and over July it weakened against the ruble by 2.8 per cent, amounting to 30.38 rubles by July 25. Significant reduction of the rate was a response to negative news from the USA. First, the Committee on Open Market transactions has lowered the forecast for economic growth and inflation and increased unemployment forecast. Secondly, the US consumer confidence index has fallen down. Thirdly, the largest national banks JPMorgan, City and Bank of America have demonstrated not the best quarterly performance. Fourthly, the market reacted with a sharp fall in the

of providing liquidity was introduced as an emergency measure at the peak of the crisis in October 2008 to overcome the systemic liquidity deficit in the banking sector. During this period, the debt to credit institutions on the unsecured loans has decreased almost 40 times from the peak of 1.9 trillion rubles in mid-February 2009 to around 50 billion rubles on July 1, 2010. It is worth noting that a large portion of that amount – 32 billion rubles – falls on the problem bank – the International Industrial Bank. Other banks have no need for this type of loan any more and repay their loans early. As to the saturation of the banking sector liquidity, the demand for this refinancing tool has nearly come to zero.

The decision to suspend unsecured lending was not unexpected for the banks. From the beginning of the year, the Central Bank gradually began to limit that channel to provide liquidity. Thus, from February 1, the Bank of Russia has tightened the requirements the rating of the borrowers of unsecured credits, admitted to the auction, and from May 1, the Bank has reduced the limits on credit risk imposed on credit institutions to provide loans without collateral. This measure taken by the Central Bank seems to be quite adequate and timely. Due to the normalization of the situation in the domestic financial market this tool, obviously, should be replaced by other types of non-crisis of refinancing. ●



Source: RF Central Bank, author's estimates.

Fig. 3. Indicators of Ruble's Exchange Rate Dynamics within January 2005 – June 2010

FINANCIAL MARKETS¹

N.Burkova, E.Khudko

In July a highly volatile dynamics was observed in the Russian financial market. Volatility of the global economy, decreased oil prices, fluctuations in the national currency exchange rate have led to a drop in trading volume of the government securities market and the corporate securities market. However, positive results of European banks stress-tests, conducted by the Committee of European Banking Supervisors (CEBS) have supported the market and contributed to the growth of stock indices, despite a decline in trading volume in financial markets. In addition, investors' desire to hedge against the risk of investment losses led to increased turnover rates in the MICEX derivatives market. Key indicators of corporate bond market showed steady growth in the volume of the market, the index of corporate bonds, the number and volume of IPOs. Investors have demonstrated the interest in the long-term investments in bond issues, although in general their activity on the secondary market has slightly decreased. The main problem remains the failure of issuers to perform their obligations to the bonds' holders

Government securities market

The negative dynamics of oil prices, the volatility of global stock markets and the national currency of Russia have contributed to reduction of investors' interest in the government securities market in July 2010 against the background of downward dynamics of the Russian Eurobonds yield.

As of July 26 of the current year, the Russian Eurobonds RUS-28 yield to maturity has reduced as compared with the level of June 24 from 6.39 to 6.02 per cent per annum (by 5.76 per cent), RUS-18 – from c 5.47 to 4.9 per cent per annum (by 10.37 per cent), RUS-30 – from 5.4 to 4.85 per cent per annum (by 10.16 per cent), RUS-15 – from 4.32 to 3.85 per cent (by 10.93 per cent), and RUS-20 – from 5.46 to 4.99 per cent (by 8.47 per cent). Herewith, the 24th coupon of the seventh tranche of external currency debt bonds was redeemed at the rate of 11 per cent per year. As of the same date, a similar downgrading trend was observed in the yields of external currency debt bonds. Thus, the yield to redemption of the seventh tranche of external currency debt bonds has decreased from 2.44 to 2.06 per cent per annum (by 27.61 per cent) (see Figs 1- 2).

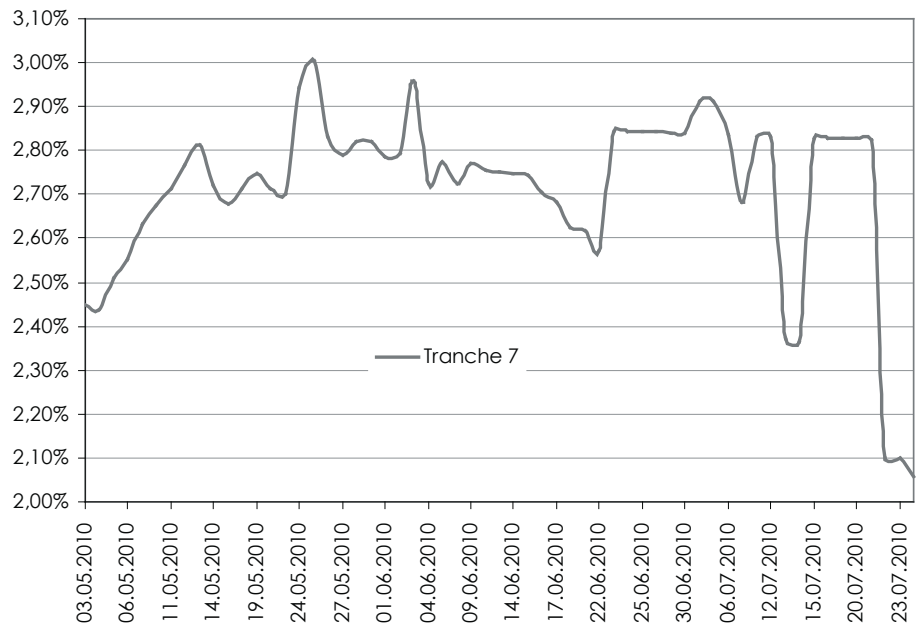
Within the period from June 25 to July 26 the total turnover of the secondary market of government bonds amounted to approximately RUR 127 billion with an average daily turnover of RUR 5.77 billion (about RUR 665.66 billion with an average daily turnover of RUR 30.26 billion in June), which means the decrease of an average monthly turnover by 5.2 times.

In the period from June 25 to July 26, there were seven auctions on government bonds additional placement at the primary government bonds market (a month before there were three auctions). Thus, on June 30 there was an auction for government bonds series 26201 for the total volume of RUR 30 bn; the actual volume of placement made RUR 3.86 bn with an average weighted yield of 6.56 per cent per annum. On July 7 there were two auctions on government bonds placement 25071 and 25074; the total placement volume was RUR 20 bn each. The actual volumes of placement were RUR 10.67 bn and 6.15 bn with an average weighted yield of 7.12 and 4.63 per cent per annum, accordingly. On July 14 there were arranged 3 auctions on government bonds placement series 25072, 25073 and 25074 for RUR 15, 20 and 10 billion, actual placement was RUR 10.67 billion, 10.99 billion and 1.16 billion with the average weighted yield of 6.25 per cent, 5.92 and 4.66 per cent per annum, accordingly. On July 21 an auction on placement of additional government bonds placement series 25072 at the volume of RUR 15 billion, the actual placement was RUR 11.16 billion with the average weighted yield of 6.28 per cent per annum. Therefore, the total volume of placement for the period under review was RUR 42.05 per cent versus the estimated level (8.5 per

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.

cent a month earlier), which demonstrates a decreased interest to the primary sector of government bonds.

As of July 26, the volume of government bonds market made RUR 1 541.75 bn at face value and RUR 1 574.39 bn at the market value (as compared with RUR 1,505.32 bn and RUR 1,536.67 bn accordingly as of June 24). The duration of the OFZ market portfolio was 1,543.26 days, having decreased by 30.92 days as compared with the preceding month (as of June 24).



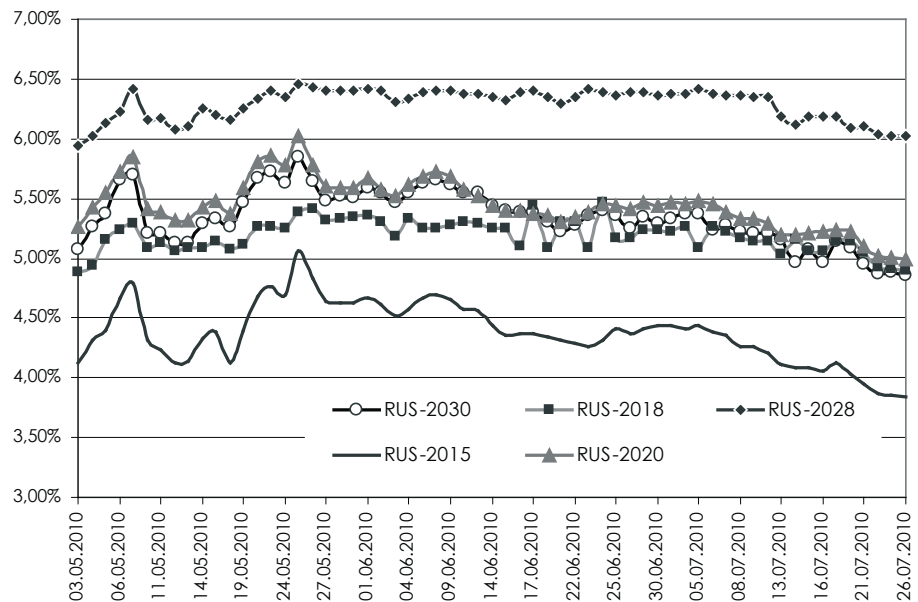
Source: "Finmarket" Information Agency data

Fig. 1 Minfin bonds' yields to maturity in May – July 2010

Stock market

Stock market situation

In July 2010, like a month before, the volume of trading in the stock market showed a decline at the background of the sustained volatility of the global financial and commodity markets, the RF Central Bank maintained refinancing rate at the level of 7.75 per cent, information on the RF federal budget deficit as of the first six months of 2010 (2.3 per cent of GDP), growth of trade surplus of Russia in January-May 2010 by USD 79.9 billion and reduction of unemployment level in June to 6.8 per cent, increase in international reserves.



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 May – July 2010

The maximum value within the month the MICEX index has reached on July 26, having reached 1,396.92 points (1 406.21 per cent points in the preceding month) (Fig. 3). The minimum value for the period of July 1 – 1 254.65 points (against 1 254,65 points in the preceding month).

In general, within the period from June 25 through July 26, the MICEX index has increased to 2.48 per cent, what makes about 33.77 points in absolute terms (within the year, from June 27, 2009 through July 26, 2010, the MICEX index has been upgraded by 45.5 per cent). Over the same period, the turnover of trades in securities included in the MICEX index made about RUR 945.59 bn at an average daily turnover of RUR 42.98 bn (against RUR 1 214.26 bn with an average daily turnover

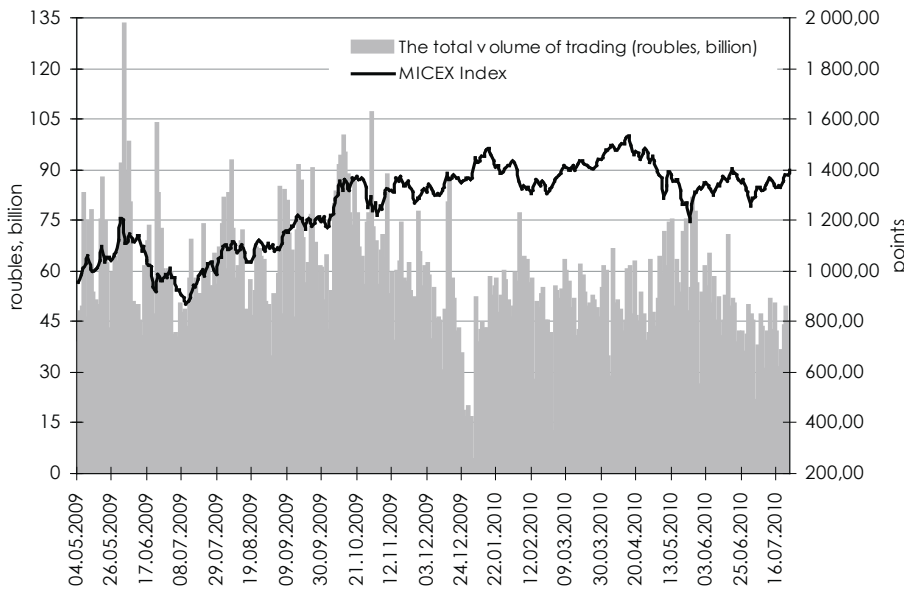


Fig. 3. Dynamics of MICEX Index and trading volume

per cent, Surgutneftegas (6.77 per cent), Gazprom (6.66 per cent) and GMK Nornickel (6.46 per cent). Some less upgrading rates were noted in securities of Rosneft (5.08 per cent), VTB Bank (5.06 per cent) and Tatneft (2.49 per cent). The leader in terms of decrease was Rostelecom, whose shares declined by 9.01 per cent. They were followed by the securities of Mosenergo (decline by 2.22 per cent), Gazprom Neft (1.25 per cent), and LUKOIL (1.25 per cent) (Fig. 4).

In July of the current year the MICEX turnover leaders were: “Sberbank of Russia” (40.33 per cent of the total turnover), Gazprom (14.60 per cent), GMK “Nornickel” (8.62 per cent), Rosneft (6.53 per cent) and LUKOIL (5.29 per cent). The total volume of transactions with the shares of those five «blue chips» was about 75.37 per cent (all «blue chips» - 82.07 per cent) of the total trades in shares at the MICEX stock market over the period from June 25 to July 24.

According to MICEX information, as of July 26, the top five leaders of the domestic stock market in terms of capitalization were: “Gazprom” – RUR 3 829.90 bn (RUR 3,696.62 bn a month

of RUR 55.19 bn in the preceding period). Therefore, the investors’ average daily activity in the stock market in July has decreased as compared with the preceding period by 22 per cent. The indicators of maximum and minimum daily turnover in the market trades made, accordingly, RUR 51.69 bn (as of July 13), and RUR 21.56 bn (on July 5).

As of the month results (from June 25 through July 26), the “blue chips” securities have shown volatile dynamics. The leaders in the growth were Sberbank of Russia, whose shares have grown by 7.94

earlier), “Rosneft” – RUR 2 155.03 bn (against RUR 2 116.99 bn), “Sberbank of Russia” - RUR 1,811.58 bn (against RUR 1,745.52 bn), “LUKOIL” - RUR 1 438.79 bn (against RUR 1 441.26 bn), Surgutneftegaz - RUR 1 081.78 (against 1 042.41 bn rubles) and GMK “Nornickel” – RUR 971.49 bn (against RUR 935.58 bn).

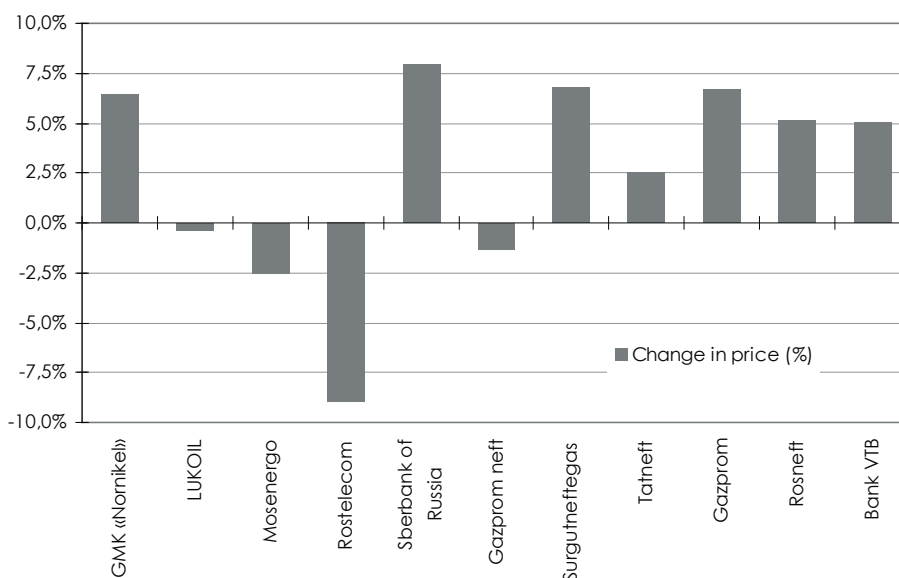


Fig. 4. Dynamics of the Russian Blue Chips from June 25 to July 26, 2010

Futures and Options Market

In July the total turnover in the MICEX futures market has grown nearly by 12.6 per cent as compared with the preceding month. Thus, in the period from June 25

through July 26 the total turnover in the MICEX (futures) market made approximately RUR 144 bn (964.54 thousand of transactions, 3.23 mln of contracts) against approximately RUR 127.87 (837.53 thousand of transactions, 3.41 mln of contracts) in June. The largest volume of trading in July, like a month before, was observed in contracts for futures and equity instruments, amounting to RUR 112.12 billion (949.12 thousand of transactions, 2.36 mln of contracts). Herewith, futures for the MICEX index in the short-term MICEX market section in terms of the volume of trade were followed by contracts for «Sberbank», “Nornickel”, “Gazprom” and “LUKOIL” shares. It should be noted, that the value of the MICEX index (the price of transactions) for September 2010 was basically within the range of 1,300–1,410 points and for December - within the range of 1,370–1,400 points.

The second place in terms of trading volume within the month of July was taken by foreign currency futures (RUR 29.97 bn). Herewith, contracts for the US dollar were in the first place in terms of trading in the MICEX futures market, followed by futures contracts for Euro/USD and for Euro rate. It is worth noting that prices of futures contracts, concluded in July for RUR/USD futures in the MICEX market were within RUR/USD 30.4–31.4 for September, and RUR/USD 30.8–31.6 for December. Trading volume in futures for commodity assets within the period has increased by 1 per cent (from RUR 4.36 billion to RUR 4.4 billion). There were no contracts for interest rate in July. Among the news of the MICEX futures market, one should mention a new service introduced on July 19, 2010 - foreign currency is accepted now as collateral for transactions with foreign currency and stock derivatives.

Opposite trends were observed in the RTS FORTS futures market, where the investors' activity in July has decreased by 17.5 per cent as compared with the previous month. Thus, in the period from June 25 through July 26 the total market turnover of futures and options in RTS was about RUR 2,276.23 billion (10.71 million of transactions, 50.41 million of contracts) as compared with about RUR 2 758.15 billion (13.1 million of transactions, 62.29 million of contracts) in June. The greatest demand among the market participants, as before, was demonstrated in futures: trading volume in them during the period under review amounted to RUR 2,189.06 billion (10.54 million of transactions and 48.79 million of contracts). 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 dollar-ruble rate and for the shares of Sberbank of Russia, Euro-USD rate and Gazprom shares. It should be noted that prices of the transactions, concluded in the RTS FORTS on futures contracts for the date of execution on September 15, were within RUR 30.6–31.4/USD, and on December 15, 2010 - RUR 30.8–31.4/USD. The value of futures contract for the RTS index (based on the prices of recent contracts) with the execution date on September 15 was estimated on average at 1,300–1,450 points, for December 15, 2010 – 1,350–1,450 points. Options enjoyed far less demand, the turnover made about RUR 87.17 bn (165.44 thousand transactions and 1.62 mln of contracts). The maximum daily turnover in the short-term RTS futures market in the period under review made RUR 121.92 billion (as of July 15), and the minimum was RUR 59.84 bn (as of July 5). In addition, since July 8, 2010 there were started trading in options for EURO/USD futures contracts and from July 12 - margined trading options in futures contracts for refined platinum.

External factors behind the Russian stock market dynamics

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

- Fitch Ratings upgrading of the forecast for global economic growth in 2010 from 2.8 per cent to 3.1 per cent;
- revision of GDP growth in China in 2009 from 8.7 per cent to 9.1 per cent;
- growth of China foreign currency reserves in Quarter II of 2010 up to USD 2.45 trillion;
- Spain placing government bonds amounting to EURO 3.5 billion for five years;
- decreased unemployment rate if the USA to 9.5 per cent in June;
- IMF upgrading of the forecast for global economic growth in 2010 from 4.2 per cent to 4.6 per cent;

– decision of the European Central Bank and the Bank of England to maintain the refinancing rate at the same level;

– published results of passing the stress test by the European banks.

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

– international rating agency Moody's Investors Service transfer of Spain credit rating (AAA) to the list for review with possible reduction;

– rating agency Moody's Investors Service reduction of rating of Ireland government bonds from AA1 to Aa2, with the forecast - "stable";

– global oil prices decline.

All those factors have generally resulted in the positive dynamics of the global stock indices in July, as of the month results. Thus, the markets of the developed countries were demonstrating a general growth in the indices by 1-5 per cent over the month, while the stock indices of the developing markets were upgraded by 1-7 per cent. The exception was the indices of Switzerland Swiss Market and Japan Nikkei-225, which have declined by 1.92 and 4.28 per cent. Herewith, there was observed volatile trends in the basic global stock markets indices as compared with early January 2010 indicators (See *Table 2* and *Fig. 5*).

Table 2

DYNAMICS OF THE GLOBAL STOCK INDICES (AS OF JULY 26, 2010)

Index	Ticker	Value	Dynamics within the month(%)	Dynamics since the year beginning(%)
MICEX (Russia)	MICEXINDEXCF	1 396.92	2.48	1.96
RTS (Russia)	RTSI	1 467.68	4.61	1.60
Dow Jones Industrial (USA) Average (USA (USA) (USA)	DJI	10 525.43	3.67	0.93
NASDAQ Composite (USA)	NASD	2 296.43	3.56	1.20
S&P 500 (USA)	SPX	1 115.01	3.848	-0.01
FTSE 100 (UK)	FTSE	5 351.12	4.92	-1.14
DAX-30 (Germany)	DAX	6 194.21	1.29	3.97
CAC-40 (France)	CAC	3 636.18	2.27	-7.63
Swiss Market (Switzerland)	SSMI	6 199.46	-1.92	-5.29
Nikkei-225 (Japan)	NIKKEI	9 503.66	-4.28	-9.89
Bovespa (Brasil)	BUSP	66 443.26	3.92	-3.13
IPC (Mexico)	IPC	32 958.89	2.00	2.61
IPSA (Chile)	IPSA	4 366.66	7.15	21.93
Straits Times (Singapore)	STI	2 966.99	4.19	2.39
Seoul Composite (South Korea)	KS11	1 769.07	1.68	5.13
ISE National-100 (Turkey)	XU100	59 507.68	6.42	12.65
BSE 30 (India)	BSE	18 020.05	1.63	3.18
Shanghai Composite (China)	SSEC	2 588.68	0.85	-21.01
Morgan Stanley Emerging&Frontier Markets Index	EFM	780.18	3.44	-0.34

* – Versus index indicator valid on June 24, 2010.

Corporate news

OAO "VTB Bank"

On July 5, 2010 VTB Bank has signed a framework loan agreement with Export-Import Bank of the Republic of Korea, enabling VTB Bank to attract financial resources amounting to USD 100 million for up to 14 years to finance joint Russian-Korean projects and to provide loans to companies involved in trade turnover between the Russian Federation and the Republic of Korea.

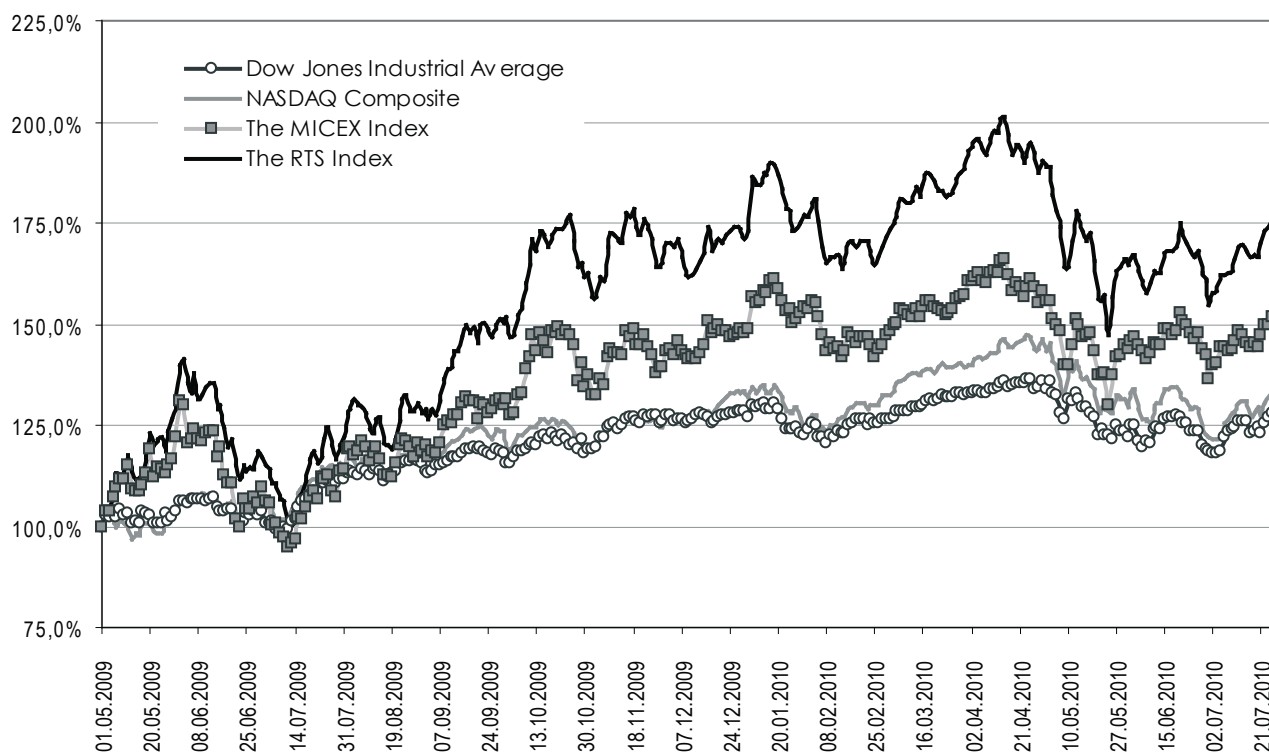


Fig. 5. Dynamics of the main USA and Russian stock indexes (in per cent to the date 01.05.2009)

OAO «GazpromNeft»

On June 29 the annual general meeting of shareholders of OJSC “Gazprom oil” has decided to pay before May 31, 2011 dividends as per results of 2009 in the amount of RUR 16.93 billion from the net profit; dividends totaled to RUR 3.57 per ordinary share. On July 26 OAO “Gazprom Neft” and NOVATEK have formed a joint venture company OOO “Yamal Development“ for the implementation of joint projects to develop oil and gas fields in the Yamalo-Nenets Autonomous Region, the share of Gazprom Neft in the authorized capital of the enterprise is 50 per cent.

GMK «Norilsk Nickel»

On June 28 the annual general meeting of shareholders of GMK «Norilsk Nickel» has approved the payment of dividends as per 2009 performance in the amount of RUR 210 per share, which corresponds to 50 per cent of the net profit under IFRS or USD 1.325 billion. On June 29 GMK «Norilsk Nickel» has repaid a syndicated loan in the amount of USD 1.5 billion.

NC «Rosneft»

On July 26 Rosneft has disclosed consolidated financial results for the first six months of 2010: net profit made USD 5.0 billion, what is by 37 per cent higher than the corresponding indicator 2009;

OAO «Rostelecom»

On June 26 the annual general meeting of shareholders of OAO “Rostelecom” decided to pay dividends on shares of in the amount of RUR 1.53 billion, or 30 per cent of the net profit. In accordance with the approved distribution of profits, dividends for 2009 will be paid: RUR 2.1005 per on type A preferred share (total payment on the shares of type A is 10 per cent of the net profit) on ordinary shares RUR 1.4002 per share (total payment on the shares is 20 per cent of the net profit).

Sberbank of Russia

On July 6 Sberbank of Russia has informed of the acquisition of Strategy Partners company shares (ZAO “Strategy Partners Group”) in the amount of 75 per cent minus one share in order

to create a leading national strategic consulting company on the basis of Strategy Partners . On July 7 Sberbank of Russia performed a new emission of 5-year summer Eurobonds in the amount of USD 1 billion at the rate of 5.499 per cent. On July 15 Sberbank of Russia has disclosed financial results under RAS for the first six months results of 2010: net profit totaled to RUR 60.7 billion against RUR 5.3 billion for the first six months of 2009, assets increased by 5.9 per cent to RUR 7.526 billion; Russian enterprises were granted loans amounting to over RUR 1.7 trillion; capital adequacy ratio was 19 per cent. On July 21 rating agency Moody's has changed from "negative" to "stable" the forecast of the financial strength rating of Sberbank of Russia (the bank's individual rating), and also affirmed the ratings of Sberbank of Russia: long-term rating of deposits in foreign / local currency at the level of Baa1/A3, outlook stable, short-term rating of deposits in foreign / national currency - at the level of P2.

ОАО "Татнефт"

On June 28 ОАО "Татнефт" has informed of attraction a new loan of USD 2 billion, the funds from which will be used to replenish the working capital, and of the early repayment of loan, attracted by ОАО "TANECO".

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 July of the current year after a short term of decline has expressly grown and at the end of the month made RUR 2 432.9 bn, which exceeds the relevant indicator of preceding month by 2.7 per cent¹. Partially this is a result of a large number of bond emissions in circulation, denominated in national currency, which increased from c 646 651. Herewith, the total number of emitters has decreased from 357 to 355. There is still one emission of bonds in circulation, denominated in Japanese yens and two emissions denominated in US dollars.

The activity of investors in the secondary market of corporate bonds has somewhat decreased as compared with preceding month, what was observed in the volume of trading. Thus, the trading volume in corporate bonds in the MICEX market in the period from June 25 through July 26 amounted to RUR 99.1 billion (for comparison, from May 25 through June 24 the trading volume was equal to RUR 109.3 billion). However, the number of transactions in the period under review was not changed and made 23.7 thousand in the period (ass compared with 24.0 thousand transactions in the preceding period)². Therefore, the trading indicators are still the highest over the last two years.

Index of Russian corporate bonds market IFX-Cbonds continued its upward trend emerging since the beginning of 2009. The increase by 2.3 points (0.8 per cent) was demonstrated in the period from June 24 through July 23. Effective yield after a sharp decline in the preceding month by 1 p.p. remained practically unchanged – 7.46 per cent against 7.57 per cent in late June (*See Fig. 6*). The duration of corporate bonds market portfolio has regained a downgrading trend and made 698 days, which is by 19 days less against the last month indicator.

Among the most liquid emissions the effective yield in the period under review decreased on all series of bonds of ОАО "Gazprom Neft" (by 0.2-0.5 p.p.) and on ОАО "Mobile TeleSystems" (by 0.1-0.9 p.p.), on thirteen series of ОАО "Russian Railways" (by 0.1-1.2 percentage points), on six series of bonds of ОАО "Lukoil" (by 0.2-0.8 percentage points), on five series of bonds of ОАО "Mechel" (by 0.1-0.6 percentage points). At the same time demonstrated a significant increase in yield bond issue VTB Bank (Series 06), ОАО "Bank Zenit" - more than 2 percentage points. At the same time bond issues of "VTB Bank" (Series 06), ОАО "Bank Zenit" demonstrated a significant increase in yield by more than 2 percentage points.

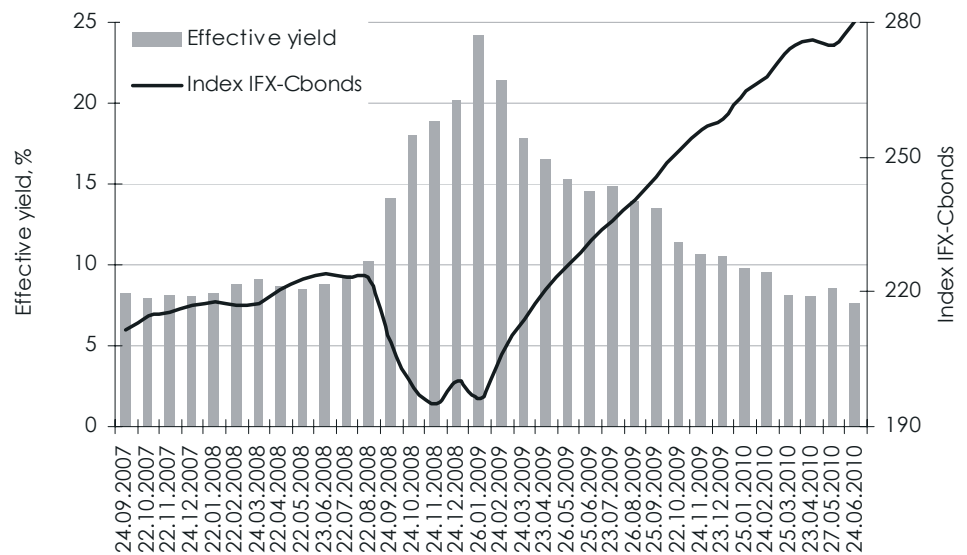
In July companies were actively registering bond issues again. Thus, from June 25 through July 23, twelve emitters have registered 38 bond issues amounting to 161.4 billion rubles (as compared with thirteen emitters who registered 30 bonds issues worth of 181.5 billion rubles from May 28 through June 24). The greater part of the reported emissions were exchange bonds. The majority

1 As per Rusbonds information

2 As per "Finmarket" Information agency.

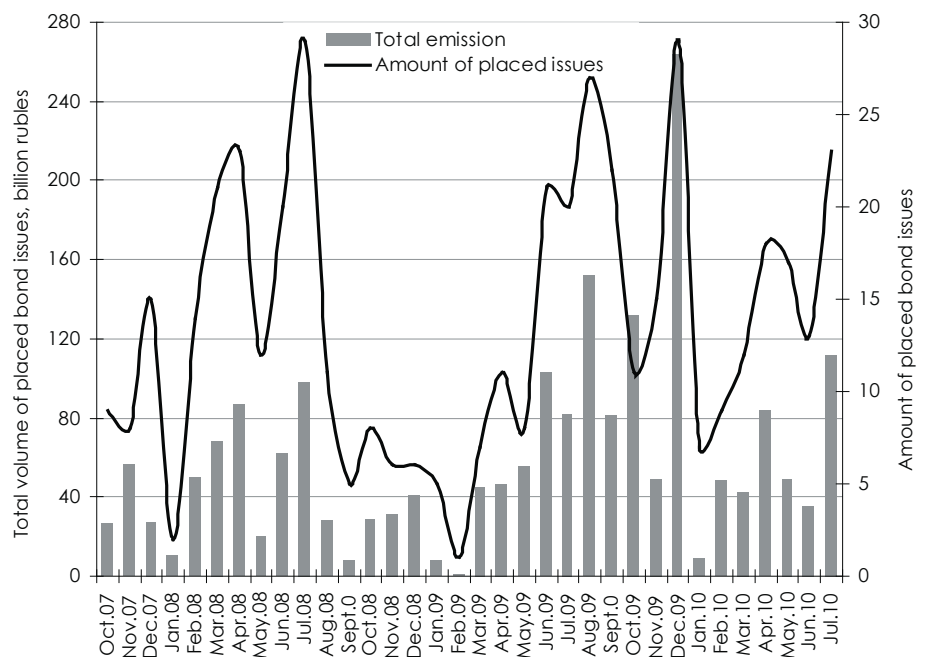
of registered emissions fell within seven series of exchange bonds of OAO “Russian Agricultural Bank”, totaling to 50 billion rubles, four series of OOO GMK “Norilsk Nickel” exchange bonds for the amount of 50 billion rubles and three series of exchange bonds of OAO “Alliance” Oil Company” for the amount of 20 billion rubles, three series of OAO “X 5 Finance” exchange bonds for the amount of 15 billion rubles¹

Basic indicators of the primary bond market have significantly grown and reached the maximum values since the beginning of the year. Thus, in the period from June 25 through July 23 there were placed 23 corporate bonds emissions totaling to RUR 111.5 billion (for comparison, from May 28 through June 24 there were placed 13 bonds emissions for the total amount of RUR 35.2 billion (See Fig. 7). During the period under review the largest bond emissions were placed by OAO “AK ALROSA” (two series of stock bonds for the total amount of RUR 11 billion), OAO “Agency for Housing Mortgage Lending” (one series of bonds worth 10 billion rubles), OAO “Wimm-Bill-Dann Food Products” (two series of stock of bonds worth 10 billion rubles), OAO “Novatek” (one series of exchange bonds worth 10 billion rubles), AKB “Rosbank” (two series of exchange bonds worth 10 billion rubles), and OOO “SUEK Finance” (one series of exchange bonds worth 10 billion rubles). It should be noted that some companies have succeeded in attracting investments through bond issues on a sufficiently long period - OAO “Mineral and Chemical Company EuroChem” - for 8 years, OAO “WEB-Leasing” and “SUEK-Finance” - 10 years. There were also emitted three series of mortgage bonds of ZAO “Mortgage Agent AIZHK 2010-1” in the amount of 13.5 billion with maturity in 1932. Herewith, over the third consecutive month no emissions were recognized as invalid by the Federal Financial Monitoring Service



Source: Cbonds data.

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



Source: Rusbonds data

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

1 Source: Rusbonds data.

(FFMS) due to non-placement of any security, which testifies a sustained demand for the bonds of Russian emitters¹.

In the period within June 25 through July 23, seventeen emitters were supposed to redeem their 18 bond issues totaling to RUR 27.8 billion. However, four emitters have announced a technical default on repayment of their bond loans for the total amount of RUR 6.5 bn (against two emitters, who announced a technical default on repayment of their bond loans, totaling to RUR 8 bn in the relevant preceding period). In August 2010, redemption of eleven emissions of corporate bonds for the total amount of RUR 11.5 bn is expected².

The situation with the performance of current debt liabilities is still not easy. From June 25 through July 23, the real default on bonds coupon yield redemption was announced by ten emitters (against twelve emitters from May 28 through June 24). In regard to only one emission the emitters managed to reach agreement with bondholders to restructure the debts.

Offer (bonds purchase) was carried out by all issuers in due time, like in the preceding reporting period. A real default on bonds redemption at the nominal value of their bonds was announced by three emitters (in the preceding relevant period - two emitters), though none of them managed to restructure their debt³. ●

1 FFMS of Russia data

2 Rusbonds data.

3 Cbonds data

REAL ECONOMY SECTOR: TRENDS AND FACTORS

O.Izryadnova

According to the preliminary estimation of the RF Ministry for Economic Development, in the 1st half of the current year the increase in the GDP by 4.2% is accounted for by both the expansion of the foreign trade turnover and the recovery of the positive dynamics at the domestic market. In the 2nd quarter 2010 the growth of investments in fixed assets was observed to accelerate to 105.3%, the volume of foreign trade turnover – to 105.1%, the output of manufacturing industry - to 116.3% versus the corresponding period of the previous year. The upsurge at the domestic market had a positive impact on the situation at the labor market. As compared with May 2010 in June 2010 the number of employed population went up by 762 thousand or by 1.1%, the number of the unemployed decreasing by 347 thousand or by 6.3%.

The results of the first half of 2010 were considerably influenced by the trend towards the recovery of the positive dynamics of the Russian economy development. The acceleration of the economic growth rates from 102.9% in the 1st quarter to 105.4% in the 2nd quarter 2010 as compared with the corresponding period of the previous year determined the growth of the GDP by 4.2% in the first half of the current year. The increase in the GDP over the elapsed period of 2010 was accounted for by the favorable situation for the Russian export and gradual expansion of the domestic demand.

In the 1st half of 2010 the growth of the investments in fixed assets made 101.3%, that of the retail trade turnover – 103.4% as compared with the corresponding period of the previous year. It should be noted that in the 2nd quarter the investments went up to 105.3%, anticipating by 0.2 percentage points the dynamics of retail trade turnover. However comparison between the figures of investments in fixed assets growth and the expansion of workload in construction demonstrates that the factors of low financing, contraction of orders and volumes of unfinished construction still exhibit inertial influence, which was accumulated in 2009 - the beginning of 2010. The drop of investments ceasing in the 2nd quarter 2010, the positive dynamics of the volumes of residential housing construction recovered. In the 2nd quarter 2010 commissioning of the housing made 7.5% versus the level of the previous year, while on the whole over the 1st half of the year it decreased by 0.1% (table 1).

Table 1

INDICES OF MAIN MACROECONOMIC INDICATORS IN 2009-2010, AS PERCENTAGE TO THE CORRESPONDING PERIOD OF THE PREVIOUS YEAR

	2009 1 st half	Quarters		2010 1 st half	Quarters	
		1	2		1	2
Gross domestic product	89.9	90.6	89.2	104.2	102.9	105.4*
Investments in fixed assets	79.4	82.7	77.2	101.3	95.3	105.3*
Construction	80.7	80.7	80.7	96.9	91.9	99.9
Commissioning of residential housing	99.7	102.4	97.2	99.9	91.7	107.5
Volume of industrial production	85.7	84.6	85.2	110.2	109.5	110.9
Agriculture production	100.9	102.3	100.8	102.9	103.6	102.3
Freight turnover	82.5	82.8	82.2	112.2	111.7	112.7
Retail trade turnover	97.6	100.4	95.2	103.4	101.3	105.1
Paid services rendered to population	97.2	99.1	95.3	100.3	99.1	-
Foreign trade turnover	55.8	56.2	55.4	140.7	145.9	136.2
Real disposable monetary incomes	102.1	100.7	103.4	104.8	107.4	102.8
Real wages	97.2	99.2	96.1	104.4	103.1	103.6
Number of unemployed	142.8	126.5	157.4	91.6	114.2	91.1

*) preliminary data

Source: Federal State Statistics Service

In the 1st half of 2010 the expansion of consumer market was supported by the growth of real disposable monetary incomes of the population (by 4.8%) and of the real wages (by 4.4%). Social parameters gradually increasing, in the 2nd quarter 2010, for the first time since January-March 2009 the sales of non-food goods were observed to increase by 4.8%. In the 2nd quarter 2010 the consumer behavior of the population was affected by the trend towards consumer prices growth rates slowdown. Index of consumer prices going up by 4.4% in the 1st half of 2010, prices for foodstuffs rose by 5.4%, for non-food goods – by 1.9%, for paid services rendered to the population – by 6.9%.

As compared with the 1st half of 2009 in the 1st half of 2010 index of industrial production made 110.2% versus 85.7% a year ago. It should be noted that the growth of production was registered in all enlarged types of economic activities. Index of minerals extraction made 105.8% versus the first half of 2009, index of manufacturing industry – 114.3%, that of electricity, gas and water production and distribution – 105.6%. Oil production went up by 2.8% versus the first half of 2009, natural gas production – by 22.6%, and metal ores production – by 9.9%.

Recovery of the positive dynamics of manufacturing industries, the rates accelerating versus the corresponding periods of the previous year, up to 112.1% in the 1st quarter and 116.3% in the 2nd quarter is a positive characteristic (*table 2*). Taking into account the fact that the most dramatic drop of production was observed in the 1st half of 2009, low base effect defined the upsurge in the growth rates in the first half of the current year and accounted for the perseverance of high differentiation between the output rates of goods in natural terms.

Table 2

PRODUCTION INDICES BY TYPES OF ECONOMIC ACTIVITIES IN 2009-2010, AS PERCENTAGE TO THE CORRESPONDING PERIOD OF THE PREVIOUS YEAR

	2009	Quarters		2010	Quarters	
	1 st half	1	2	1 st half	1	2
Industry	85.7	84.6	85.2	110.2	109.5	110.9
Minerals extraction	96.1	94.9	97.3	105.8	106.7	104.8
Fossil fuels	98.0	96.8	99.2	105.6	106.4	104.9
Minerals, excluding fossil fuels	83.0	80.0	85.6	108.4	110.9	106.1
Manufacturing industries	77.7	76.1	79.3	114.3	112.1	116.3
Production of foodstuffs, including beverages	97.5	97.5	97.5	105.2	103.8	106.8
Textile and sewing	78.5	79.1	78.0	112.9	110.2	115.6
Leather, leather goods and footwear	91.1	85.8	92.3	122.8	126.1	120.0
Wood processing and timber goods	73.2	71.7	74.7	111.9	111.1	112.6
Pulp and paper, publishing and printing	80.6	78.1	82.9	109.3	106.7	111.7
Coke and oil products	97.8	95.8	99.8	105.0	104.7	105.3
Chemistry	82.2	77.9	86.4	119.5	123.8	115.7
Rubber and plastic goods	79.3	72.7	84.7	120.7	122.8	119.2
Production of other non-metal mineral commodities	65.3	63.5	66.0	110.3	104.9	114.2
Metallurgy industry and production of finished metal goods	72.7	70.0	75.2	119.2	118.8	119.6
Machinery and equipment	59.7	56.5	62.5	121.0	109.1	130.5
Electric, electronic and optical equipment	59.1	56.8	61.3	128.8	130.4	127.5
Transport vehicles and equipment	60.0	61.0	59.2	128.1	113.3	141.2
Other industries	69.0	67.3	68.4	133.1	130.7	135.4
Electricity, gas and water production and distribution	94.7	94.9	94.5	105.6	107.7	102.6

Source: Federal State Statistics Service

Growth of manufacturing industries versus January-June 2009 was determined by anticipating recovery growth rates of electric, electronic and optic equipment production (128.8%), leather, leather goods and footwear production (122.8%), rubber and plastic goods production (120.8%), chemistry industry (119.5%), metallurgy production and production of finished metal goods (119.2%).

In January-June 2010 machinery and equipment production index made 121.0% versus the corresponding figure of 2009. It was the production of general-purpose equipment (160.3% versus the

1st half of 2009), machine tools (140.9%), forge and press tools (128.5%), rolling equipment (11.3%) that made the major contribution in this growth. The increase in wood processing volumes by 11.9% accounted for the growth of woodworking machines by 2.3 times. At the same time contraction and suspension of investment programs at some industrial enterprises resulted in the decrease of metal-cutting equipment production by 4.6%, numerical controlled turn equipment – by 39.7%, steel-smelting equipment – by 22.5%.

The dynamics of mechanical equipment production (growth by 20.9%) is characterized by considerable fluctuations which are connected with the characteristics of production cycle in this goods group. Thus, steam turbines production went up by 2.7 times, while gas turbines manufacturing dropped by 56.4%.

Positive changes in construction observed in January-June 2010 as compared with the corresponding period of 2009 accounted for the recovery in some kinds of machinery and equipment used in housing and road construction production: excavator production went up by 2.6 times, tower cranes production – by 45.2%, elevators – by 19.8%, equipment and installations for liquids purification – by 2.8 times. At the same time the volumes of some kinds of equipment output continued to decrease; for instance, crawler tractor production fell by 69.7%.

Decrease in production of machinery and equipment for agriculture and forestry (by 23.5% versus the level of the 1st half of 2009) and equipment for special purposes (by 15.6%) still has a negative impact on the dynamics of machinery and equipment production.

In January-June 2010 metallurgy and finished metal goods production index made 119.2% versus January-June 2009, metallurgy production index being 122.0% and finished metal goods index – 108.8%. The demand for ferrous metals at the domestic market is secured by growth rates of metal-consuming sectors of economy. In January-June 2010 steel pipes production made 143.1% versus the corresponding period of 2009. Domestic consumption of steel pipes had recovered by the 1st quarter 2010 to the pre-crisis level of 2008, and since then has been accompanied by the expansion in the domestic steel pipes consumption due to activation of import substituting processes.

Over the last decade Russian ferrous metallurgy was considerably modernized and it still has significant investment potential. In 2000-2010 the total volume of investments in fixed assets made approximately RUR 900 billion, wear and tear of fixed assets in the sector reducing from 54% to 43%. Fulfillment of large-scale investment projects and measures on production efficiency increase allowed the sector to reach new quality level: new technologies have been implemented, inefficient facilities have been closed, added value proportion in goods has been increased.

In this connection the completion of the division for production of pipes of large diameter for oil and gas pipeline (Chelyabinsk tube-rolling plant group - ChPTZ). The cost of project realization is estimated to be USD 21 billion. Credit of RUR 5 billion issued by Gazprombank with state guarantees allowed the company to accomplish construction. Production of ChTPZ new division will meet the international standards. Pipes are envisaged for the use in constructing major pipelines in the area of offshore development, in seismically active regions, in permafrost areas, regions which are difficult to access, when constructing underwater and sea pipelines. Division capacity is estimated at 600 thousand tons a year, including breeches of large diameter (508–1420 mm). Up to the end of 2010 Chelyabinsk plant division “Vysota 239” will produce about 50 thousand tons of pipes, and in 2011 it will achieve project capacity. New production envisages two technological lines: one for production of pipes of 18 m with the thickness of the wall up to 38 mm, second – for 12m pipes with 48 mm wall thickness. Magnitogorsk metallurgy plant will serve as the main supplier of the metal for the new division. German company SMS Meter will supply the equipment.

Since the start of the construction works of North flow gas pipeline, which length makes about 1.2 thousand km, pipes production has increased significantly and over January-June 2010 as compared with the figures of the corresponding period of the previous year it made 181.4% for electric weld pipes of large diameter, 131.5% for other electric weld pipes, 161.0% for drill pipes, 129.5% for seamless pipes, 118.2% for weld steel pipes suitable for water and gas.

In January-June 2010 transport vehicles production index made 128.1% versus the level of the corresponding period of 2009. The contraction of OJSC Russian Railways investment program was accompanied with slack dynamics of railway equipment production. Thus, in January-June

2010 passenger carriages production reduced by 10.8%, mainline diesel locomotives – by 5.6%, while electric locomotives production went up by 5.9%.

Executing RF Government measures on stimulation of the demand for cars and stabilization of financial and economic situation at the automobile industry enterprises contributed into the increase of orders for production of all car assembling plants. As compared with January-June 2009 in January-June 2010 passenger cars production went up by 67.9%, trucks production – by 51.5%, but such high rates are also accounted for by the low level of 2009 base due to the dramatic decrease in the demand and production suspension at a number of enterprises.

High difference in rates is maintained in consumer goods production. Textile and sewing industry as well as leather and footwear production is characterized with high dependence from import supplies.

Low rates of foodstuffs production growing are also worrying – this results in the acceleration of import supplies and stabilization of import share in the retail foodstuffs trade resources at the level of 35%. The domestic foodstuffs production dynamics, import supplies dynamics and changes in prices levels are to be closely observed, taking into account unfavorable conditions for agriculture production in the current year.

In the 2nd quarter 2010 positive dynamics of economic development determined the change in the situation of the labor market. As a result of June 2010 71.0 million out of economically active population were classified as engaged in economic activity and 5.2 million – as unemployed according to the ILO methodology. As compared with May 2001 the number of the employed went up by 762 thousand or by 1.1%, the number of the unemployed decreasing by 347 thousand or by 6.3%. The total number of the unemployed calculated according to ILO methodology is 2.8 times higher than the number of the unemployed registered at state employment services. By the end of June 2010 there were 1866 thousand of the unemployed registered in state employment services. ●

RUSSIAN INDUSTRY IN JUNE 2010

S.Tsukhlo

Weak growth of the demand for industrial goods forces the enterprises to correct price and staff policy, but does not impede output increase or control over finished goods stocks. Accessibility of credits for the industry has not changed in June. For the second month in a row it is estimated as normal by 2/3 of enterprises, and the average interest rate offered by banks continues to decrease.

Official Statistics in May

According to the data of the Federal State Statistics Service, as compared with May 2009 in May 2010 the industrial production went up by 12.6%. As compared with April 2010 the increase in production made 1.2%. Upon exclusion of seasonal and calendar factors Federal State Statistics Service, which excluded the seasonality for the first time, registered the growth of 1.4% versus April. Centre for Macroeconomic Analysis and Short-term Forecasting estimated the growth in May versus April upon exclusion of seasonality by 2.3%, growth in April versus March being 0.9%. The conclusions drawn by experts – even the highest-rank ones – are similar: “the industry is recovering”, “Federal State Statistical Service data register a new wave of recovery growth”, “we are at the beginning of recovery”.

However, doubts on the correctness of statistical data can still be found in comments: “according to the data of the Federal State Statistics Service it seems that we have already overcome the crisis, whereas according to the old data in April industrial output was by 12.5% lower than the pre-crisis (by 5.2% now)”.

Demand for Industrial Goods

In June the demand for industrial goods continued to expand, however its growth rate remains low, no significantly different from zero (*fig. 1*). Thus, without any doubts one can only claim that the sales ceased to drop. The demand for industrial goods has not started to grow at full speed yet. The situation of “no growth, no decrease” has been registered by surveys since October 2009, when the balance of changes in demand approximated zero for the first time. As a result no considerable progress in sales dynamics has been registered in the industry for the third quarter in the row.

Such uncertainty results in a wide variation between the estimation of the current sales volumes by enterprises. Up to July 2009, the proportion of “normal” estimation had stayed at the bottom of the crisis for 8 months (satisfaction with the sales level was at steady 23%), then it reached the next level of 35%. After that the figure of satisfaction with the demand jumped from 33% to 54%, the growth of the demand being practically zero (*fig. 2*). It seems that producers tried to clarify what is happening in the economy and which volumes of the demand are

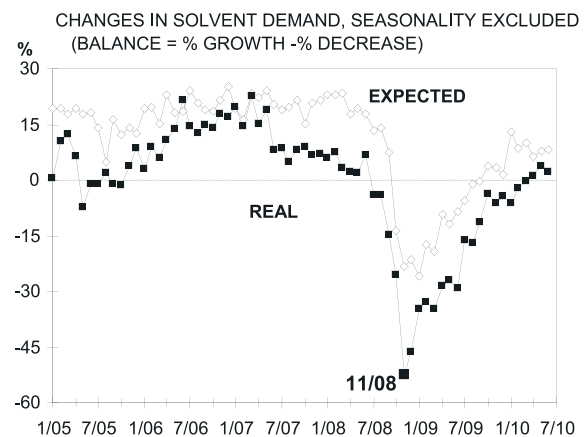


Fig. 1.

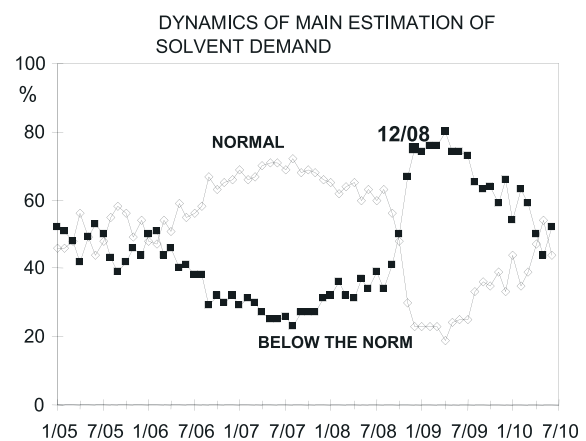


Fig. 2.

adequate to the existing situation. As a result in the 2nd quarter 2010 it is the ferrous metallurgy enterprises (satisfaction of 74%), chemistry and petrochemistry 71% and foodstuffs production (64%) that adapted best to the sector dynamics of the demand. The situation is the worst in industry of construction materials (satisfaction of 26%), timber industry (40%) and machine-building (41%).

Investments

In the 2nd quarter only 44% of enterprises consider the volume of investments as insufficient, while 47% considered their volumes as adequate to the existing economic situation and its prospects. It should be noted that the lack of investments can also be regarded as normal if there is much idle facilities and uncertain future. The highest dissatisfaction with the investments volumes is registered in machine-building industry (58% of enterprises) and timber industry (56%). The second place is held by the light industry (49%). The third – shared by the industry of construction materials (38%), foodstuffs production (35%), chemistry and petrochemistry (32%).

Stocks of Finished Goods

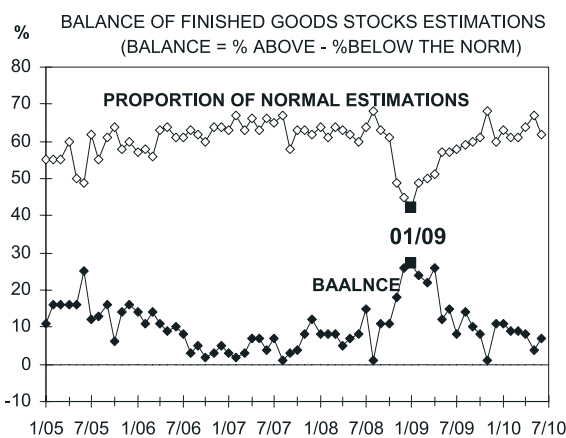


Fig. 3.

Since December 2009 the dynamics of finished goods stocks has a steady positive trend, which reflects good stocks management during the crisis. Industry was characterized by excessive stocks at storehouses for only 6 months (from November 2008 to April 2009). In May 2009 the balance of estimations returned to the level of 2004-2005, and has been reducing gradually to the figures of 2006-2007 down to the level of 2006-2007 (fig. 3). The problem of finished goods, which was so acute in the industry of 1990ies, turned out to be easy to solve during this crisis.

Production Output

According to the surveys data, in June output growth rates again broke the crisis record and is

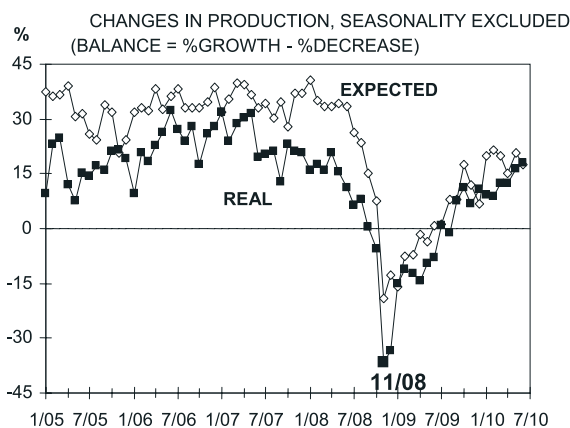


Fig. 4.

becoming more and more comparable to the figures of the beginning of 2008. Thus, starting with September 2009 the industry has been demonstrating quite decent and stable production growth rates for a crisis (fig. 4). Moreover, they have been increasing for the last two months, though little. As broken by sectors, the production output growth was registered by surveys in all the sectors of the industry with the exception for the industry of construction materials. Producers of construction materials made an attempt to launch production in March-May, but not finding the support from the demand had to retreat.

Since January 2010 output plans have maintained high and comparatively stable optimism, which is quite successfully fulfilled in the real changes of forthcoming months. Record-breaking intentions to expand production, which were registered in May, are highly likely to fulfill in Federal State Statistics Service data (they have already realized in June survey results). June plans are not significantly different from the intentions of the previous month, which testifies that the enterprises wish to maintain the production growth further. In July-August it is not planned to decrease production in any of the sectors.

Prices of Enterprises

In June the enterprises again decided to resort to price lever in order to stimulate the sales of their goods and put a stop to the increase of sales prices, which has been observed since the beginning of the year. Over the month prices growth rates dropped from the crisis maximum to nearly zero (fig. 5). There has not been such a considerable price policy correction after December 2008. Only chemistry, petrochemistry and light industry have not changed the previous prices growth rates.

Since March pricing plans of enterprises have stabilized at the level of real sales of January-May, which testifies that June correction was not planned and the enterprises would like to recover the previous prices growth in July-August. Only timber industry is willing to continue prices decrease started in June.

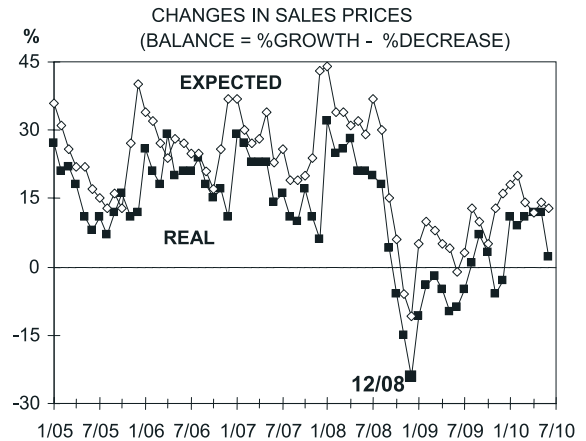


Fig. 5.

Dismissals: Real Dynamics and Plans

In June the industry continued to hire the staff, which it started to do in March. The employment growth rates throughout these months is not high but stable (fig. 6). The enterprises pursue conscientious policy at the labor market, choosing, as it seems, the best-qualified employees. However the forecast of enterprises for the forthcoming months dropped to six-month minimum. Employees hiring may cease if the demand does not start to grow steadily. As it is shown by calculations, in 2010 enterprises are mostly guided by demand forecast and not by output plans when planning staff policy. In 2009 the situation was reverse. In 2005-2007 the hire of employees was also dependent on the demand estimations.

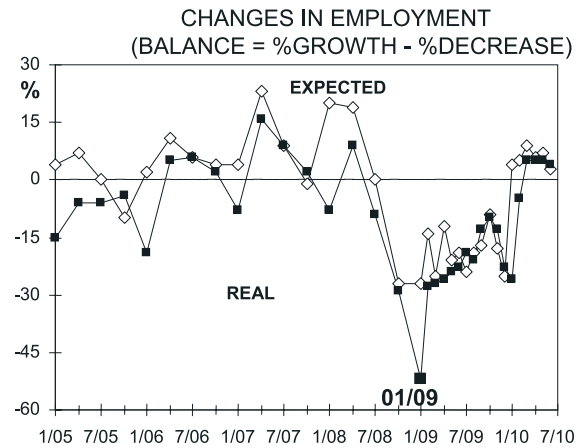


Fig. 6.

Industry Crediting

The accessibility of credits for the industry has not changes in June. For the second month in the row it is estimated as normal by 2/3 of enterprises. The interest rates offered by banks, however, continues to decrease. In June it was on average equal to 14.2% per annum, while its normal level is estimated by enterprises to be at 13.4% per annum. However the value of interest rate is obviously dependent on the size of an enterprise. Whereas small- and medium-scale enterprises are now offered loans with 15.9% per annum, (decrease by 3 percentage points versus September 2009), the enterprises with 251-500 employees – with 14.7% per annum (decrease by 4.1 percentage points), large enterprises (above 1000 employees) are offered the loans with 12.6% (decrease of 5.1 percentage points) (fig. 7).

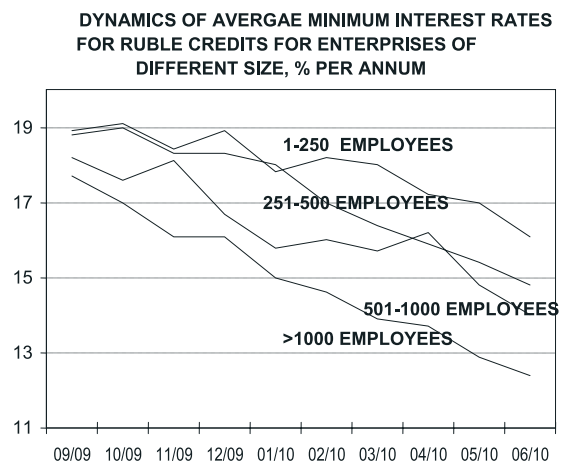


Fig. 7.

Sector priorities of banks have not changes. It is metallurgy industry (11.5% per annum), chemistry and petrochemistry (13.7% per annum) that enjoyed the most favorable credit offers in June. The second place is occupied by foodstuffs production and machine-building industries

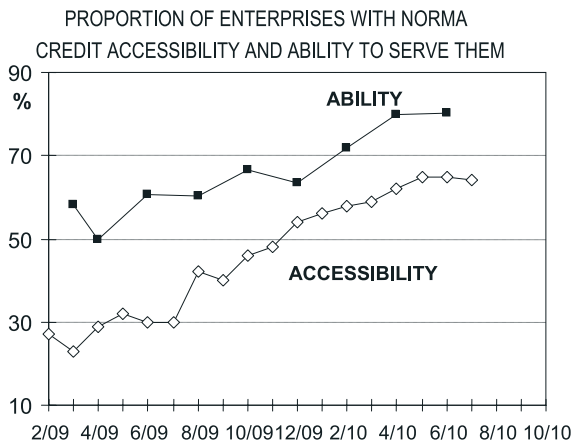


Fig. 8.

In April-June 2010 the highest inability to serve their credits is characteristic for the industry of construction materials. 26% of enterprises that have credits admitted this. The second place is held by machine-building (22%), the third – by timber industry (18%). Only metallurgy plants are 100% sure in their solvency. ●

(14.3%). The highest interest rates are offered for the light industry and industry of construction materials (15.2%).

The ability of enterprises to pay for credits reached 81% in June (among those that have credits), but a little changed over the last two months (fig. 8). It seems that this indicator has reached the limit for the growth under current conditions. The worst value (unfortunately the monitoring started only in March 2009) of this specific index was registered in April 2009. At that time only 50% of enterprises among those that have credits admitted to be able to pay the debts. Other 50% of enterprises self-critically estimated their abilities as insufficient. Such distribution of estimation when responding such delicate and painful question proves, in our opinion, that the enterprises' responses are quite reliable.

FOREIGN TRADE

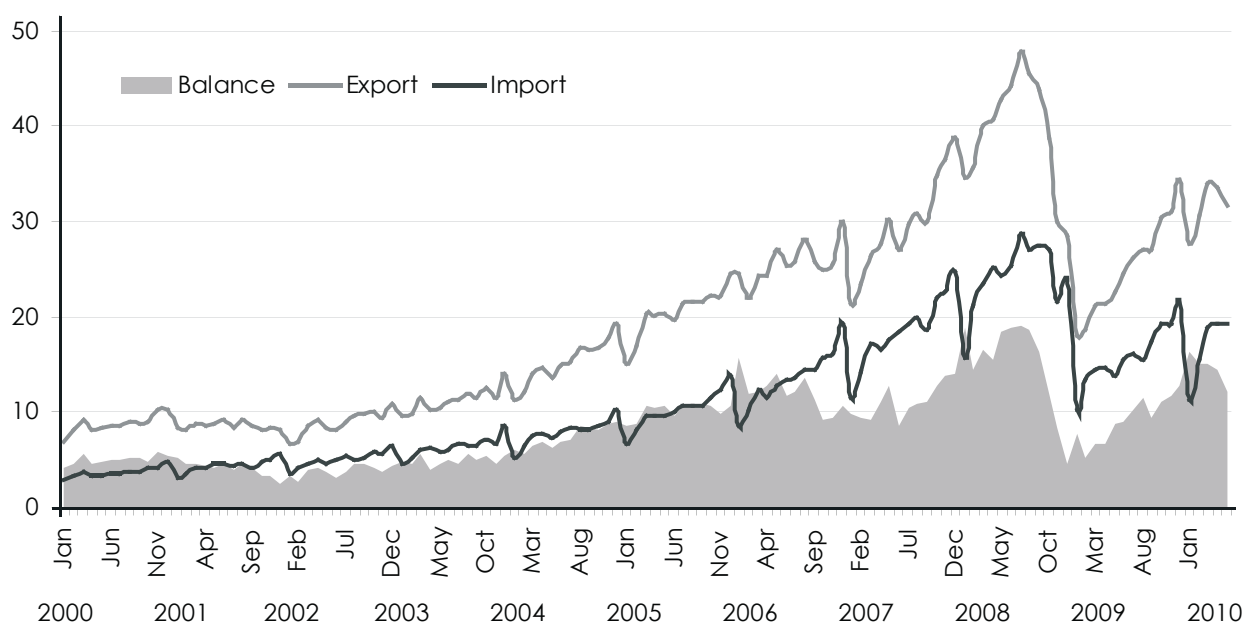
N.Volovik

Main indices of Russian foreign trade continue to recover after a sharp drop in 2009. However as a result of Russian export growth rates slow-down and the continuing import growth the foreign trade balance is decreasing. Federal Service for Supervision in the Sphere of the Protection of Consumer Rights and Human Welfare and Federal Service for Veterinary and Phytosanitary Surveillance reinforce their activity on import regulation.

In May 2010 Russian foreign trade turnover calculated on the basis of balance-of-payments methodology reached USD 51.0 billion, which exceeds the figure of May 2009 by 40.4%. Export value volume increased up to USD 31.6 billion, i.e. by 40.2% versus May 2009. Russian import recovery rates are quite close. In May 2010 import value volume went up by 40.7% versus May 2009 and made USD 19.4 billion. RF foreign trade balance in May 2010 was positive and equal to USD 12.2 billion, which is by 39.3% more than the corresponding figure of the previous year.

The debt crisis in Eurozone caused a drop of oil prices at the beginning of May 2010. On May 7, 2010 oil markets registered the most significant decrease in prices over the last 18 months, prices for crude oil falling by 6.5% after steady growth in April. Despite the fact that a number of OPEC ministers present at the conference of Arabic petroleum exporting countries (OAPEC) in Doha on May rejected the necessity to change the production level in connection with the drop of oil prices with the purpose of their correction under the conditions of overheated market. Despite the drop, average price of OPEC oil barrel made USD 74.48 in May 2010 and remained within the price corridor comfortable for the Group. Kuwait Minister of Oil stated that the decrease of oil price down to USD 65 per barrel is the level which is likely to require calling for special meeting of OPEC ministers.

In May 2010 price for oil grade Urals made USD 73.4 per barrel, which is by 11.1% below the level of April 2010, as compared with May 2009 the price for oil went up by 1.3 times.



Source: Central Bank of the Russian Federation

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

Over the period of monitoring from June, 15th to July, 14th inclusive average price for Russian oil made USD 74.45455 per barrel. The maximum duty level will consequently make USD 263.862 per ton. Thus, export duty rate is likely to be established at the level of USD 263.8 per ton from August, 1st. At the same time the duty for oil produced at the oil fields of the Eastern Siberia will probably be USD 80.3 per ton, having increased by 14.9% as compared with the July duty rate of USD 69.9 per ton. The duty rate for light oil products may be USD 190 per ton, for dark oil products – USD 102.4 per ton. In July export duty rate for light oil products was USD 179.9 per ton, for dark oil products – USD 96.9 per ton.

The continuing decrease of metals consumption in China, expected deceleration of housing construction growth rates decrease the demand and contribute into the decrease of prices for metals. According to the data of London metal exchange, in May 2010 as compared with April of the current year prices for nickel dropped by 15.1%, for copper – by 11.7%, for aluminum – by 11.9%, for ferrous metals – by 13.9%; as compared with May 2009 the prices for nickel went up by 1.7 times, for copper – by 1.5 times, for aluminum and ferrous metals – by 1.4 times.

Table 1

AVERAGE WORLD PRICES IN MAY OF THE CORRESPONDING YEAR

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Oil (Brent), USD/barrel	15.91	27.50	28.71	25.21	25.34	37.9	47.8	68.68	67.64	119.4	58.63	76,99
Natural gas, USD/1 million BTU	2.349	3.724	4.220	3.254	5.984	6.465	6.497	7.97	7.94	11.44	3.901	5,277
Petrol, USD/gallon	0.529	0.957	1.095	0.767	0.835	1.342	1.44	2.072	2.293	3.22	1.71	2,111
Copper, USD/ton	1539.9	1834.7	1708.2	1596.2	1667.5	2720.0	3254.0	8022.0	7682.2	83825	4568.6	6837,7
Aluminum, USD/ton	1317.9	1464.7	1536.7	1344.3	1397.6	1615.7	1746.0	2852.0	2797.4	2902.9	1460.5	2040,53
Nickel, USD/ton	5239.5	10141.4	7115.7	6764.0	8351.9	11068	16930.0	21038	52179.1	25735	12635	22008,2

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

According to the data of the bank of Russia, in January-May 2010 Russian foreign trade turnover will make USD 241.8 billion, which exceeds the figure of the corresponding period of the previous year by 44.0%, export reaching USD 157.5 billion (156.1%), import – USD 84.3 billion (125.8%). Foreign trade balance remained positive and was equal to USD 73.2 billion (33.9 billion in January-May 2009).

Despite the high growth rates of Russian rates, pre-crisis indices have not been reached yet. As compared with January-May 2008 value volume of export supplies over 5 months of 2010 was below 18.4%. Monthly dynamics of Russian export in the current year testifies that its growth rates have slowed down, which is accounted for by physical volumes of main goods export is nearing pre-crisis level, while external demand has not recovered yet at the moment. In May sustention of the trend for export physical volume growth was characteristic only for oil products, chemistry production and ferrous metallurgy. Consequently, potential for accelerated export growth in the nearest future is likely to be exhausted.

In January-May 2010 as compared with the corresponding period of 2009 goods import value went up by 25.8%, but remained 23.4% less than before the crisis – in January-May 2008. At the same time imported goods value growth rates continue to increase. Whereas in February 2010 import in annual terms went up by 15.4%, in May 2010 growth rates reached 40.7%.

Structure of import as broken by goods types reflects the trends in the real sector of the Russian economy. Thus, the proportion of chemistry goods import in May 2010 in the structure of goods import made 16.1% which corresponds to the figure of 2009.

The proportion of foodstuffs import in the total volume of import, reducing as it has from 21% in May 2009 to 19.6% in May 2010, is still considerably higher than in May 2008.

As to foodstuffs import, supplies of sugar, grain crops – by 2.1 times, of fish – by 36.6%, of dairy – by 35.2%, of fruits – by 30.2%, of vegetables – by 27.8%, of alcohol and alcohol-free beverages – 17.2%, of tobacco – by 9.0%. At the same time value volume of meat and variety meat import in May 2010 as compared with May of the previous year reduced by 14.6%, of oil – by 12.1%.

On July 23, 2010 temporary agreements for supplies of meat and dairy to the Russian Federation from 14 Finnish enterprises introduced by the Federal Service for Veterinary and Phytosanitary Surveillance (Rospotrebnadzor) as a result of inspection of 23 Finnish enterprises in May 2010 came into effect. At 14 of these enterprises, according to the data of the sanitary service, moments when the final products may be polluted have not been technologically excluded. Differences between Russian and European legislation regulating dairy sector can also be the reason for temporary prohibition.

Sanctions concerned 6 out of 15 Valio Finnish plants. The company exports its goods to more than 40 countries of the world and Russia accounts for about 30% of the total export volume. Melted cheese Viola, semi-soft cheese Oltermanni, Valio butter are the main products of its export into the Russian Federation.

Besides, the supplies of meat-producing enterprises Atria Suomi, Shellmanin Lihanjalostus, HK Ruokatalo, Saarioinen, and ice-cream producer Ingman Ice Cream are limited.

According to the estimation of the National Dairy Producers Union (SOUZMOLOKO) suspension of supplies from Finnish and Dutch enterprises (supplies from a number of enterprises were limited earlier) will not affect the provision of the Russian population with milk and dairy products since the volume of dairy subject to ban makes approximately 1-2% of the total import volume to the Russian market.

The proportion of Finnish meat processing enterprises is also low. The volume of bilateral goods turnover between Russia and Finland made USD 13.1 billion in 2009. And although due to the economic crisis it reduced as compared with the previous year, Russia still holds the first place among the trading partners of Finland. Moreover, over the 1st quarter of the current year bilateral goods turnover went up by more than 20%, reaching USD 5 billion.

Limitation of supplies from abroad can be a measure of support for domestic producers. It should be remembered that from January 1, 2010 in Russia sanitary norms prohibiting import and sale of poultry treated with chlorine came into effect. All chicken imported into the Russian federation from the USA is subject to this ban. Before that, Russia's share in USA poultry export structure made 20%.

Russian and American experts conducted several rounds of talks concerning the renewal of American chicken supplies. As a result, the USA have agreed to fulfill Russian requirements on chlorine-free chicken treatment but could not at once bring products into concordance with new requirements and the supplies will be resumed only in September.

In 2009 Russia imported 950 thousand of tons of chicken meat, and 750 thousand of tons – from the USA. Domestic production at the same time made about 2.5 million of tons. According to the data of the Federal Service for Veterinary and Phytosanitary Surveillance, as on January 1, 2010 245 American poultry farms were accredited for supplies to Russia.

At the end of 2010 the presidents of Russia and the USA negotiated the resume of American chicken meat supplies to Russia. In order to execute this decision at the middle of July the head of the Federal Service for Veterinary and Phytosanitary Surveillance S. Dankvert, the head of the Federal Service for Supervision in the Sphere of the Protection of Consumer Rights and Human Welfare G. Onischenko and Under Secretary for Farm and Foreign Agricultural Services of the USA Department of Agriculture, J. Miller signed the corresponding agreement. After that the American party started to prepare the list of the enterprises allowed to export chicken meat to Russia.

According to the information on the site of Food Safety and Inspection Service (FSIS), by July, 23 the list included 27 farms of 15 companies, including one of the biggest poultry producers in the USA, Pilgrim's Pride. Nearly all the American enterprises that were earlier accredited would like to resume export into Russia, but each of them needs different time to adapt to the Russian legislation requirements.

On June 29, 2010 Federal Service for Supervision in the Sphere of the Protection of Consumer Rights and Human Welfare declared the reinforcement of sanitary and epidemiological control over alcohol goods from Moldova: wine stocks not meeting safety requirements had been found repeatedly. In April 2010 Federal Service for Supervision in the Sphere of the Protection of Consumer Rights and Human Welfare rejected 47 thousand liters of Moldavian wine due to inadequacy to safety requirements.

The history of complaints about Moldavian wine quality started in 2006 when in March supplies of Moldavian wines were banned. Supplies resumed partially in the second half of 2007, and in summer 2009 Russia lifted all limitations concerning Moldavian wines import. As a result of 2009 Moldavian wine held the third place at the market of wines import with the share of 12% (France holding the first place, Bulgaria – the second). As a result of the 1st quarter 2010 Moldavian wines went up to the second place, expanding their market share to 17% (France – 20%, Germany – 10-12%). ●

THE STATE BUDGET

E.Fomina

The federal budget deficit unrelated to revenues from oil and gas in the first 6 months of 2010 rose to nearly 11 % GDP. The volume of general government budget revenue increased by 1.9 p. p. of GDP by comparison with the same period of 2009, which happened primarily due to higher prices for raw materials. The RF Ministry of Finance presented its proposals concerning the ways to increase federal budget revenue in the years 2011 – 2013.

An Analysis of the Main Parameters of the Execution of the General Government Budget in January – May 2010

At present it can be stated that the situation in the national economy has noticeably improved, which is confirmed by the positive dynamic of the main macroeconomic parameters – while at the same time the consequences of the economic crisis have not been fully overcome. This can be observed in the lack of proper balance in the structure of budgets and in the presence of a marked gap between the amounts of available resources and state obligations.

According to the operative data published by the RF Treasury concerning the budget execution in January – May 2010, the revenue volume in the general government budget rose by 1.9 p. p. of GDP on the corresponding period of 2009; its volume increased in absolute terms as well (see Table 1). The expenditure side of the general government budget in the first 5 months 2010 dropped by nearly 1 p. p. of GDP – to 34.7 % of GDP, while in absolute terms this index somewhat increased. As a result, the general government budget continues to be executed with a surplus (1.7 % of GDP), although every month this surplus displays a steady decline.

Table 1

THE EXECUTION OF BUDGET REVENUE AND EXPENDITURE AT ALL LEVELS OF AUTHORITY IN JANUARY – MAY 2009 – 2010

	January - May 2010		January - May 2009		Deviation, p. p. GDP
	bn Rb	as % of GDP	bn Rb	as % of GDP	
Federal budget					
Revenue	3,195.7	18.8	2641.4	18.1	+ 0.7
Expenditure	3,658.9	21.6	3117.9	21.3	+ 0.3
Deficit (-) /Surplus (+)	- 463.2	- 2.8	- 476.5	- 3.2	+ 0.4
Consolidated budgets of RF subjects					
Revenue	2,658.9	15.7	2,309.0	15.8	- 0.1
Expenditure	2,138.0	12.6	2,056.9	14.1	- 1.5
Deficit (-) /Surplus (+)	520.9	3.1	252.1	1.7	+ 1.4
General government budget					
Revenue	6,182.8	36.4	5,048.2	34.5	+ 1.9
Expenditure	5,893.9	34.7	5,210.9	35.6	- 0.9
Deficit (-) /Surplus (+)	288.9	1.7*	- 162.7	- 1.1	+ 2.8
For reference: GDP, bn Rb	16,968.0		14,632.0		

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

Source: RF Ministry of Finance; IET estimates.

The consolidated budget of RF subjects in January – May this year was also executed with a significant surplus of 3.1 % of GDP (against 1.7 % of GDP in the same period of 2009). Although the volume of expenditure in the first 5 months of 2010 already decreased by 1.5 p.p. of GDP, the federal authorities recommend that the expenditure part of the RF subjects' budgets should be further decreased. In the medium term it can be expected that the government support to the regions from the federal center will become less pronounced: from the year 2011 onwards, it is planned to decrease the volume of subsidies and budget loans.¹ This toughening of the government policy with regard to state support of the regions manifests itself in the reduced funding of the measures envisaged in the anti-crisis program.

On the whole, the situation in Russia's public finances is still being influenced by the relatively high world prices for energy carriers. Against the backdrop of an improving situation on foreign markets the inflow of revenues from oil and gas is also increasing; in particular, the volumes of revenues from *the tax on mineral resources extraction* and *foreign trade* rose notably on their last year's levels (Table 2). Thus, growth of the collectability of the tax on mineral resources extraction amounted to 1.1 p.p. of GDP by comparison with the 2009 level. In addition to the growing prices for raw materials on world markets, since last year there has also occurred a marked growth of the physical volume of the extraction of mineral resources. The overall growth of the extraction volume in January – May 2010 was 6.0 % against the same period of the previous year.

The volume of *revenues from foreign trade* in the first 5 months this year rose by 2 p.p. of GDP on the 2009 index. In view of growing world oil prices, from early 2010 onwards the rates of export duties on crude oil began to be adjusted – mainly upward. Thus, the export duty on oil in the Russian Federation from 1 August 2010 onwards will amount to 263.8 USD/ton, which is by 15 USD higher than the duty effective in July. At the same time, the export duty on the oil produced in East Siberia may become as high as 80.3 USD/ton, thus increasing by 10.4 USD/ton².

Following the increased share of the oil and gas revenues in the general government budget, the revenues unrelated to oil and gas have also demonstrated a certain upward trend, the rate of their growth being however somewhat lower. The volume of revenues from *the tax on profits of organizations* in the general government budget in January – May 2010 increased both in absolute and relative terms, amounting to 4.7 % of GDP against 3.9 % p. p. of GDP in the corresponding period of 2009. This positive dynamic was largely the result of the generally positive economic background.

In January - May 2010 the volume of revenues from *excises* in the general government budget continued to grow at a markedly high rate. Growth amounted to 0.2 p.p. of GDP against the previous year's index. The cause of this growth was the accelerated increase of the rates of excises for a number of excisable commodities.

The volume of revenues from the personal income tax in the general government budget declined by 0.3 p.p. of GDP against the previous year's level. This index also dropped in absolute terms. At the same time, growth of real wages in January – May 2010 amounted to 4.4 % of the level in the corresponding period of last year, which on the whole is quite compatible with the growth rate of the national economy (since the year's beginning, the economic growth index has been 4.2 %).

Table 2

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

	5 months of 2010	5 months of 2009	Deviation, p. p. of GDP
Tax burden level (1 + 2 + 3)	33.7	30.3	+ 3.4
Tax revenues (1), including:	21.3	21.4	- 0.1
Tax on profits of organizations	4.7	3.9	+ 0.8
PIT	3.8	4.1	- 0.3
SST*	-**	2.2	-
VAT	5.5	5.5	0.0

1 <http://www.minfin.ru/ru/press/speech/index.php?id4=10146>

2 <http://www1.minfin.ru/ru/press/speech/index.php?id4=10217>

Table 2, cont'd

	5 months of 2010	5 months of 2009	Deviation, p. p. of GDP
Excise	1.1	0.9	+ 0.2
Tax on mineral resources extraction	3.3	2.2	+ 1.1
Insurance contributions to mandatory pension insurance (2)	5.1	3.6	+ 1.5
Revenues from foreign trade (3)	7.3	5.3	+ 2.0

* less insurance contributions to mandatory pension insurance.

** from 2010 onwards, SST is transformed into insurance contributions to be transferred to off-budget funds.

Source: RF Ministry of Finance; Rosstat; IET estimates.

On the whole, it can be noted that the level of *tax load* on the national economy in the first 5 months of 2010 rose by 3.4 p.p. of GDP on the same period of 2009, having reached the level of 33.7 % of GDP. This happened in the main under the influence of external factors.

Against the backdrop of the growing general government's budget revenue in January – May 2010, budget *expenditure* was declining in relative terms, which is compatible with the concept of curbing the growth of expenditure adopted for the year 2010; in the first five months of this year, the volume of expenditure in the general government's budget declined by 0.9 p. p. of GDP. The downward dynamic of budget expenditure can be explained by the restrictions imposed on the level of expenditures at the regional level of Russia's budgetary system (*Table 3*).

Table 3

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

	January – May 2010		January – May 2009		Deviation, p.p. of GDP
	bn Rb	as % of GDP	bn Rb	as % of GDP	
Expenditure, total	5,893.0	34.7	5,210.9	35.6	– 0.9
including					
Nationwide issues	492.7	2.9	457.9	3.1	– 0.2
Of these, servicing of state and municipal debts	109.6	0.7	92.2	0.6	+ 0.1
National defense	495.8	2.9	445.1	3.0	– 0.1
National security and law- enforcement activity	469.5	2.8	441.8	3.0	– 0.2
National economy	632.9	3.7	752.2	5.1	– 1.4
Housing and utilities system	260.9	1.5	253.2	1.7	– 0.2
Environment protection	8.2	0.05	9.2	0.06	– 0.01
Education	643.2	3.8	606.6	4.2	– 0.4
Culture, cinematography and mass media	110.5	0.7	103.3	0.7	0
Public health care and sports	561.4	3.3	546.6	3.7	– 0.4
Social policy	2,218.6	13.1	1,594.4	10.9	+ 2.2

Source: RF Federal Treasury; IET estimates.

In spite of the declining overall volume of the general government's budget expenditure, a certain growth of funding was noted in January - May 2010 with regard to a number of budget items. Increased financing was allocated in the main to the following items of the functional classification: 'Social Policy' and 'Servicing of State and Municipal Debts', which is more by 2.2 p.p. and 0.1 p.p. of GDP respectively than in the same period of 2009. The volume of expenditure allocated to all the other budget items displayed a downward trend; the biggest drop on 2009 was noted with regard to the item 'National Economy' – by 1.4 p.p. of GDP.

The Execution of the RF Federal Budget in January – June 2010

Over the first half-year 2010 the role of the State in putting the economy back to normal and in consolidating the improved economic environment remained rather prominent; the government continued to pursue its aggressive investment policy by means of ‘budget injections’ in the national economy. The federal budget has remained the main instrument for redistributing public finances.

According to the operative data published by the RF Ministry of Finance, federal budget revenue in the first half-year 2010 amounted to 19.3 % of GDP, which is by 1.3 p.p. of GDP higher than in the same period of 2009.

Federal budget expenditure in January – June 2010 dropped on 2009 by 0.5 p.p. of GDP – to 21.5 % of GDP (*Table 4*). It should be borne in mind, though, that in spite of its slight decline as demonstrated by the results of the first half-year 2010, this particular level of the expenditure volume represents one of the historic highs achieved lately. One has only to compare it to the pre-crisis period when the federal budget expenditure never exceeded 16 % of GDP.

Table 4

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

	January – June 2010		January – June 2009		as % of budget revenue and expenditure for 2010	Deviation	
	bn Rb	as % of GDP	bn Rb	as % of GDP		bn Rb	p.p. of GDP
Revenue, including:	3,995.4	19.3	3,172.2	18.0	57.5	823.2	+ 1.3
Revenues from oil and gas	1,790.9	8.7	1,053.4	6.0	56.1	737.5	+ 2.7
Deductions to Reserve Fund and National Welfare Fund (Stabilization Fund)	26.5	0.1	272.6	1.5	–	- 246.1	- 1.4
Expenditure, including:	4,435.3	21.5	3,893.8	22.0	44.9	541.5	- 0.5
interest	95.2	0.5	86.4	0.5	31.3	8.8	0.0
non-interest	4,340.1	21.0	3,807.4	21.5	45.3	532.7	- 0.5
Federal budget surplus (deficit)	- 439.9	- 2.1	- 721.7	- 4.1	15.0	281.8	+ 2.0
Deficit unrelated to revenues from oil and gas	- 2,230.8	- 10.8	- 1,775.0	- 10.0	36.4	455.8	- 0.8
GDP estimations	20,660.0		17,679.6				

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

As a result of the multi-vector trends displayed by federal budget revenue and expenditure in the first 6 month of this year, the RF federal budget was executed with a deficit of 2.1 % of GDP against 4.1 % of GDP in 2009. The volume of the deficit unrelated to oil and gas, according to preliminary estimates, remains at the level of about 11 % of GDP. Such a high value of this index is indicative of the presence of some substantial government expenditures that are not backed by budget revenues from oil and gas, which results in weakening of this country’s budgetary system and strengthening the dependence of its budget parameters on the world prices for raw materials.

It is intended that the switchover from a functional structure of federal budget expenditure to that based on allocations to government programs should promote its higher efficiency. It is planned that from the year 2011 the state budget will be presented in the form of 35 direction-based programs. Federal target programs will be integrated into those state programs as their components. The final list of programs is to be approved in August 2010¹. At the same time it should be noted that the price of achieving a better-balanced budget through direct cuts of budget expenditure allocated to certain items, and in particular social items, may be an increased social tension.

1 <http://www1.minfin.ru/ru/press/speech/index.php?id4=10189>

The main source of achieving a properly balanced federal budget is, as before, the Reserve Fund. Its size in the first 6 months of this year decreased by 604 bn Rb - to 1,226.6 bn Rb. This drop resulted from the spending allocated to the achievement of a well-balanced federal budget, as well as from the changes in the national currency's exchange rate. The volume of the National Welfare Fund during the same period decreased by 102.6 bn Rb - to 2.66 trillion Rb (*Table 5*).

Table 5

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

Indices	Fund residuals, end of 2009	Approved for 2010 budget	Received in January – June 2010	Allocated in January – June 2010		Allocated in January – February 2010
				to maintaining well-balanced federal budget	to maintaining well-balanced federal budget	
Oil and gas revenues in federal budget	x	2,057.2	1,790.9			x
Areas for allocating oil and gas revenues:	x	x				x
Oil and gas transfer	x	2,531.1	1,790.9			
Reserve Fund	1,830.5	5,147.5	0	519.5	0	1,226.6
National Welfare Fund	2,769.0	x	26.5	2.5	–	2,666.4
Total	4,599.5	x	1,817.4	522.0	0	3,893.0

* residuals as recalculated at the exchange rate as of 1 July 2010

Source: RF Federal Treasury.

Table 6 shows the execution of the federal budget in cash terms in January–May 2010 in accordance with the functional classification of budget expenditure. The allocation of federal budget resources this year was done at a higher operative level by comparison with 2009, the overall deviation with regard to federal budget expenditure was 5 % of the initial budget revenue and expenditure. The highest achievement in this respect was demonstrated by the item 'Interbudgetary Transfers'. The expenditures on this item increased by 10.5 p.p. Such an increase of the volume of interbudgetary transfers this year can be explained in the main by the significantly raised pensions – among other things, as a result of pension valorization that took place in January 2010 and the more speedy transfer of resources to the RF Pension Fund.

The funding of the items 'Social Policy', 'National Defense', 'Education', and 'Public Health Care and Sports' was allocated at an accelerated rate.

An opposite trend of falling behind last year's rates was demonstrated by the items 'National Economy' and 'Servicing of State and Municipal Debts'.

Table 6

FEDERAL BUDGET EXECUTION IN CASH TERMS IN JANUARY – MAY 2010 AND 2009 JANUARY 2009 AND 2010 (AS A PERCENTAGE OF ANNUAL BUDGET REVENUE AND EXPENDITURE)

	January – May 2010	January – May 2009
Budget expenditure, total	36.9	31.9
including		
Nationwide Issues	27.1	28.2
Servicing of State and Municipal Debts	27.8	32.5
National Defense	39.2	36.5
National Security and Law Enforcement Activity	35.3	35.0

Table 6, cont'd

	January – May 2010	January – May 2009
National Economy	25.6	26.5
Housing and Utilities System	36.5	16.6
Environment Protection	33.8	28.9
Education	32.0	29.9
Culture, Cinematography and Mass Media	32.5	28.7
Public Health Care and Sports	26.2	24.5
Social Policy	38.7	33.0
Interbudgetary Transfers	45.0	34.5

Source: RF Ministry of Finance; IET estimates

As is seen from the operative data published by the RF Ministry of Finance, in the first half-year 2010 the RF ministries and departments received 99.9 % of the total planned volume of federal budget expenditure for that period. At the same time, the ministries and departments, in their turn, transferred 73.9 % of the budget allocations to their subordinated institutions which, as estimated by the RF Ministry of Finance, 'is an insufficient volume for that particular period of the year, as part of budget-funded institutions do not know their established budget limits up until the year's end'¹.

An Overview of the Main Developments in the Sphere of Tax and Budgetary Policy in July 2010

In July 2010, the RF Ministry of Finance presented its proposals concerning the ways to increase federal budget revenue in 2011 – 2013.²

It should be noted that the majority of the initiatives put forth in this document are aimed at increasing the volume of taxation levied on the raw materials sector of the national economy. Thus, among the measures designed to replenish the federal budget in the medium term the following ones appear to be capable of producing the strongest effect:

- an increase of the rate of the tax on mineral resources extraction levied on the production of oil and gas. It is suggested that from the year 2012 the base rate of the tax levied on oil extraction should be raised - by 6.5 % and 5.4 % in 2012 and 2013 respectively. Thus, in those periods the indexation of the tax rate will correspond to the expected inflation rate. Besides, this particular rate of the tax on mineral resources extraction has not been adjusted for a few years. The implementation of this measure will generate additional revenues in the amount of approximately 225 bn Rb in two years.

At the same time, the rate of the tax on mineral resources extraction levied on the production of natural gas can be raised, from the year 2011 onwards, by 61 % - with a subsequent annual adjustments in accordance with the actual growth of prices. In the event of this measure being implemented, the amount of additionally generated federal budget revenue will be in the whereabouts of 180 bn Rb;

- an improved approach to collecting export duties on petroleum products. It is suggested that export duties should no longer be subdivided into those levied on light and heavy petroleum products. It is planned that by 2012 a mean rate of 58 % should be established. This measure is to conduce to a more efficient and transparent taxation;

- changed rates of and principles applied to levying the transport tax. The RF Ministry of Finance suggested that the existing rate of the transport tax should be reduced by half, while at the same time regional authorities should be granted the right of decision-making with regard to

1 <http://www.minfin.ru/ru/press/speech/index.php?id4=10204>

2 <http://www1.minfin.ru/ru/press/speech/index.php?id4=10248>

exempting from the transport tax passenger cars with engine capacity above 150 hp. This proposal has been put forth as a result of the substantial increases of the rates of excises on petrol and some other petroleum products from the year 2011 onwards, which will impose a rather heavy burden on passenger car owners. So, a lower transport tax will make it possible to soften the effect of the forthcoming increase in the prices of petrol. ●

THE RUSSIAN BANKING SECTOR

S.Borisov

In May the banking system's assets increased by 0.5 %. The principal distinctive feature of the asset growth that occurred in May was its 'credit' nature. For the first time since the year's beginning the main contribution to the increase of the balance value was made by the growing volumes of loans to the real sector instead of growth of alternative sources of investments. Reserves against losses on loans were growing at a slower rate than previously, while at the same time growth of accumulated profit since the year's beginning reached its historic high. The credit portfolio's quality became stabilized.

Table 1

THE MAIN INDICES OF THE RUSSIAN BANKING SYSTEM

	As of 01.06.2009, bn Rb	As of 01.01.2010, bn Rb	As of 01.06.2010		
			Nominal value, bn Rb	Growth since year's beginning, %	Growth per annum, %
Assets	27,407.5	29 430.0	29 725.0	1.0	8.5
Credits granted to non-financial institutions	12,982.4	12,541.7	12,769.3	1.8	- 1.6
Credits granted to physical persons	3,738.3	3,573.8	3,613.7	1.1	- 3.3
Credits granted to banks	2,314.0	2,725.9	2,555.7	- 2.6	14.8
Investments in bonds	2,109.7	3,379.1	3,944.8	16.7	87.0
CB's deposits	2,269.9	1,423.1	434.9	- 69.4	- 80.8
Banks' deposits	3,372.2	3,117.3	3,093.4	- 0.8	- 8.3
Deposits of legal entities	5,126.0	5,466.6	5,492.6	0.5	7.2
Population's deposits	6,316.1	7,485.0	8,176.0	9.2	29.4
Reserves against potential losses	1,453.3	2,050.6	2,200.9	7.3	51.4
Profit (current year)	37.0	205.1	198.2		435.7

Source: Bank of Russia.

Growth of assets in the Russian banking system in May amounted to 0.5 %, thus ensuring the rate of growth of 1 % since the year's beginning. The distinctive feature of May's growth of assets was its 'credit' nature. And finally, one can speak of a certain change of the trend in crediting, because this was largely the reason why assets were growing in May. According to the data released by the RF CB, the volume of portfolios of retail credits in May increased by 1.2 %, while the residuals of credits granted to non-financial institutions during the same period increased by 1.9 %. Growth of the volumes of crediting can serve as an indirect confirmation of the impending positive shift with regard to financial stability of borrowing clients. Growth of the share of outstanding debt in May was only 1 p.p. in respect of corporate and retail portfolios. It is noteworthy that simultaneously with the restart of crediting the interest rate margin for credits continues to become narrower. This has to do, on the one hand, with fierce competition in attracting reliable borrowers in the corporate segment, while on the other – with the aggressive policy of lowering the interest rates on credits granted to physical persons currently pursued by the key banks. One such example is that the margin for Rb-denominated credits granted to the population for periods of less than 1 year decreased from 24.5 to 18.4 p.p. (Fig. 1).

Russian banks continue to increase their reserves against potential losses on loans, but the intensity of this growth is becoming noticeably weaker. The aggregate banking provisions in

May rose by only 1.7% on the previous month (3.1 % in April).

The stabilization of the Rb's exchange rate, together with the expectations of its further steady strengthening in the next 1 – 1.5 years, have been boosting up the demand for Rb-denominated credits for periods over 1 year both among corporate borrowers and among the population. On the whole, the Rb-denominated component of credits

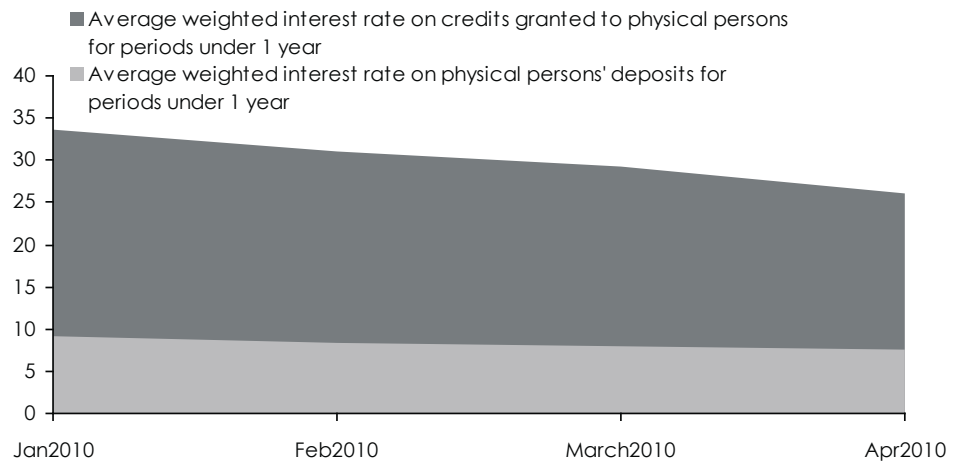


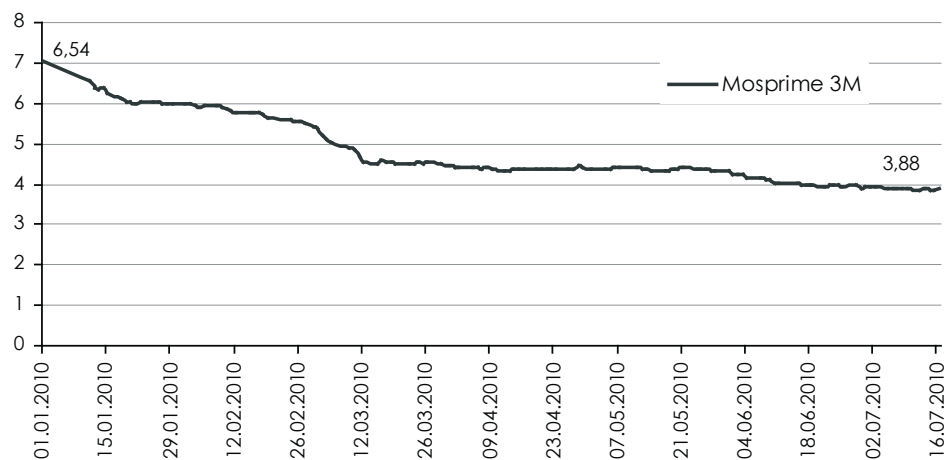
Fig. 1. Behavior of average weighted interest rate on Rb-denominated credits and deposits for periods under 1 year, %

granted to the private sector and businesses increased in May by 1.1 and 1.0 p.p. respectively. The strengthening by 4.6 % of the USD's exchange rate in May (the USD being the principal currency in the foreign-currency denominated credit portfolios of banks) produced, in its own turn, some positive effect associated with the reevaluation by banks of their credit portfolios. It is noteworthy that alongside the revival of crediting of the real sector the volume of credit resources granted to other banks continues its downward trend. For a fourth month in a row the portfolio of credits granted to banks has been decreasing, its decline as of 1 June since the year's beginning already amounting to 2.6 %. In May the drop in the volume of interbank crediting amounted to 3.4 %. The behavior of Mosprime 3M continues to display a downward trend (Fig. 2), while the residuals of banks on the correspondent accounts with the RF CB remain on the average at the level of 500 bn Rb.

According to the data published by the RF CB, the volume of capital in the banking system in May declined by 3.2 %. The main reason for this drop was the redemption, by Sberbank on 19 May 2010, of its subordinated loan in the amount of 200 bn Rb. At the same time, the capital sufficiency norm in the banking system in May was 19.2 %.

The deposits of legal entities – as well as those of physical persons – were increasing in May at a slower rate than in the previous months. Growth with regard to the population's deposits amounted to 1.7 % (9.2 % since the year's beginning), while growth of deposits made by non-financial institutions – to only 0.1 %. The slowdown in the growth rate of deposits can be explained mainly by the excess of free liquidity in the banking

sector alongside the persistently high credit risks. Banks continue to lower their interest rates on deposits. Thus, for example, in April 2010 (no later statistics has been as yet published by the RF CB) the average weighted interest rates on Rb-denominated credits granted to the population for periods under 1 year dropped by 30 basis points.



Source: National Currency Association.

Fig. 2. Behavior of Mosprime 3M

As demonstrated by May's results, Russia's

banking system achieved a historic high of profit in the amount of 198.2 bn Rb, thus gaining 437 % on the same index for May 2009. Nevertheless, there still exist some risks of considerable growth of reserves due to the effect produced by the concealment, by some banks, of sector information concerning the quality of credit redemption by problem borrowers. There is no doubt that the size of accumulated profit in May 2010 was significantly influenced by the drop of operational costs across the whole system coupled with growth of interest-linked income and positive reevaluation of part of investment assets. A more detailed structure of the statement of the system's profits and losses will become available in August.

Below is the list of the most notable events that occurred in the banking sector in June and July 2010:

- From 10 May onwards, the RF CB's territorial agencies no longer register new currency exchange offices, while previously an advising procedure was established for their registration. At present any currency exchange office in Russia must belong to some Russian bank and conduct operations on that bank's behalf.

- Half of the banks that have acquired the status of asset managers with regard to the placement of citizens' pension savings can no longer enjoy the access to that particular resource. This happened after it was established, from 1 June onwards, that the main criterion for assessing a bank's reliability for the purpose of placing pension savings should be a rating granted by an international rating agency. The shortening of the list of banks gave rise to a need to urgently discontinue the previously concluded agreements between asset managers and banks, which had its negative impact on the rate of return on the investment of pension savings.

- The RF CB is continuing to tighten its control over the level of interest rates on deposits applied by banks. While previously the regulating agency was worried by the overestimated interest rates on individuals' Rb-denominated deposits, now the RF CB is preparing to establish control over the level of interest rates on foreign-currency-denominated deposits. The RF CB is preparing banks to the lifting of a moratorium on removing banks from the deposit insurance system: those banks that will continue to attract foreign currency resources against interest rates of 10.5 % may risk being excluded from the system because of the associated losses. ●

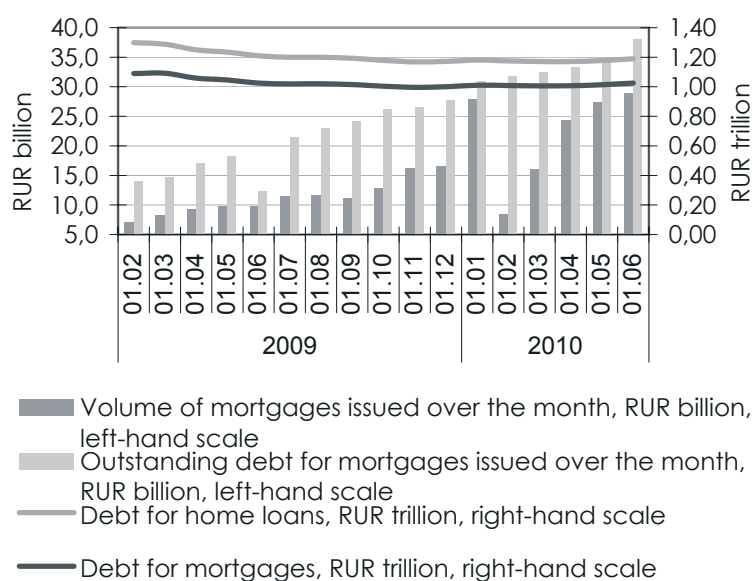
MORTGAGES IN THE RUSSIAN FEDERATION

G.Zadonsky

Despite the growth of the outstanding debt (by 9.8% more as on 01.06.2010 than on 01.05.2010), growing volumes of mortgage crediting and involving of small banks in crediting testifies that mortgage home crediting has been recovering quite steadily. Open joint-stock company AHML concluded 6796 contracts for the program of support for economy-class housing "Stimulus" construction and id decreasing down to 8% interest rate for purposeful bank loans within the framework of the program.

According to the data of the RF Central Bank, over five months of 2010 84867 mortgages were issued at the sum of RUR 105292 million, which is 2.37 times more than in the corresponding period of 2009. Stable level of outstanding debt changed in 2010 with a small growth of the debt for credits in rubles. As on June 1, 2010 the debt went up by 1.37% versus January 1, 2010 and reached RUR 1.025 trillion. (fig. 1).

Outstanding debt (fig. 1) as on June 1, 2010 went up by RUR 3.75 billion (9.8%) versus may, 1 and made RUR 38.04 billion whereas its increase over April made RUR 1.0 billion (2.9%). The proportion of stale debt in the total debt for mortgages made 3.71% as on June 1, 2010, where as for credits in rubles it is equal to 2.69%, and for credits in foreign currency – 8.2%. It is Moscow that occupies the first place as to the volume of stale debt in the total debt for mortgages (table 1). Kemerovo oblast holds the leading position in the rank of biggest stale debt in total debts – 5.91%.



Source: according to the data of the Central Bank of the Russian Federation

Fig. 1. Dynamics of Mortgages Issue

Table 1
LEADERS IN RANK OF STALE DEBT VOLUME FOR MORTGAGES ISSUED IN RUBLES,
AS ON 01.06.2010

Region	Volume of stale debt, RUR million	Total volume of debt, RUR million	Proportion of stale debt in total volume of debt, %
1. Moscow	2 090	64 967	3.22
2. Moscow oblast	2 038	47 282	4.31
3. Samara oblast	1 278	24 286	5.26
4. Chelyabinsk oblast	1049	28 875	3.63
5. Kemerovo oblast	981	16 603	5.91

Source: according to the data of the Central Bank of the Russian Federation

The Central Bank of the Russian Federation gives the data on the volumes of outstanding debt for credits which planned payments are delayed depending on the period of payment delay (table 2).

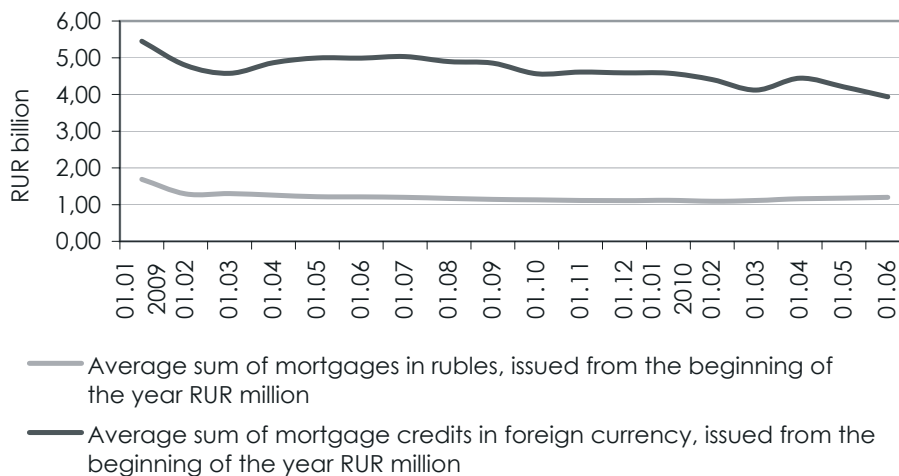
Whereas the proportion of delayed payments for mortgages made 3.71% as on June 1, 2010, the proportion of the high-risk debt and default debt made 14.73%.

Table 2

CATEGORIES OF DEBT FOR MORTGAGES BY PAYMENT DELAY PERIODS

	Total sum of debt for mortgages	Including:									
		without delayed payments		with payments delayed by 1 - 30 days		with payments delayed by 31 - 90 days		with payments delayed by 91 - 180 days		with payments delayed by more than 180 days	
		As RUR million	As percentage to the total sum of debts, %	As RUR million	As percentage to the total sum of debts, %	As RUR million	As percentage to the total sum of debts, %	As RUR million	As percentage to the total sum of debts, %	As RUR million	As percentage to the total sum of debts, %
2010											
01 Feb	1 008 449	864 843	85.76	49 447	4.9	24 120	2.39	17 676	1.76	52 363	5.19
01 Mar	1 005 624	859 380	85.46	51 685	5.14	23 573	2.34	17 673	1.76	53 313	5.3
01 Apr	1 006 841	858 603	85.28	53 319	5.3	23 605	2.34	17 688	1.76	53 626	5.32
01 May	1 013 687	867 255	85.55	52 200	5.15	22 518	2.22	19 815	1.95	51 899	5.12
01 Jun	1 025 009	874 025	85.27	53 505	5.22	22 653	2.21	18 860	1.84	55 966	5.46

Source: data of the Central Bank of the Russian Federation



Source: according to the data of the RF Central Bank

Fig. 2. Dynamics of Mortgage Credit Sums

The decrease in the average value of mortgage credits issued in rubles from the beginning of the year in 2009 (fig. 2) was replaced with the growth in 2010. As on July 1, 2010 the average sum of the credit went up by 8.9% versus February 1, 2010 and made RUR 1.2 million. At the same time average sum of mortgages issued in foreign currency from the beginning of the year demonstrates the trend for the decrease – from RUR 5.45 million over 2008 to RUR 4.58 million in 2009 and to RUR 3.93 million over

the first five months of 2010.

Average weighted period of crediting for mortgages issued in rubles from the beginning of the year is practically stable and makes 16.5 years (fig. 3), and for credits in foreign currency it is still growing and has reached 14.3 years.

Average weighted interest rate for mortgages issued from the beginning of the year according to the data of RF Central Bank as on June 1, 2010 remained unchanged as compared with April and made 13.5% (fig. 3), and for credits in foreign currency went up by 0.1 percentage points up to 11.0%.

The proportion of mortgages issued in foreign currency in the volume of credits issued from the beginning of the year continues to decrease: from 6.25% as on 01.01.2010 to 5.10% as on 01.06.2010.

While the interest rates for home loans are decreasing over the whole market, it is the banks that participate in AHML refinancing program (table 3) that have minimal rates. As on January 1, 2009 the minimum interest rates according to the AHML made 13.05%.

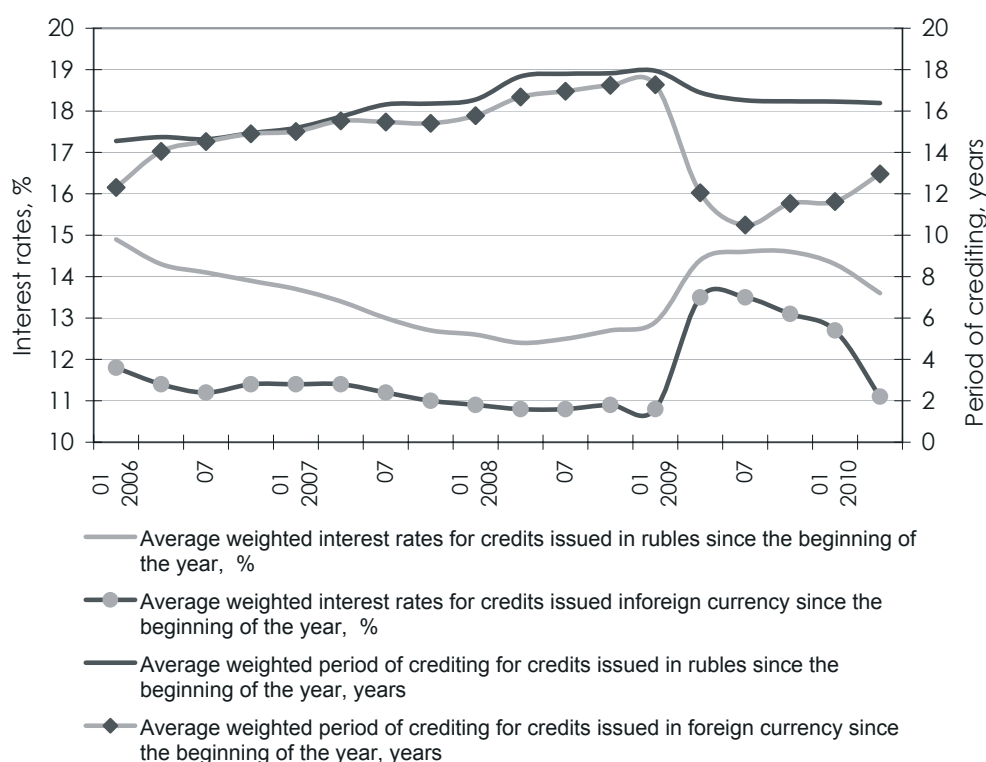
Table 3

FIXED INTEREST RATES FOR PROGRAMS OF LEADING MORTGAGE BANKS FOR IMMOVABLE PURCHASE AT SECONDARY MARKET

Bank	Interest rates in rubles		Interest rates in foreign currency	
	minimum	maximum	minimum	maximum
AHML refinancing rate standard	9.28	13.2	-	-
1. Absolut Bank	12	19	-	-
2. Alfa Bank	13	16	10	13
3. Bank of Moscow	14.2	18.45	9.75	13.8
4. BSGV	13.5	15	8	11
5. Vozrozhdenie bank	13	15.5	11.5	14
6. VTB 24	13.6	18.35	9.1	15.1
7. Gazprombank	15	15.5	11.5	12.5
8. DeltaCredit	13.5	15.5	9	11.5
9. Housing Finance Bank	13.75	16.75	8.75	10.75
10. Moscow Credit Bank	10	-	9	-
11. Nordea Bank	11.5	18.5	9	16
12. Raiffeisen bank	14	17.5	10.5	14
3. Sberbank	11.65	13.5	10.1	12.1
14. Uralsib	15	16	-	-
15. UniCredit Bank	12	17	10.5	15

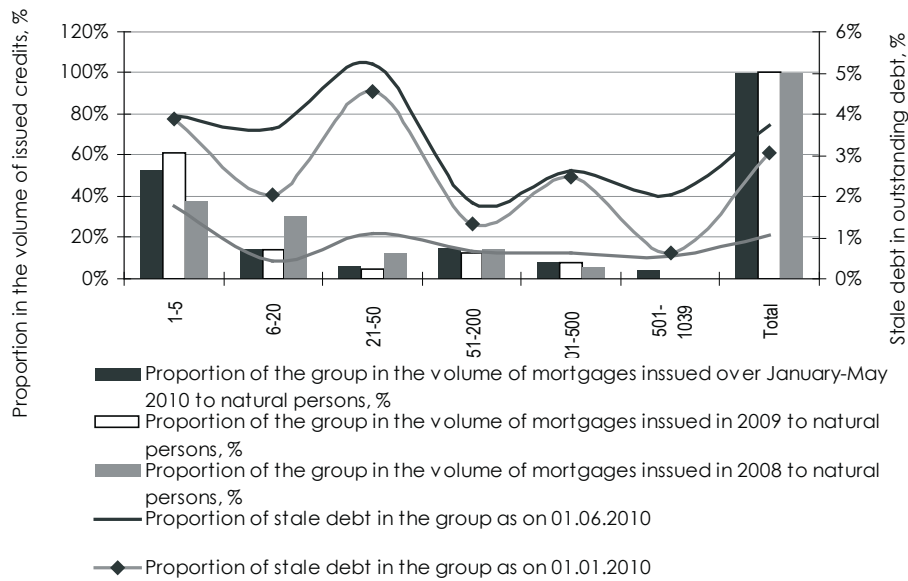
Source: Rusipoteka data from July 7, 2010

As on June 1, 2010 the shares of five largest mortgage creditors in the volume of mortgages issued for natural persons reduced from 60.82% to 52.77% (fig. 4). Redistribution occurred in particular due to small banks entering the market – their share as a group expanding from 0.15% in 2009 to 3.78% in 2010, which is the evidence of the upsurge at the mortgage market. The number of crediting banks in the last (sixth according to the size) group – 207 – is practically equal to that in the fourth group – 210. The biggest volume of delayed payments is



Source: data of the RF Central Bank

Fig. 3. Average Weighted Data for Mortgages Issued in Rubles and Foreign Currency from the Beginning of the Year



Source: according to the data of the RF Central Bank

Fig. 4. Dynamics of Issued Mortgages Volumes and State Debt by Groups of Crediting Organizations Grouped by Size of Assets

still characteristic for the third group of banks.

Moscow is the leader among the regions by the volume of mortgage credits issued in January-May 2010 per 100 thousand people with RUR 128 million (table 4). Moscow is also leading by the sum of the average mortgage credits – RUR 3.467 million. However by the number of credits issued per 100 thousand people Moscow (with 35 credits) is behind Urals (99 credits), Siberian (84 credits) and Privolzhsky federal okrugs, the number of credits being less in North-Caucasian federal okrug (22).

Table 4

VOLUME OF CREDITS PER 100 THOUSAND PEOPLE, ISSUED IN JANUARY – MAY 2010

	Volume of credits, total, per 100 thousand people, RUR million	Number of home loans, per 100 thousand people	Number of mortgage credits, per 100 thousand people	Volume of home loans, per 100 thousand people, RUR million	Volume of mortgage credits, per 100 thousand people, RUR million	Average sum of home loans, RUR million	Average sum of mortgage credit, RUR million
RUSSIAN FEDERATION	846.703	78	60	86.477	74.199	1.107	1.241
CENTRAL FEDERAL OKRUG	1106.711	54	42	94.993	79.271	1.775	1.906
Moscow oblast	1332.781	44	40	105.280	93.392	2.392	2.326
Moscow	2140.457	38	35	158.788	127.957	4.145	3.647
NORTH-WESTERN FEDERAL OKRUG	792.898	73	57	91.173	76.176	1.256	1.342
Saint-Petersburg	1138.666	52	46	107.838	90.356	2.077	1.970
SOUTHERN FEDERAL OKRUG	641.717	60	48	66.775	59.943	1.113	1.261
NORTH-CAUCASIAN FEDERAL OKRUG	290.261	30	22	27.485	21.487	0.917	0.971
PRIVOLZHISKY FEDERAL OKRUG	652.414	99	70	74.820	62.392	0.758	0.897
URALS FEDERAL OKRUG	941.201	118	99	135.977	124.888	1.154	1.267
SIBERIAN FEDERAL OKRUG	1052.883	109	84	96.027	83.953	0.877	0.998
FAR EASTERN FEDERAL OKRUG	795.159	72	58	85.107	75.618	1.187	1.305

Source: according to the data of the RF Central Bank and Federal State Statistics Service

OJSC AHML preserves dominating influence on the situation at the market of mortgage credits refinancing. As on June 1, 2010 OJSC AHML refinanced mortgage assets at the sum of RUR 19538 million, which made 19.5% of the volume of all the mortgages issued in rubles in this period; it concluded contracts for refinancing of mortgage assets in 2010-2011 (upon deduction of mortgage assets refinanced in 2010) at the sum of RUR 40 12 million and signed 6796 contracts to support housing construction program “Stimul”. Starting from July 1, 2010 AHML reduces rates for purposeful loans for banks crediting construction of economy-class housing within the program “Stimul” to 8%.

Net mortgage portfolio of Sberbank by June 1, 2010 went up to RUR 520 billion from RUR 514 billion on January 1, 2010. In July Vnesheconombank registered the application of Sberbank for purchase of mortgage bonds from it for the sum of RUR 30 billion within the framework of mortgage support program of RUR 250 billion.

Federal Service of Financial markets registered three issues of bonds of closed joint-stock company “Mortgage agent AHML 2010-2” of the total volume of RUR 13.54 billion.

As on 01.06.2010 filial company of AHML, OJSC “Agency for restructuring of home mortgage credits” (ARHMC) received 9270 applications for restructuring, 6953 applications were approved with the loan debt remainder of RUR 12166.6 million, 1698 applications were refused and 862 applicants recovered solvency. ARHMC developed additional (second and third) levels of mortgage holders support. The second level of support represents redemption of restructures credits, and the third – redemption of credit objects from the creditor. There are 4827 credits that are considered for endorsement at ARHMC as on 01.06.2010 of the total value of RUR 10.1 billion. 22 crediting organizations wanted to participate in the third-level support program, which offer 326 flats worth RUR 965.5 million for redemption. Execution of the third-level support program started in April 2010.

The decree of the RF Government from July 19, 2010 No 1201-r approved “Strategy for the development of home mortgage crediting in the Russian Federation up to 2030” with the purpose of formation of common guidelines for all participants of the market; defining main long-term goals and tasks of the state policy; determining main measures aimed at the development of home mortgage crediting for the prospect. ●

INVESTING RETIREMENT SAVINGS IN THE SYSTEM OF MANDATORY PENSION INSURANCE IN THE FIRST QUARTER OF 2010

L.Mikhailov, L.Sycheva

In the first quarter of 2010 the value of the assets in the mandatory accumulative pension system has grown by 47 per cent. The share of the state management company (SMC) in the total assets of the accumulative mandatory pension system has increased from 83.9 per cent to 84.2 per cent in the first quarter of 2010. RPF share has increased from 13.5 to 13.7 per cent over the same period. The share of pension savings, invested by RPF in private management companies (PMC) continued the decline and made 2.1 per cent at the end of the I Quarter.

In the first quarter of 2010 the value of the assets in the mandatory accumulative pension system¹ has grown by 47 per cent (for comparison, over the complete year 2009 the growth of assets made 48 per cent). The main reason of such an upsurge is the transfer of person contributions for 2008 from the RPF to the accumulative pension system (APS), when the rate of contributions has been increased from 4 to 6 per cent. Insurance contributions made RUR 251 bn, and the yield on pension savings investments reached RUR 24 bn. RUR 35 bn were transferred to APS, and RUR 240 bn were addressed to management companies, including SMCs, but with regard to the transition of pension savings of the individuals who selected the APS, the net outflow of assets from RPF to management companies reached RUR 214.4 bn, which made 92 per cent of the total assets growth in the period under review.

Table 1

THE VALUE OF THE ASSETS IN THE ACCUMULATIVE MANDATORY PENSION SYSTEM,
2007-2010, (RUR BLN)*

Date	The value of assets, in which pension savings are invested, allocated in management companies			Retirement savings in APS	Total
	Total	Including SMC	Including PMC		
01.01.2007	276.2	267.1	9.2	9.96	286.2
01.01.2008	375.1	362.9	12.2	26.8	401.9
01.04.2008	360.7	348.7	12.1	42.6	403.3
01.07.2008	366.0	353.7	12.3	43.1	409.1
01.10.2008	360.6	350.1	10.6	39.9	400.5
01.01.2009	352.2	343.1	9.1	35.5	387.8
01.04.2009	334.8	325.7	9.1	46.9	381.6
01.07.2009	459.3	446.6	12.7	67.3	526.6
01.10.2009	466.6	452.5	14.1	71.7	538.3
01.01.2010	495.5	480.6	14.9	77.2	572.6
01.04.2010	728.1	710.2	17.8**	115.4	843.5

* regardless insurance contributions to the accumulative share of RPF.

** regardless the assets in MC RBusiness trust management.

Notes:

- management companies' performance indicators – net assets value, displayed at the RPF web-site pfrf.ru;

- RPF indicators – accumulated pension assets as per consolidated data on RPF performance, displayed by the Federal Service for Financial Markets at the web-site fscm.ru.

The share of the state management company (SMC) in the assets of the accumulative part of mandatory pension system, regardless insurance contributions to the RPF, which were

¹ regardless the funds of insurance contributions to the consolidated Russian Pension Fund (RPF).

decreasing within 2006-2009, over the I Quarter of 2010 increased from 83.9 per cent to 84.2 per cent. The share of APS within the same period has grown from 13.5 to 13.7 (see *Table 2*). The share of pension funds allocated by the RPF in trust management for private management companies (PMC), has continued to decline and made 2.1 per cent at the end of quarter I. But the main reason was not a poor investment result, or the choice of insured persons in favor of the SMC or APS, but the termination of a contract of trust management of pension savings funds with RBizness management company.

Table 2

DISTRIBUTION OF THE PENSION SAVINGS IN THE ACCUMULATIVE MANDATORY PENSION SYSTEM BETWEEN MC AND RPF, 2006-2010, IN %

	1.1.2006	1.1.2007	1.1.2008	1.1.2009	1.1.2010	1.4.2010
Share in SMC	95.8	93.3	90.3	88.5	83.9	84.2
Share in PMC	3.1	3.2	3.0	2.3	2.6	2.1*
Share in APS	1.1	3.5	6.7	9.2	13.5	13.7
Total	100	100	100	100	100	100
Including share in PMC and APS	4.1	6.7	9.7	11.5	16.1	15.9

* regardless the assets in MC RBizness trust management.

Note. See note to *Table 1*.

Structure of the pension savings investments by private management companies. The structure of SMC, which functions are performed by Foreign Trade Bank, and aggregate portfolios of PMC, investing pension assets under agreements with RPF as of late 2009 and the end of I quarter of 2009, accordingly is provided in Figs 1-4.

Following the adoption of amendments to the Law No. 111-FZ “On investment the funds for the accumulative part of labor pensions in the Russian Federation”, retirement savings that were in the SMC trust management, were split into two portfolios: the default option and even more conservative option - for the insured individuals who wish to limit investments in government securities. The investment portfolio of government securities in the SMC is relatively small: at the end of the first quarter of 2010 its value amounted to 1.2 billion rubles. Thus, the bulk of pension savings has been concentrated in the investment portfolio by default (the so-called expanded portfolio). Investment structure of this portfolio has been supplemented by new instruments, an access to which the SMC got since November 2009. As one can see in *Fig. 1* and *2*, currently the share of

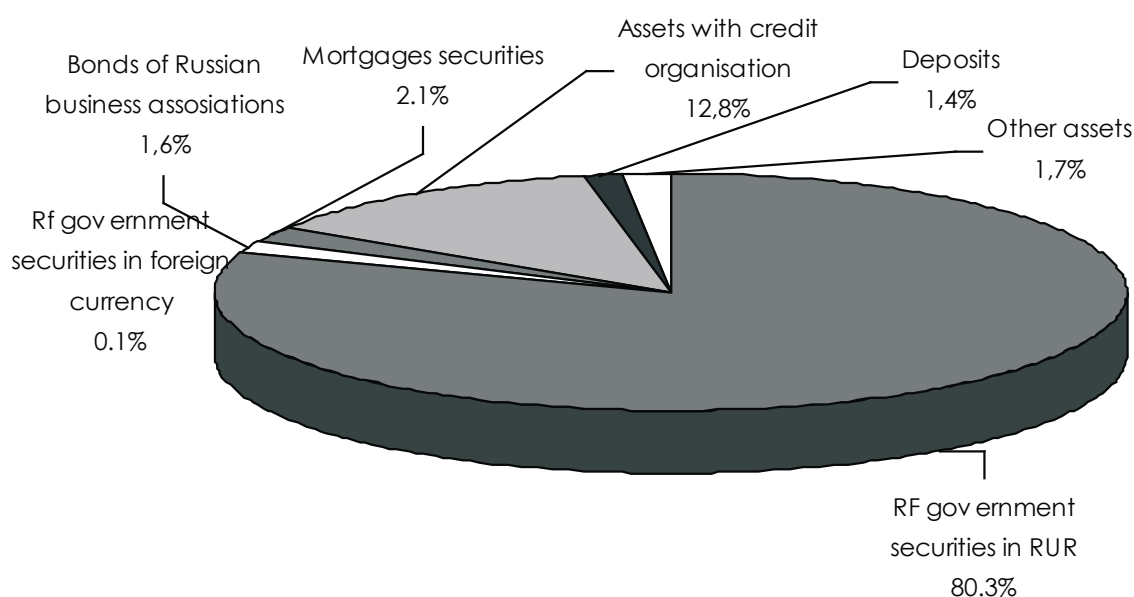


Fig. 1. Structure of the investment portfolio of state management company at the end of 2009

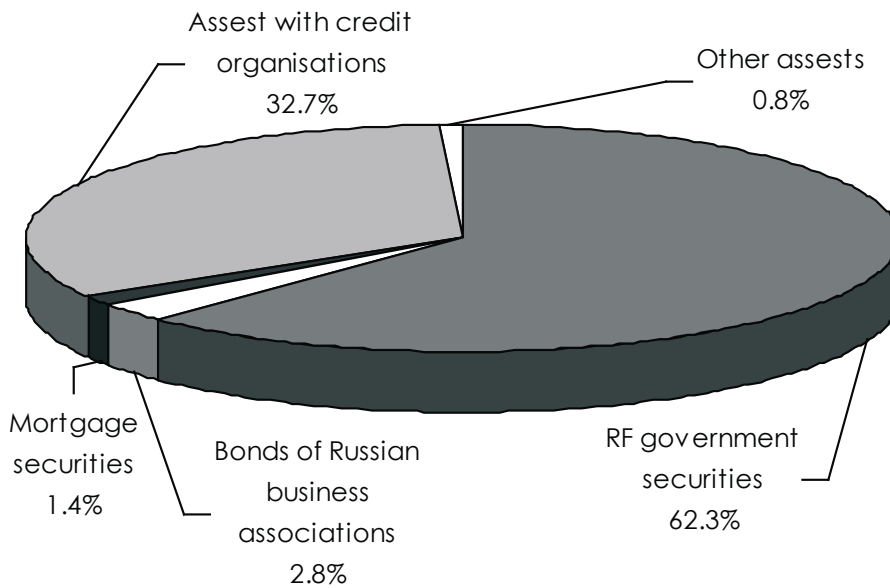


Fig. 2. Structure of state management company extended investment portfolio at the end of the 1st quarter of 2010

these instruments is rather small: bonds of the Russian business associations make 1.6 per cent at the end of 2009 and 2.8 per cent at the end of the first quarter of 2010, respectively, mortgage-backed bonds - 2.1 per cent and 1.4 per cent accordingly, deposits in banks denominated in RUR – 1.4 per cent at the end of 2009 (at the end of I quarter of 2010 there were no deposits in the SMC extended investment portfolio). Herewith, the share of bonds of the federal government got sharply decreased: if at the end of 2009 they accounted for 80.3 per cent of assets of the SMC extended investment

portfolio, at the end of I quarter 2010 they made only 62.3 per cent. Decrease was noted as in in the percentage of the federal loan bonds (OFZ) (from 44.4 to 30.9 per cent) as in the state savings bonds (GSO) (from 35.9 to 31.4 per cent). In absolute terms, SMC investment in GSO grew by 29 per cent, and OFZ - less than by 3 per cent. Simultaneously, bank deposits have grown by 3.8 times, having reached by the end of the I quarter of 2010 232 billion rubles - more than the net contributions from the RPF over the I quarter.

PMCs Investments. In the PMC total investment portfolio in the period under review there occurred reallocation of the most conservative instruments (bonds of the federal government) in favor of the most risky ones (equities). Although the dynamics of the Russian stock market in the quarter I was unstable, and the growth of the MICEX index was only 5.8 per cent, the share of equities in the aggregate PMC investment portfolio increased from 25.1 per cent at the end of 2009 to 29.4 per cent at the end of Quarter I of 2010, having nearly reached the pre-crisis level (in late 2007, this indicator was 28.8 per cent).

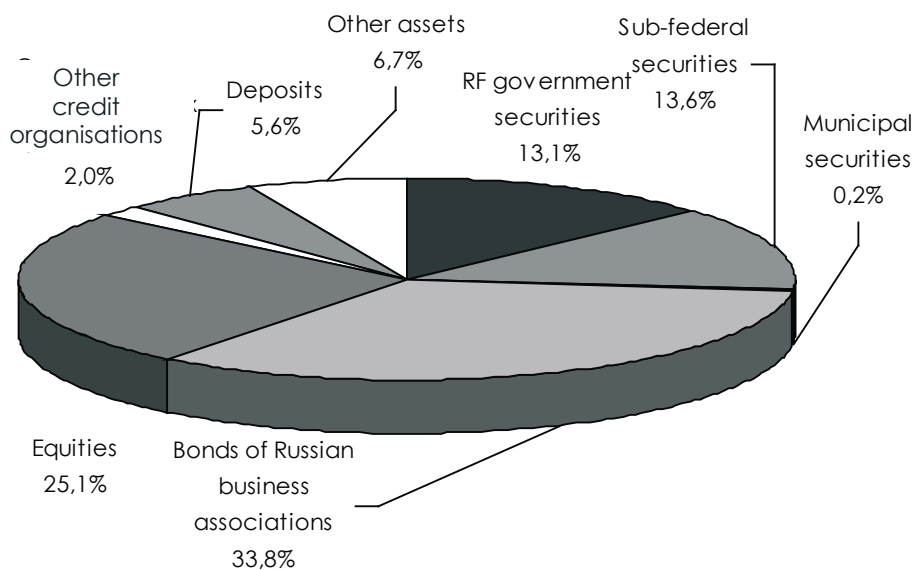


Fig. 3. Structure of the investment portfolios of private management companies at the end of 2009

However, it is early to speak about complete recovery from the crisis in terms of the SMC investing of pension savings. In particular, there are unresolved problems in the regulation of investments, which were revealed during the crisis:

- investments should be made in securities included in the stock

market quotation lists of the top level (A1). As a matter of fact, the requirement to invest the assets of pension funds only in the listed securities is common, along with the requirement to quality of investment securities. At the same time, for various reasons, the securities of a number of leading Russian companies are not included in the stock market quotation lists of the top-level (A1). And meanwhile, a number of Russian emitters of bonds, included in those lists, defaulted on their obligations, and the government and other investors had to rescue a number of banks whose bonds were listed in the MICEX A1.

- investments in instruments denominated in foreign currencies. The crisis of 2008 has once again demonstrated the importance of currency diversification of investments. Losses of the companies would be less if part of the assets was exchanged in foreign currency into monetary instruments in due time, but deposits in foreign currency were not allowed. However, PMCs did not invest in the RF Eurobonds, although formally it is a permissible instrument.

More complex is the issue with the possibility of investing in corporate Eurobonds and shares of foreign investment funds. Corporate bonds in foreign currency are emitted by the leading Russian companies, and the Law No. 111-FZ "On investment the funds for the financing the accumulative part of labor pensions in the Russian Federation" does not prohibit their purchase, but they remain unavailable for investing retirement savings due to technical reasons and circulation specifics. The main obstacle is that the securities are formally issued on behalf of foreign entities. As to the shares of foreign investment funds, the formal grounds for inability to buy them at the expense of retirement savings is the lack of necessary decree of the RF government. Herewith, there are several other problems, in particular, the provision of the Law No. 111-FZ "On investment the funds for the financing the accumulative part of labor pensions in the Russian Federation", which requires a contract between the Russian and international management companies. It is difficult to do it in practice.

Another problem, which is reflected in the PMCs reporting for the first quarter of 2010 is a high level of accounts payable in a number of management companies. On average, this indicator made 4.3 per cent, and is fully accounted for other accounts payable, i.e. not associated with PMCs reserves for reward or payment for services of a specialized depository. However, two PMCs the indicator exceeded 20 per cent of market value of the investment portfolios managed by them. ●

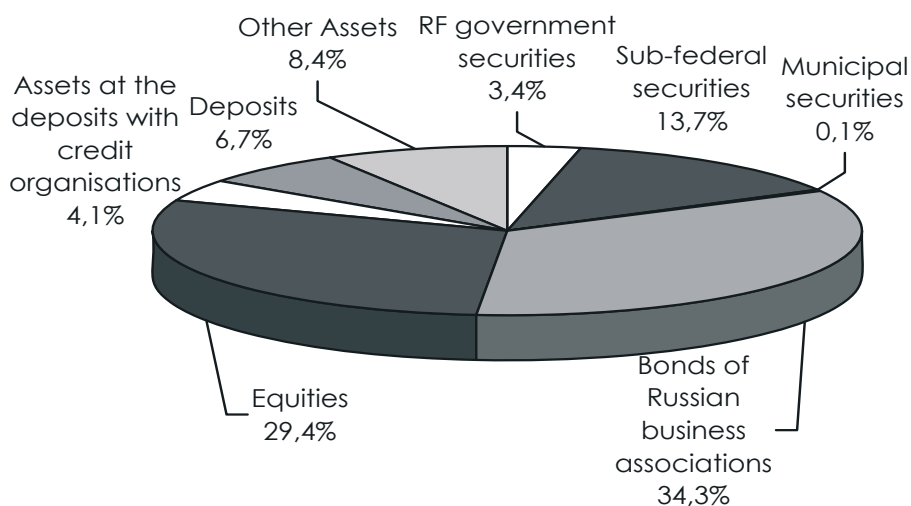


Fig. 4. Structure of the investment portfolios of private management companies at the end of the 1st quarter of 2010

CHANGES IN LEGISLATION ON PRIVATIZATION IN 2010 AND THEIR POSSIBLE INFLUENCE ON PRIVATIZATION PROCESS

G.Malginov

The obvious failure of Russian privatization during the crisis revealed shortcomings in a number of privatization mechanisms and procedures. Latest changes and addenda to the current law on privatization create some potential for privatization process intensification within the classical model but do not guarantee the increase in its efficiency. Besides, the privatization format can be described as changed towards the shift of accents from the usual model “state as assets sellers, budget as funds recipient” to the model when the companies with the state’s share in the capital act as assets sellers, and the state regulates this process within the framework of existing procedures of corporate and strategic management.

At the end of spring 2010 a large number of amendments to the current law on privatization from 2001 was adopted.

Before turning to its content analysis, it should be noted that for a three-year period since the law on privatization came into effect on April 26, 2002 it was not subject to any considerable changes. Starting with spring 2005 the law was repeatedly corrected by numerous amendments, but up to 2010 most of them were not of principal significance.

On the whole earlier amendments to the law can be divided into two large groups.

The first and the largest group of amendments extended the list of object categories which alienation from the state and municipal ownership is regulated by legal and regulatory acts other than the Law “On privatization” from December 21, 2001 (No 178-FZ). As a result, by now there are more than 15 object categories that are out of the sphere of application of this law, whereas at the moment of law adoption there were only 11 such.

Another group of amendments regulated specific features of privatization and legal status of some kinds of privatized property (for instance, parameters for evaluation of cost of some kinds of privatized land plots when alienated have been changed, the ban for their purchase by legal entities the share of the state and municipalities in which exceed 25% has been lifted, the reduction of the state (municipal) share when increasing authorized capital stock of open joint-stock companies formed during privatization preserving minimum possible threshold levels of state (municipal) share packages has been allowed, special statements for participation of small- and medium-scale enterprises in privatization of rented state and municipal immovable property have been envisaged¹).

The following norms have become invalid: reference for the RF legislation on currency regulation and currency control in order to define requirements for the documents submitted to the customers of state and municipal property that are not RF residents (2005), the responsibility of the Government to submit a forecast plan (program) for federal property privatization together with the project of the federal budget for the following year (2007), detailed procedure for distribution of monetary funds received as a result of sale of state or municipal property (from January 1, 2008).

The obvious failure of Russian privatization during the crisis revealed shortcomings in a number of privatization mechanisms and procedures, which prevent increase in rates and efficiency of federal property privatization in the period of economic growth.

The limitation of the effective period of the Privatization Program with one calendar year resulted in factitious pauses in its fulfillment from the beginning of one calendar year up to the mo-

1 Such statements are envisaged in the Federal Law from July 22, 2008 No 159-FZ “On characteristics of alienation of immovable property in the ownership of municipalities or subjects of the Russian federation that are rented by subjects of small- and medium-scale entrepreneurship and on making changes to some legislative acts of the Russian federation”, the period of action for the basic articles of which was initially stated for the period up to July 1, 2010 but was later prolonged to July 1, 2013.

ment the privatization program was supplemented with the property that was not privatized in the preceding year. As it was shown by practice after the law on privatization came into effect in 2001, real number of sold share bundles and unitary enterprises turned into joint-stock companies during the calendar year was always lower than initial planning.

As to unsold object of share bundles, the procedures concerning them had to be repeated the following year. Such a situation allowed managers in charge of assets (and primarily unitary enterprises) to be privatized to influence indirectly the privatization process procrastinating endorsements etc. besides, even if there had been no such intentions, privatization procedures concerning large objects could only be executed in a longer period of time due to higher level of requirements for pre-privatization preparation (choice of favorable moment at the stocks market, necessity to create consortium of investment banks, search for consultants for the deal, accumulation of large amount of sums by customers to participate in privatization).

Thus, suggestions on making corresponding changes to the legislation of the Russian Federation, which would be aimed at increasing the privatization process efficiency and perfection of the mechanism for its execution on the basis of expansion of the prolongation of privatization program for the planning period in order to secure privatization continuity and optimization of management decisions concerning the state property, that have been developed by the Federal Agency on State Property Management and RF Ministry for Economic Development since 2005 seem to be only a logical consequence¹.

These suggestions found practical realization in the Federal Law from May 31, 2010 No 106-FZ, which makes the following important amendments and addenda to the current law on privatization:

- the term of Privatization Forecast Plan (Program) for the federal property can vary from 1 to 3 years;
- the RF Government can now attract legal entities to organization of sale of federal property to be privatized, listing in a corresponding decision such property, actions of legal entities mentioned, rate and procedure for remuneration payment for them;
- the possibility for privatization of share bundles of open joint-stock companies formed as a result of federal state unitary enterprises reorganization by their introduction in the authorized capital stock of other open joint-stock companies upon a decision of the RF President and RF Government not making changes to privatization program is envisaged;
- the transfer to establishing of the initial cost of the state or municipal property to be privatized only on the basis of the RF legislation that regulates the appraisal practice excluding the notion of “normative price”. i.e. the minimal price defined according to the procedure established by the RF Government with which it was earlier possible to alienate this property²;
- norms differentiating the number of possible privatization ways and the consequence of their application depending on particular characteristic (earlier – balance value of federal state unitary enterprises property complexes to be privatized and balance value of shares in an open joint-stock company in the federal ownership and other criteria established by the Government) became invalid;
- information support for the privatization process was improved, which besides publication in official print should include placement of the corresponding data on official Internet sites;

1 See IET annual review “Russian economy in 2005. Trends and prospects (Issue 27)” (Section 4.8.1. Development of modern legislation on privatization of the state and municipal property in the Russian Federation, p. 499-510); Report of the Federal Agency on State Property Management “On federal property privatization in 2005” Moscow, 2006.

2 It should be remembered that the formula for its determination according to the decree of the RF Government from February 14, 2006 No 87, which substituted the decree of the RF Government from May 31, 2002 No 369 was based on the following approaches to property appraisal.

A normative price of the unitary enterprises property complex to be privatized was defined as the sum of the cost of its net assets calculated on the basis of the data of the interim accounting balance according to the procedure established for the appraisal of the open joint-stock companies net assets and appraisal of land plots, defined by the law on privatization upon deduction of balance cost of the objects that are not to be privatized in the property complex of a unitary enterprise.

For stocks (shares) of joint-stock companies and limited liability companies normative price was calculated as an average weighted figure of a number of values (value of assets on the basis of net profit, on the basis of exchange quotations and net assets) with the use of special coefficients, reflecting the extent of stockholder influence on decision making in the open joint-stock company depending on the share belonging to him or use of the special right “golden share”.

– the value of advance for participation in contest and auction was reduced by half (from 20% to 10% of initial price stated in the notification on property sale);

– the mechanism for state or municipal property sale with the public offer was improved, from now on the sale should be conducted in one trading session using open form of submission of offers for purchase, declared by participants by raising the cards after publication of initial offer price or the price of offer at the corresponding “lowering step”¹, with the possibility to conduct auction not only for the decrease of the price but also for its increase, since if the price mentioned is established by several participants at once, all participate in the auction for the given initial price of the property² (earlier this way of privatization envisaged closed forms of price offers submission fixing the period of price decrease according to the corresponding step);

– the requirement for registration of the offering circular that meets the requirements of legislation on securities in case stocks of open joint-stock company are alienated is abolished, excluding the sale of these shares through trade at the securities market organizer;

– the possibility for property privatization by conduction of biddings in electronic form was introduced.

The forthcoming years are to reveal whether the potential of the latest amendments to the law on privatization package will affect the results of this process from the point of view of contribution to federal budget deficit coverage and replenishment of the budget system at other public government levels.

In any case the experience of a number of privatization deals concluded in 2000s let us conclude that there being corresponding political will in the environment of economic growth the state can count upon the receipt of adequate compensation for the privatized assets, i.e. sort of compensation for the profits underreceived during the crisis.

The fulfillment of the RF Ministry of Economic Development initiative on the prolongation of privatization plan terms from 1 to 3 years allows to come through the whole cycle of preparations for sale of an object of property and this, together with the possibility to attract private legal entities (and primarily high-profile financial organizations) allows hoping for the increase in pre-sale preparation efficiency³.

The improvement of the sales mechanism by public offer, decrease of requirements for the amount of advance payment made for participation in auctions and contests should contribute into activation of non-liquid assets sale, acting at the same time as the measure of support and stimulation for small- and medium-scale business, though the existing problems of taxation and administration barriers still seem to be more significant for the development of this sector of economy.

Legal novelties aimed at improvement of information support for privatization of state and municipal property and implementation of the mechanism for its sale in electronic form can provide for higher transparency of the process.

At the same time it should be noted that attraction of private sellers for the sale of federal property to be privatized requires both the development of the corresponding mechanism for their contest selection, which is not mentioned in the legislation, and the fulfillment of pilot projects that will allow estimating its advantages and disadvantages.

Abolition of normative price raises the possibilities and stimuli for the customer to interest the appraiser in establishing understated price for privatized property, which is especially true for the local level. It is obvious that the same risk applies to the employees of property management organization, involved in the process of normative price calculation. However, in the past the mecha-

1 The right to purchase the property belongs to the participant that confirmed the price of the initial offer or the price of the offer at the corresponding “lowering step”, there being no other participants of the sale by the public offer. In case only one participant participates in the sale, it is recognized as invalid.

2 If the participants of such an auction do not declare price offers exceeding the initial price, the right to purchase it belongs to the participant of the auction that was first to confirm the initial price.

3 It should be noted at the same time that according to the formal declarative approach, Russian privatization has a term of 3 years starting with 2003. Broad forecast plans (programs) of the federal property privatization for the next calendar year with the main direction for the following two years approved annually by the Russian Government since then really included the list of the privatized property only for one year ahead. Besides, the question arises on correspondence between the term of privatization program with the real budget planning time-frame.

nism of normative price secured some control and provided for more accurate estimations due to the use of different sources of information.

On the whole the latest amendments and addenda to the existing law on privatization create some potential for privatization process intensification with its classical model, they, however, do not guarantee the increase in its efficiency. Besides, the privatization format can be described as changed towards the shift of accents from the usual model “state as assets sellers, budget as funds recipient” to the model when the companies with the state’s share in the capital act as assets sellers, and the state regulates this process within the framework of existing procedures of corporate and strategic management. ●

INTELLECTUAL PROPERTY RIGHTS PROTECTION IN RUSSIA: INDICATORS OF SITUATION

A.Pakhomov, Yu.Potantina

Efficiency of intellectual property (IP) rights protection and piracy level remain one of the key elements characterizing national investment climate and attractiveness of the country for the development of the innovative economy. In this connection mixed estimations of piracy and counterfeit goods in Russia by foreign organizations as well as indicators of IP rights protection in the country are of great practical interest.

Formation of efficient and reliable intellectual property rights protection system in Russia is one of the most important factors of innovations development and stimulation, since inventions and authoring are their moving force. The situation in intellectual property rights protection has changed during the economic reforms and this primarily concerned the legislative base.

According to OECD data, from 2007 to 2009 the trade with counterfeit and pirate goods increased from USD 200 billion to more than USD 250 billion in the world, making about 2% of the global trade turnover¹. The growth in the volume of counterfeit and pirate goods results in destabilization of the Russian consumer market, development of its criminal component, increase in illegal turnover of material and financial assets, which leads to the worsening of the investment climate.

The estimations of direct and indirect losses of IP rights owners (including for the strategic export goods) as a result of violations, as it is shown by the results of international studies and monitoring are quite subjective².

The history of intellectual property regulation in Russia demonstrates that efforts aimed at the improvement of its protection and execution of owners' legal rights create many internal contradictions. For some kinds of intellectual property (imported goods) the real level of rights protection and law enforcement practice is quite high, while administrative control and registration of IP objects at private and public enterprises are on the whole ineffective (providing grounds for corruption and violations, including illegal import of IP goods from the country). At the same time the problem of non-material assets appraisal is acute, the organizations' level of investment activity at the domestic market is low and scales of intellectual capital drain and pirate copying of Russian intellectual property abroad are significant.

Indicators characterizing the proportion of counterfeit and pirate goods for some goods types (such estimations in Russia are given mainly for import goods) do not always reflect the real situation, which is connected with specific goals the authors of such studies pursue at the Russian market and with the application of different evaluation methodologies.

For instance, USA *Business Software Alliance (BSA)* together with the International Development Corporation (*IDC*) has been publishing annual estimations for the levels of piracy and financial losses calculated for right owning companies (members of this organization) in different countries starting with the turn of the century. The global indicator, which went up to 43% in 2009 (41% in 2008), according to the 7th BSA Study is calculated on the basis of country levels of software piracy (proportion of software used without a license)³.

According to BSA data the proportion of non-licensed software programs installed on personal computers in Russia made 67% in 2009 (decrease of 1% versus 2008), which is accounted for by the economic crisis. The country's image is further worsened by the fact that according to BSA ver-

1 World Intellectual Property Organization site <http://www.wipo.int>

2 Intellectual Property: Observations on Efforts to Quantify the Economic Effects of Counterfeit and Pirated Goods. GAO-10-423, Government Accountability Office, Washington D.C., April 12, 2010, pp. 10–13. See USA Government Accountability Office site <http://www.gao.gov>

3 Seventh Annual **BSA/IDC** Global 2009 Software Piracy Study. Washington D.C., May 2010, pp.14–15

sion Russia holds 47-51st place in the world in the general ranking of piracy, sharing these places, the same as in 2008, with Brunei, Macedonia, Bulgaria and Ecuador¹. It should be noted that only in 2005 the country held the 6th place in the ranking of software piracy there being 83% of non-licensed programs.

According to BSA Report, the growth of licensed sales of Association members in the recent years has considerably suffered from illegal use of software in developing BRIC economies, where the market of information and communication technologies has been growing rapidly which resulted in the increase of losses scale despite the fact that piracy has been decreasing at fastest rate in the world (*table 1*). However, in Russia, according to estimations, the sum commercial cost of illegally used software went up (estimation of right-holders' financial losses) as a result of the previous year (up to USD 2,6 billion versus USD 4.2 billion in 2008) due to slow-down observed in information and communication technologies market development. At the same time, Russia again holds the third place after the USA and China regarding financial losses of foreign right-holders.

When calculating losses from software piracy by country in 111 states participating in the study in 2009 BSA is more interested not in fighting with the piracy itself but in protection of corporations' non-material assets increasing their export. That is why many parameters, which seem to be necessary for examination when defining reliable national losses figures, are not included in the study. They would primarily include losses of national producers from counterfeit, their connection with "information inequality" of the regions within the country and the transparency level of departmental purchases during software legalization as well as marketing and advertising efforts of the companies.

Table 1

DYNAMICS OF SOFTWARE PIRACY LEVEL AND FINANCIAL LOSSES OF RIGHTHOLDERS,
BSA MEMBERS IN SOME COUNTRIES

	Level of piracy, %					Commercial cost of illegally used software, USD million				
	2005	2006	2007	2008	2009	2005	2006	2007	2008	2009
Total in the world	35	35	38	41	43	34482	39698	47809	52998	51411
BRIC	81	77	75	73	71	6841	10049	14429	15305	14453
Russia	83	80	73	68	67	1625	2197	4123	4215	2613
China	86	82	82	80	79	3884	5429	6664	6677	7583
India	72	71	69	68	65	566	1275	2025	2768	2003
Brazil	64	60	59	58	56	766	1148	1617	1645	2254
EU	36	36	35	35	35	12048	11003	12383	13981	12469
USA	21	21	20	20	20	6895	7289	8040	9143	8390
Japan	28	25	23	21	21	1621	1781	1791	1495	1838
Canada	33	34	33	32	29	779	784	1071	1222	943
Australia	31	29	28	26	25	361	515	492	613	550
Indonesia	87	85	84	85	86	280	350	411	544	886
Pakistan	86	86	84	86	84	48	143	125	159	166
Ukraine	85	84	83	84	85	239	337	403	534	272
Kazakhstan	85	81	79	78	78	69	85	110	125	74

Source: Seventh Annual BSA/IDC Global 2009 Software Piracy Study. Washington D.C., pp.14–15. BSA site <http://www.bsa.org>

Annual reports of US Trade Representative Office (TRO) devoted to protection of American rightholders' rights abroad are another example of tight connection between the estimations of the situation with piracy and counterfeit and goals of organizations that conduct such calculations. In the report for 2009 (published on April 30, 2010) 41 out of 76 studies countries (46 out of 77 in 2008) caused apprehension, according to TRO, which are divided into several categories of violators depending on efficiency and adequacy of IP rights protection².

1 Seventh Annual BSA/IDC Global 2009 Software Piracy Study, pp. 14–15.

2 Office of U.S. Trade Representative Special 301 Report, Washington, D.C., April 30, 2010, pp.23–24

Traditionally, this document is of more aggressive nature as compared with BSA/IDC monitoring results. The USA Law on Trade envisaged the possibility of introduction trade and economic sanctions against countries included in “priority watch” list (11 countries, including Russia), which can extend as far as rejection for right of Generalized System of Preference (GSP) use to national exporters, which provide duty-free import of a number of goods in the USA. The procedure of special review of situation with intellectual rights can also be applied to these countries. GSP is managed by US Trade Representative Office, which enables efficient use of this instrument to put trading and political pressure on different aspects of foreign economic relations with USA partner countries. The “watch” list includes 29 USA trade partners (33 in 2009), which lists Belorussia, Ukraine, Vietnam and Guatemala, although the level of counterfeit goods registered in these countries is higher than in Russia (see *table 2*)¹.

The USA policy on necessity to compensate for the losses of American rightholders abroad is logically pursued by the country’s government internationally. In 2007 it started negotiations with a number of trading partners (Canada, Australia, EU, Japan, Mexico, Marocco, New Zealand, Singapore, South Korea, Switzerland) upon conclusion of new Anticounterfeit Trade Agreement (ACTA), not within the framework of the WTO or other international structures. The project of the Agreement envisages establishment of new stricter requirements (standards) on IP rights protection. It was planned to finish the elaboration of the new agreement in a short time, but during the ACTA negotiations there were a lot of contradictions found.²

Table 2

 PIRACY AND COUNTERFEIT INDICES IN “PRIORITY WATCH”
AND “WATCH” LISTS OF COUNTRIES IN 2008–2009

Country	Professional software				Films and music			
	Piracy level, %		Losses of American rightholders, USD million		Counterfeit level, %		Losses of American rightholders, USD million	
	2008	2009	2008	2009	2008	2009	2008	2009
“Priority watch” list								
Algeria	84	84	30	55	no data	no data	no data	no data
Argentina	73	71	339	645	60	60	75.1	63.4
Venezuela	86	87	484	685	no data	no data	no data	no data
India	68	65	2768	2003	55	60	36.2	17.7
Indonesia	85	86	544	886	95	95	20.0	24.7
Canada	32	29	1222	943	no data	no data	no data	no data
China	80	79	6677	7583	90	90	564.0	466.3
Pakistan	86	84	159	166	no data	no data	no data	no data
Russia	68	67	4215	2613	no data	no data	no data	no data
Thailand (SR) ¹	76	75	609	694	65	50	17.8	15.1
Chile	67	64	202	315	66	no data	21.0	no data
“Watch” list								
Belorussia	no data	87	no data	55	no data	no data	no data	no data
Bolivia	81	80	20	40	no data	no data	no data	no data
Brazil	58	56	1645	2254	48	48	117.1	147.0
Brunei	68	67	15	14	100	no data	2.4	no data
Vietnam	85	85	257	353	95	no data	no data	no data
Guatemala	81	80	49	74	no data	no data	no data	no data
Greece	57	58	238	248	60	no data	no data	no data
Dominican Republic	79	77	43	66	no data	no data	no data	no data

1 Office of U.S. Trade Representative Special 301 Report, pp.23–24

2 For instance, the USA unlike Switzerland and the EU, have logically pursued the policy for legally stated compensation for financial losses to the rightholder in case of violations concerning his non-material assets. Supporters of toughening of administrative and criminal proceedings against the users of non-licensed goods in the Internet are dominating in the USA Congress and Government, a number of American sector corporation are against such a trend, which is characteristic for current Western European legislation. Inside U.S. Trade, June 18, 2010, pp. 4–5, information portal [http:// www.INSIDETRADE.COM](http://www.INSIDETRADE.COM)

Table 2, cont'd

Country	Professional software				Films and music			
	Piracy level, %		Losses of American rightholders, USD million		Counterfeit level, %		Losses of American rightholders, USD million	
	2008	2009	2008	2009	2008	2009	2008	2009
Egypt	59	59	148	146	no data	no data	no data	no data
Spain	42	42	1029	1014	20	no data	13.4	no data
Italy	48	49	1895	1733	25	no data	350	no data
Columbia	56	55	136	244	no data	no data	no data	no data
Costa Rica	60	59	24	33	60	no data	14.8	no data
Kuwait	61	60	69	62	no data	no data	no data	no data
Lebanon (GSP) ²	74	72	49	46	70	no data	3.0	no data
Malaysia	59	58	368	453	60	26.2	60	23.5
Mexico	59	60	823	1056	80	82	419.7	436.4
Norway	28	29	229	195	no data	no data	no data	no data
Peru	71	70	84	124	98	no data	57.2	no data
Romania	66	65	249	183	40	no data	10.0	no data
Tadzhikistan	no data	no data	no data	no data	no data	no data	no data	no data
Turkmenistan	no data	no data	no data	no data	no data	no data	no data	no data
Turkei	64	63	468	415	no data	no data	no data	no data
Uzbekistan (GSP) ²	no data	no data	no data	no data	no data	no data	no data	no data
Ukraine	84	85	534	272	no data	no data	no data	no data
Philippines (SR) ¹	69	69	202	217	83	83	117.0	112.1
Finland	26	25	194	175	no data	no data	no data	no data
Ecuador	66	67	37	65	no data	no data	no data	no data
Jamaica	no data	no data	no data	no data	no data	no data	no data	no data

Note: 1. Special review is envisaged in 2010; 2. GSP review is envisaged

Source: Office of U.S. Trade Representative Special 301 Report, Washington, D.C., April 30, 2010; 2010 Special 301 USTR Decisions. 2008 and 2009 Estimated Trade Losses Due to Copyright Piracy and Estimated Levels of Copyright Piracy, pp.1–2, International Intellectual Property Alliance site IIPA <http://www.iipa.com>; Seventh Annual BSA/IDC Global 2009 Software Piracy Study, Washington D.C., pp.14–15

The contradiction between BSA and USA TRO monitoring results sets a goal for Russia to develop objective indicators reflecting the situation with piracy and counterfeit and IP rights protection. The indices characterizing legal regime of innovations protection should include not only the extent of rightholders' losses but also take into account the environment for commercial implementation of innovative developments and the existing conditions for foreign and domestic investors. Such an approach can be quite effectively fulfilled with the use of index method, with which the state of society (information, innovative, educational etc) is determined by the level of industry, services, consumption and institutes development¹.

Corresponding indicators that have recently been gaining more and more popularity when the Russian government bodies explain their policy are developed by international non-commercial structures and research organizations.

The analysis of global competitiveness indices, which have been published annually since 2004 by the World Economic Forum, demonstrate that in 2009 the Russian Federation holds only the 102nd place out of 133 countries depending non the level of intellectual property rights protection and 121st place as to the situation in IP rights on the whole². It should be noted that this parameter is included by the developers of competitiveness index into the section of "Institutes quality", which occupies the first place among 12 summand of the index.

1 Yusupov R. M., Zabolotsky V. P., Indices of information society development. Saint-Petersburg. Saint-Petersburg Institute for Information technologies and Automation of the Russian Academy of Sciences, 2009

2 The Global Competitiveness Report 2009–2010. World Economic Forum, Geneva, September 2009, pp.268–269. World Economic Forum site <http://www.weforum.org>

The parameters of property rights protection are also taken into account when calculating institutional index of economic freedom (Heritage Foundation's IEF)¹. Institutional lag in Russia is especially obvious in the sphere of intellectual rights protection, corruption and freedom for investments, in which categories the country, the same as a year before, has only 25, 21 and 25 points out of 100, correspondingly. On the whole in annual IEF ranking Russia holds 143rd position out of 183 countries².

Over the recent years the RF Government managed to create legislative base for right protection of domestic and foreign rightholders. At the same time legal support for non-material assets has little affected tax, crediting and budget policy that are connected with commercial implementations of innovations. Liberalization of the economic police was not accompanied with the creation of the regulation system for this process from the government structures, which is a serious obstacle on the way for efficient fight with piracy and counterfeit.

Necessity for the increase in competitive ability of the Russian economy requires expansion and activation of measures of state support for national economy sectors (for instance high-tech and venture investments). International regulation which provides rightholders which gives wide rights for protection of the developments does not prevent the control over their monopolized use.

As it is demonstrated by the international practice, national policy in the sphere of intellectual rights protection depends on national priorities – the sector investments that correspond to interests and priorities of socio-economic development of the country, assist export and high-technology import are stimulated.

Different goals in estimating piracy and efficiency of fight against it, choice of diverse specific structures for the development of particular methods define different results in BSA/IDS monitoring and results of the USA TRO studies of 301 Special Monitoring for Russia. These evaluations do not reflect real situation with changes occurring in the Russia's investment climate and do not stimulate the development of country's innovation potential.

Scientifically based approach to the choice and application of indices for IP rights protection allow not only correct estimation of the level of this sphere development but also the contribution of the sector in innovation economy formation and investment climate in the region or the country. Application of index method seem to allow complex estimation of objective factors influencing the development of IP market sectors in Russian taking into account levels of piracy and counterfeit, unequal development of regions, actions of rightholders and efficiency of law enforcement measures. ●

1 This index is estimated as the average from one to five points regarding such factors as the level of trading protectionism, tax burden, government interference in the economy, inflation, barriers of capital flows, limitations in banking activity and financial markets, IP protection, prices and wages regulation, volume of "black market".

2 Heritage Foundation's site <http://www.heritage.org/Index/Country/Russia>

THE PROBLEMS INVOLVED IN THE DEVELOPMENT OF STATE SUPPORT FOR AGRICULTURAL CONSUMER COOPERATION

R.Yanbykh

The Federal Law 'On Agricultural Cooperation' adopted in 1995 created the prerequisites for reestablishing the system of agricultural consumer cooperatives. However, with the exception of its credit component, the system was extremely slow to take shape. A new impetus to its development was provided by its being incorporated, as one of the main priorities in the framework of developing agriculture and rural areas, in the national project 'Development of the Agroindustrial Complex (AIC)' and in the State Program for Developing Agriculture in 2008 – 2012. Among the main obstacles to the progress of cooperation it is necessary to point out the insufficient capitalization of the cooperative base and problems with product sales.

The 1995 Federal Law 'On agricultural cooperation' created the necessary prerequisites for reviving the system of agricultural consumer cooperatives that had been successfully developing in Russia prior to the Revolution and then ceased to exist after the end of the NEP period¹.

It was intended that cooperatives dealing with supply, processing and sale of agricultural product would help the peasant (or farmer) households and other small-size economic entities in marketing their product. However, the actual development of agricultural consumer cooperation, with the exception of credit cooperation, was developing very slowly. The role of agricultural credit consumer cooperatives cannot be overestimated because for a long time – from the early 1990s until 2007 – these represented the only structure capable of ensuring to the rural population an access to borrowed funds. A new impetus was given to the progress of agricultural consumer cooperatives by their inclusion, as one of the main priorities of developing agriculture and rural areas, in the national project 'Development of the Agroindustrial Complex (AIC)' and in the State Program for Developing Agriculture in 2008 – 2012 (the State Program).

It is assumed that the socioeconomic base for cooperation in rural areas is sufficiently broad². According to the 2006 All-Russian Agricultural Census, the total amount of agricultural producers is represented by 36.9 mln economic entities. Of these, there are 59.2 thousand agricultural organizations, 285.1 thousand peasant (or farmer) households and individual entrepreneurs, 22.7 mln individual households and 13.7 mln individual households belonging to not-for-profit associations (horticulturists [owners of vegetable gardens and orchards] or owners of country houses ('dachas')). Does this really mean that all these households can serve as a base for developing consumer cooperatives? Evidently no, because the scope of their agricultural economy is very versatile. Some of them are not market-oriented, and some exist only on paper. Thus, for example, in accordance with the results of the same Agricultural Census, the number of peasant (or farmer) households engaged in agricultural production is only 126.3 thousand units, and the number of individual households is 14.9 mln units. In other words, the actual base for potential cooperation is clearly more narrow. This fact is also confirmed by estimations made by some scientists³. They have distinguished four main economic classes of agricultural producers⁴ that are not dependent on the form of organization of agricultural production⁵:

1 In the Soviet times the only type of cooperative in agriculture was the collective farm, but this was cooperation in the production sphere.

2 See the works in agrarian science by I. N. Buzdalov, G. I. Shmelev, Z. N. Kozenko, I. V. Palatkin, and others.

3 V. Ia. Uzun, V. A. Saraikin, E. A. Gataulina. Klassifikatsia khoziaistvennykh proizvoditelei na osnove dannykh Vserossiiskoi sel'skokhoziaistvennoi perepisi 2006 goda. [Classification of economic producers on the basis of the data of the 2006 All-Russian Agricultural Census.] – M.: A. A. Nikonov All-Russian Research Institute for Agrarian Issues and Informatics, ERD, 2010 – 229 p.

4 Ibid, P. 95.

5 Each of these groups can contain both individual households including peasant (or farmer) households and agricultural organizations.

1. Abandoned households;
2. Residential and recreational households;
3. Consumer entities;
4. Commodity-producing entities.

The entities belonging to the first three groups either do not yield any agricultural product at all, or their production is oriented to self-provision with foodstuffs and their own consumer needs. It is evident that only the entities belonging to Group 4 can have any need in cooperation, their number amounting to only approximately 4 mln, or 10.8 % of the total number of agricultural producers. This group includes 46 thousand agricultural organizations, 107 thousand peasant (or farmer) households, 3,814 thousand individual households, and about 10 thousand individual households belonging to not-for-profit associations (horticulturists' associations, etc.). Since it is primarily small-scale commodity producers that are interested in agricultural cooperation, the existing socioeconomic base for the development of cooperation in Russia can be estimated as consisting of only 3.9 mln economic entities.

Is this sufficient or too few for reviving cooperation? According to A. V. Chayanov's estimations, in 1926 agricultural cooperation encompassed 25 % of all peasant households (i.e., 5 mln persons), and in 1928 – towards the end of the NEP period – already one-third of this country's total peasant population¹. One cannot really compare the economy of today's Russia with its predominantly agrarian economy of the early 20th century. However, there is no doubt that cooperation of peasant households played a very important role in that economy.

So what the present-day system of agricultural consumer cooperation in Russia is like? As demonstrated by the results of monitoring of the State Program's implementation by the RF Ministry of Agriculture, as of 1 January 2010 in Russia there existed 5,585 agricultural consumer cooperatives, of which 1,124 were processing cooperatives, 2,721 were storage, supply and marketing cooperatives, and 1,740 were credit cooperatives. Not all of them were actually functioning entities: in 2009, 29.3 % of credit cooperatives, 37.4 % of processing cooperatives, and 35 % of supply and marketing cooperatives were not operating. This means that on the whole in Russia there were 704 processing cooperatives, 1,769 supply and marketing cooperatives, and 1,230 credit cooperatives that were actually operating.

Over one year – from 2009 to 2010 – the number of cooperatives increased by 485. The leaders of the cooperative community in terms of the number of actually functioning entities are Penza Oblast with 403 operating agricultural consumer cooperatives (of which 93 % are supply and marketing cooperatives) and the Republic of Sakha (Yakutia) with 245 such entities (of which 76 % are credit cooperatives). Regional systems of agricultural cooperation are successfully developing in Volgograd, Tiumen, Orenburg, Rostov, Belgorod and Kaluga Oblasts; in the Republics of Buriatia, Tatarstan, Kalmykia, Mordovia, and Chuvashia; and in Trans – Baikal and Krasnoyarsk Krai. In some subjects of the Russian Federation the volumes of borrowings granted by credit cooperatives are comparable with the volumes of bank loans. This is true, for example, for Tiumen Oblast where in 2009 credit cooperatives granted subsidized loans in the amount of 711 mln Rb, while commercial banks granted subsidized credits in the amount of 725 mln Rb.

Within the framework of participation in the State Program for Developing Agriculture, supply and marketing cooperatives received 1,712 subsidized credits and loans in the amount of 6,685 mln Rb, which means that credits were granted to half of the operating supply and marketing and processing cooperatives².

The creation of a multi-tier system of rural consumer credit cooperation continued. In 34 subjects of the Russian Federation first-tier credit cooperatives created regional cooperatives of the second tier. In 2004, on the initiative of 10 regional cooperatives, the Inter-regional Agricultural Consumer Credit Cooperative *Narodnyi Kredit* ['People's Credit'] (a cooperative of the third tier) was established. At present it comprises 17 members which are cooperatives of the second tier, the

1 Vinogradova I. N. A. V. Chayanov o sel'skokhoziaistvennoi kooperatsii v period novoi ekonomicheskoi politiki. [A. V. Chayanov on agricultural consumer credit cooperation in the period of the New Economic Policy] // *Agrarnaia Rossiia*. [Agrarian Russia]. – 2004. - No 3. – P. 37 - 41.

2 National Report 'On the progress and results of implementation in 2009 the State Program for Developing Agriculture and Regulating the Markets for Agricultural Products, Raw Materials and Food for the Years 2008 – 2012'.

latter consisting of 293 cooperatives of the first tier. In 2009, an inter-regional cooperative of the third tier was registered in Astrakhan which comprises Russian agricultural consumer cooperatives dealing with storage, processing and marketing of agricultural produce (no credit cooperatives). According to the data of the Fund for the Development of Rural Credit Cooperation, agricultural credit consumer cooperatives exist in 73 RF subjects, 296 towns and 983 rural settlements¹.

The credit cooperation system is developing at a faster pace in those territories where it can rely on the support of the administrations of RF subjects (municipal formations) within the framework of the implementation of regional (municipal) programs. However, the actual contribution of these bodies is confined to consulting, educating the public and providing premises. An analysis of regional programs of agricultural development has shown that RF subjects in the main support the development of agricultural cooperatives within the framework of the measures envisaged in the State Program, that is they grant subsidies to compensate for part of the interest on received credits. The specifically regional measures aimed at supporting agricultural cooperatives are generally limited to the following five main areas:

- strengthening of the material and technical base of agricultural consumer cooperatives (subsidizing of purchases of technologies and equipment), promotion of their organization and provision of consulting services;
- education and retraining of the specialists working in agricultural cooperatives, promotion of their participation in workshops, educational courses, conferences, etc.; issue of publications on normative and legal issues, and provision of other informational services to cooperatives;
- allocation of subventions to agricultural credit cooperatives for replenishing mutual financial support funds, thus making possible the granting of loans to members of cooperatives;
- provision of pledges and guarantees against credits and loans received by agricultural consumer cooperatives from credit institutions and agricultural credit cooperatives;
- gratis provision or sale of idle lands, industrial and engineering objects, machinery and equipment that are not used by any agricultural organization.

Among the main obstacles to the development of cooperation it is necessary to point to the insufficient capitalization of the cooperative base and the problems associated with product sales. Besides, cooperatives complain of absence of any help or inadequate help from the administrations of different tiers, imperfection of the legal base, lack of qualified cadres, and weak inclination toward cooperating on the part of agricultural producers. Representatives of cooperatives also cite some other limitations and restrictions, namely lack of methodological literature, competition with banks, problems in dealing with tax agencies, but these limitations are not of much importance². Nevertheless, the majority of surveyed experts from among the managers and professional working in cooperatives³ believe that the currently existing prospects for developing agricultural cooperation are good (32 %), very good (3 %), or satisfactory (45 %). One of the interviewed experts from Kurgan Oblast expressed his point of view as follows: *‘There is no doubt that the future belongs to cooperation, but unfortunately so far no one has succeeded in convincing in this agricultural producers – no matter how hard they have tried.* This turned out to be a complicated and lengthy process. Although there indeed exist the conditions for the creation and development of cooperatives’.

From our point of view, support of agricultural consumer credit cooperatives – as financial institutions closest to rural borrowers – deserves special attention. This can take the form of subsidizing part of the interest on the credits received by credit cooperatives from banks and funds in order to cover the loans granted to their members. This practice has already been envisaged in the framework of support of small-sized entrepreneurial entities provided by the RF Ministry of Economic Development and Trade. However, this type of support is by no means rendered in every

1 Analiz sovremennogo sostoiiania sel'skokhoziaistvennoi potrebitel'skoi kooperatsii v Rossii. [An analysis of the contemporary state of agricultural consumer cooperation in Russia.] / Ed. by Dr. Ec. Sci. Pakhomov V. M., Cand. Ec. Sci. Rasskazov A. N., Cand. Agr. Sci. Medvedeva N. A. – M.: Federal State Scientific Institution 'Russian Research Institute for Information and Technical-Economic Research for Technical and Engineering Provision of the Agroindustrial Complex' (FGNU 'Rosinformagrotech'), 2008 – P. 19.

2 Data provided by monitoring of the 2009 State Program; estimations of A. A. Nikonov All-Russian Research Institute for Agrarian Issues and Informatics.

3 Interviews with experts taken during the monitoring of the State Program's implementation.

region across Russia. Besides, the existing procedure imposes significant restrictions on it: credit cooperatives must grant loans only to subjects of small-scale entrepreneurship, while citizens with individual households do not belong to that category. Therefore it appears necessary to introduce this support measure through RF Ministry of Agriculture.

It also appears feasible that support should be provided in order to replenish the circulating funds of agricultural consumer cooperatives. This can be done by means of allocating subsidies from oblast budgets to the formation of fund for mutual financial support of credit cooperatives, which can be calculated per ruble of contributions made by members of cooperatives. In some RF subjects this practice has already become widespread, and its positive effect has been confirmed. Thus, for example, in Yaroslavl Oblast targeted funding is allocated in the oblast budget to replenishing the financial mutual support fund, gratis and interest-free, its total volume over 2004 – 2009 amounting to 26.5 mln Rb; and under the Program for Agricultural Development for 2007 – 2011 currently adopted in Yaroslavl Oblast it is envisaged that credit cooperatives are to receive support in the amount of 75.7 mln Rb¹

Besides, it would be desirable to envisage in the State Program, as a measure of financial support, that Rosselkhozbank can act as an associated member in agricultural credit cooperatives of the second and third tiers (as it has already been envisaged in the Priority National Project). At present Rosselkhozbank has become an associated member in the mutual funds of 85 credit cooperatives. In 2009, Rosselkhozbank made investments in the form of contributions of the mutual funds of 12 credit cooperatives in the amount of 45 mln Rb, which is much less than the amount invested over the two 2 years of implementing the Priority National Project 'Development of the AIC' – 636 mln Rb.

In order to provide support to processing, supply and marketing cooperatives it is necessary to envisage, as part of the State Program, measures aimed at subsidizing up to 50 % of investments in the formation and expansion of the material and technical base of processing, supply and marketing cooperatives. It is feasible to allocate subsidies in equal shares from the federal budget and the budgets of RF subjects on the basis of tenders.

By providing support to agricultural cooperation, the State can provide solutions to several problems at once. Firstly, small-scale commodity producers will get a guaranteed channel for realizing their products and for acquiring resources necessary for their development. Secondly, the granting of subsidies and subventions to cooperatives of producers can promote the development of market infrastructure that can then be made use of by all the smaller economic entities existing as part of the AIC. Thirdly, other goals can be achieved as well – not only that of boosting up agriculture, but also the preservation and development of rural territories. In this connection, it can be said that the potential significance of promoting the cooperation system of agricultural consumers is presently very high. ●

1 V. Filippov. Rol' federal'nykh i regional'nykh organov vlasti v sozdanii uslovii dlia razvitiia sel'skokhoziaistvennykh potrebitel'skikh kooperativov. [The role of federal and regional bodies of authority in the creation of conditions for developing agricultural consumer cooperatives.] // Sel'skii kredit [Rural Credit]. - 2009. - No 9/10 (140). – P. 2 - 5.

THE ISSUES INVOLVED IN THE IMPROVEMENT OF THE SYSTEM OF MONEY ALLOWANCES FOR SERVICEMEN OF THE ARMED FORCES OF THE RUSSIAN FEDERATION¹

V.Tsymbal, E.Trofimova

In the nearest future the RF Government is going to discuss a draft federal law on money allowances for servicemen of the RF Armed Forces, after which the said draft law will be submitted to the State Duma for further consideration. This publication represents an attempt at a brief assessment of the suggested draft law.

So far the system of provision of money allowances (MA) to servicemen of the RF Armed Forces (AF) has been regulated by 'The Procedure for Providing Servicemen of the RF AF with Money Allowances'² (introduced by order of the then RF Minister of Defense S. Ivanov) and by orders of the current RF Minister of Defense A. Serdiukov³. The existing system of MA for servicemen has become a target for many critical comments. Some of the comments were offered by specialists from the IET⁴.

In response to experts' comments and on the basis of *The Strategy of the Social Development of the Armed Forces of the Russian Federation for the Period Until 2020* (adopted in 2008)⁵, the RF Government assigned to the RF Ministry of Defense the task of elaborating a draft law on reforming the structure of MA. As stated by L. Kudelina (then Deputy Minister of Defense for financial and economic issues), the relevant draft federal law was to be submitted to the RF Government by 1 October 2009.⁶ However, in 2009 the draft law was not submitted. In late 2009, in RF President D. Medvedev's Message to the RF Federal Assembly, a somewhat 'softer' version of the assignment was offered: 'Before 2012 we must also adopt a special law on money allowances to army servicemen. The new system of remuneration and material incentives to the military must be designed so as to significantly improve the living standards of servicemen'⁷. But it is only now that the RF Ministry of Defense has put forth a draft for a new system of MA⁸, thus making it possible to perform a comparative analysis of the two systems – the currently existing one and the one that is suggested to replace it.

A Comparison of the Assignment and Composition of a Money Allowance

In accordance with our army's traditions, the draft federal law has preserved the basic MA calculation formula:

1 The methodological part of the study was made possible by the financial support provided by the Russian Foundation for the Humanities (RHSF) under Project No 08-02-00038a 'Improvement of the Methodology for Estimating the Socio-Economic Significance and Feasibility of the Switchover of the Russian Army to a New Manning Method'.

2 Approved by Order of RF Minister of Defense as of 30 June 2006, No 200.

3 Orders of the RF Minister of Defense of 2 August 2008, No 400, 'On Money Awards to Officers of the Armed Forces of the Russian Federation' and of 17 December 2009, No 400-A, 'On Additional Payments to Officers Undergoing Military Service in the Higher Formations, Large Units, and Military Units of the Armed Forces of the Russian Federation in 2010'.

4 Vorob'ev E., Tsymbal V. O poriadke i poriadchnosti. [On order and honesty.] // Nezavisimoe voennoe obozrenie [Independent Military Review]. 9 February 2007; Tsymbal V., Zatsepin V. Armeiskaia bukhgalteria. [Accounting in the Army.] // Vlast' [Authority]. 2 April 2007; Tsymbal V., Trofimova E. Sotsial'no-ekonomicheskaiia znachimost' peremen v voenno-kadrovoi politike Rossii. [The social and economic significance of changes in Russia's policy for manning the army.] // Rossia: tendentsii i perspektivy razvitiia. [Russia: Trends and Prospects of Development.] Ezhegodnik [Yearbook]. Issue 4. Part II. M.: Institute of Scientific Information for Social Sciences of the Russian Academy of Science (SISS RAS), 2009. P. 47 - 54.

5 Approved by decision of the RF Ministry of Defense's Collegium as of 23 March 2008.

6 Kudelina L. Osobennosti i novatsii biudzheta Minoborony Rosii. [The specific features and innovations of the budget of the RF Ministry of Defense] // Rossiiskoe voennoe obozrenie [Russian Military Review]. 2008. December. P. 10 - 13.

7 Message of RF President D. Medvedev to the RF Federal Assembly. 13 November 2009.

8 <http://www.mil.ru/849/11873/1062/1347/65492/19958/index.shtml?id=72887#>

$MA = MRMA$ (the monthly rate of money allowance) + AP_i (a number of additional payments), where i is the numerical order of an additional payment. Below, in *Tables 1 and 2* and in the commentaries to these tables, we present the specific amounts of $MRMA = RPMP$ (the rate of pay for military post) + $RPMP$ (the rate of pay for military rank), as well as the list of all principal AP beginning with AP_1 – the long – service bonus. It is noteworthy that when this AP is incorporated in the calculations, one more important formula emerges:

BMP (basic monthly rate of pay) = $MRMA + AP_1$. This is the base for calculating military pensions.

It is characteristic that for contractees the following **definition** is introduced: MA ‘is the basic means of their material endowment and creating incentives for them to fulfill their obligations to prepare for the armed defense and to execute the armed defense of the RF’. However, the draft law is silent with regard to defining as to what would be MA for conscripts. This gives rise to speculations and questions.

First of all, the adjective ‘armed’ appears to be superfluous because it places outside of the framework of any consideration the category of persons termed ‘non-combatants’ in accordance with international law – i.e., those who do not use weapons in combat. This category encompasses the army’s medical personnel, quartermasters, lawyers, and even accountants who also have claims to receiving MA .

Secondly, the taciturn overlooking of the right of conscripts to receive an allowance sufficient for a dignified existence represents a violation of the constitutional right of RF citizens - in the sense that when they perform their duty and responsibility to defend the Fatherland they have a right to enjoy the corresponding remuneration. Besides, the families of conscripts also have the right to rely on an amount of allowance that would be sufficient for a dignified existence. The majority of conscripts’ families really need their allowances, and this is further enhanced by the fact that families have become less numerous while many conscripts – especially those who are enrolled in the army after graduation from a higher educational establishment – have at least one child. The currently existing child benefits can by no means compensate for the real needs of such families.

The two systems – the previously existing one (as of 1 October 2008) which was supplemented by ‘Serdiukov’s bonuses’ and the newly suggested one that envisages the provision of servicemen with $MRMA$ and BMP and no additional payments – are presented in *Table 1*. As in accordance with the existing RF normative documents and the MA Procedure one military rank can correspond to several military posts, in the framework of the existing system the table offers only average estimates for $MRMA$ and BMP for each military rank (the average maximum and minimum $RPMP$ values per rank). Bold letters mark the monthly rates of money allowance under the new system where both components ($RPMP$ and $RPMP$) are determined in the draft law’s text. The amounts of the other monthly rates under the new system have been obtained on the basis of calculations and approximations.

Table 1

THE CURRENTLY EXISTING AND SUGGESTED SYSTEMS OF PROVIDING SERVICEMEN OF THE RF AF WITH MONEY ALLOWANCES (WITH NO ADDITIONAL PAYMENTS), RB/MONTH

Military rank, tariff according to post	MRMA		BMP	
	Existing system	Suggested system	Existing system	Suggested system
Conscripts				
Private, 1	300	No data	300	No data
Corporal, 2	385	No data	385	No data
Junior sergeant, 3	440	No data	440	No data
Sergeant, 4	495	No data	495	No data
Senior sergeant, 5	550	No data	550	No data
Master sergeant, 6	605	No data	605	No data
Contractees				
Private, 1	3,337	20,000	3,504	22,000
Corporal, 2	3,567	21,500	3,924	23,650

Table 1, cont'd

Military rank, tariff according to post	MRMA		BMP	
	Existing system	Suggested system	Existing system	Suggested system
Junior sergeant, 3	3,720	23,000	4,650	26,450
Sergeant, 4	3,853	25,000	4,816	30,000
Senior sergeant, 5	3,990	26,500	5,586	33,125
Master sergeant, 6	4,123	28,000	5,772	36,400
Praporshchik (midshipman), 7	4,355	29,500	6,097	38,350
Senior praporshchik (senior midshipman), 8 - 9	4,536	32,000	6,691	41,600
Junior lieutenant, 10	4,929	33,500	6,161	36,850
Lieutenant, 11	5,196	35,000	7,274	40,250
Senior lieutenant, 12-13	5,418	38,000	7,721	43,700
Captain, 14-15	5,784	42,000	8,386	50,400
Major, 16-18	6,195	48,000	9,139	60,000
Lieutenant Colonel, 19 - 22	6,703	51,000	10,054	66,300
Colonel, 23 – 30	7,547	55,000	11,697	77,000
Major General, 31 – 34	8,708	62,000	14,367	86,800
Lieutenant General, 35 - 46	10,090	78,000	16,921	109,200
Colonel General, 47 – 48	11,432	84,000	19,434	117,600
General of the Army, 49	11,892	95,000	20,216	133,000

The estimations of MA performed in accordance with the draft federal law account for the proposal concerning changing the amount of the long-service bonus calculated as a percentage, which is shown in the first line of *Table 2*.

The results of our estimations for contractees (which are presented in *Table 1*) are also plotted in *Fig. 1*.

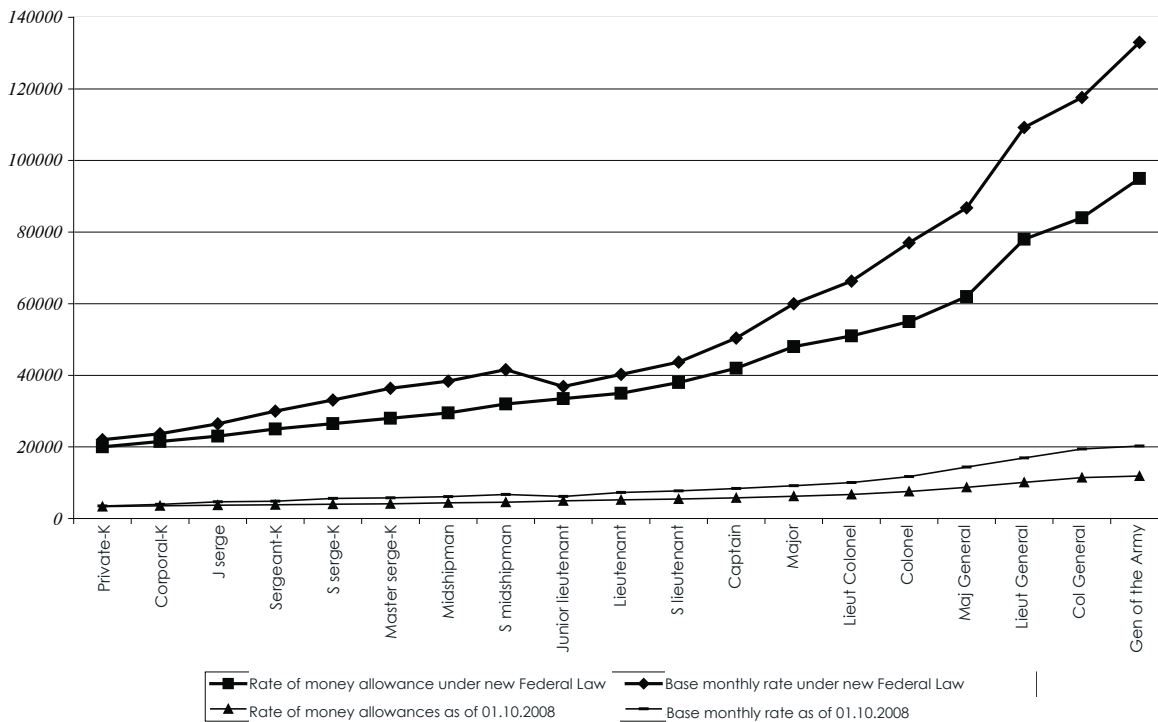


Fig. 1 MRMA and BMP under the existing and suggested systems for providing money allowances to servicemen, Rb/month

A Comparison of Money Allowance Rates and Base Monthly Rates

First of all, it should be pointed out that the draft law envisages no RPMP for conscripts. Even if they become exemplary soldiers at combat training, or become corporals, or – which has at present become a common practice – are promoted to the rank of sergeant, it is evident that their own needs and the needs of their families are totally disregarded.

As far as RPMP or any additional payments for conscripts are concerned, the draft law in its present form has no provisions to this effect; it is stipulated, however, that these payments will be established later by the RF Government on the basis of an application to be submitted by the RF Ministry of Defense. We do not know any reasons for such lack of precision.

Secondly, with regard to contractees it appears to be important that the amount of MA - as it is envisaged at present for all servicemen in the draft law – will be higher than the current average monthly wage (AMS) in this country. However, the law does not peg MA to AMS, which means that when in future AMS is increased in accordance with the existing long-term conceptual documents adopted in the RF, military service may lose its attractiveness on the labor market in absence of proper indexation.

The suggested lowering of the long – service bonus (which is a component of BMP) by comparison with its present amount will hardly please either servicemen or pensioners.

Analysis of the Additional Payments

As is noted by the majority of experts who have analyzed the existing MA Procedure since the moment of its adoption, its main drawback was the introduction, from the year 2006 onwards, of a number of additional payments – for example, for service in the Central Apparatus (CA), as a result of which the position of military CEOs was raised to a level far beyond any notions of honor or plain common sense. Indeed, the size of that particular AP inside the CA amounts to between 2.6 and 10.5 RPMP (Article 107 of the Procedure), while the AP for all the other contractee servicemen in the RF AF – just to one RPMP (Article 106 of the Procedure). Thus the entire Procedure for MA in its existing form has been made contrary to the principle of social justice (see *Fig. 2* for the amount of MA with all the principal AP included in it on a regular basis). If the same procedure for calculating additional payments for the CA is preserved in the new draft law, it will legalize social injustice in the future.

Besides, as it has already been said in one of the previous IET publications¹, there exists yet another order issued by the RF Minister of Defense that has some negative social effect² – the one concerning additional bonuses payable to military contractees and the civilian personnel of the Armed Forces in accordance with the results of their service (or work). That order permits military officials to independently dispose of the surplus of the money allowances fund. It is not easy to understand just how much and for what particular kind of service or work this money was paid. Will this ‘innovation’ be inherited by the new MA system as well?

It is alleged that the newly developed draft law dramatically reduces the number of additional payments. This is shown in *Table 2*. However there are no clear stipulations concerning their future size or the procedure for their payment. So the comparative estimates presented in the table must be treated with utmost care.

1 Trofimova E. Novyi oblik Vooruzhennykh Sil RF: problemy chislennosti i povysheniya denezhnogo dovol'stvia [A new image of the RF Armed Forces: the issues of their numerical strength and of increasing money allowances therein] E. // Ekonomiko – politicheskaiia situatsia v Rossii [The economic and political situation in Russia]. 2010. January. P. 46 - 49.

2 Order RF Minister of Defense of 28 March 2009, No 115, ‘On additional measures designed to improve the efficiency of utilization of the money allowance funds for servicemen and the remuneration funds for the civilian personnel of the RF Armed Forces’.

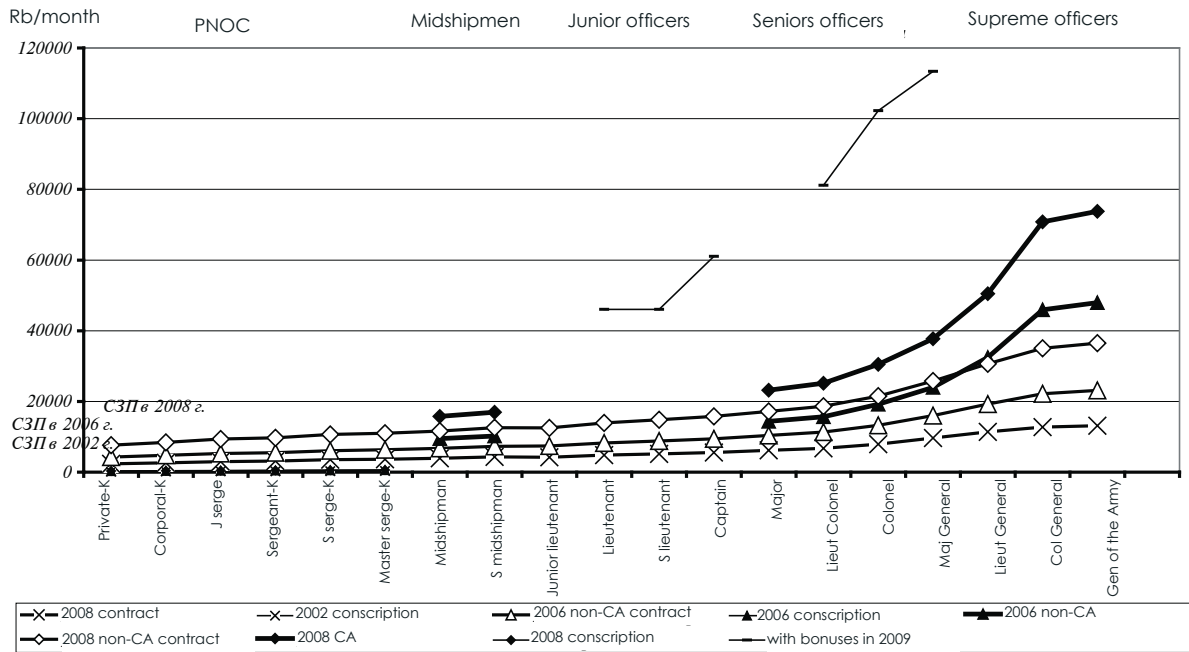


Fig. 2. Money allowances received by servicemen in 2002, 2006 and 2008

Table 2

A COMPARISON OF THE ADDITIONAL PAYMENTS INCORPORATED IN MONEY ALLOWANCES OF SERVICEMEN

No	Money allowances suggested in the new draft law	Existing money allowances
1	<p>Monthly long – service bonus (as % of MRMA) From 2 to 5 – 10 %; from 5 to 10 – 15 %; from 10 to 15 – 20 %; from 15 to 20 – 25 %; from 20 to 25 – 30 %; from 25 and longer – 40 %. Only for contractees.</p>	<p>Long – service bonus estimated as % (paid monthly as % of MRMA): From 0,5 to 1 – 5 %; from 1 to 2 – 10 %; from 2 to 5 – 25 %; from 5 to 10 – 40 %; from 10 to 15 – 45 %; from 15 to 20 – 50 %; from 20 to 22 – 55 %; from 22 to 25 – 65 %; from 25 and longer – 70 %. Only for contractees.</p>
<p><u>Conclusion on the basis of the comparison:</u> the existing rules for calculating the long – service bonus create stronger incentives for servicemen to stay on in the army than the newly introduced rules.</p>		
2	<p>Monthly additional payment for class qualification (as % of RPMP): third class – 10 %; second – 20 %; first – 30 %; master – 50 %. Only for contractees.</p>	<p>Money allowance for class qualification (monthly, as % of RPMP): For contractees: second class – 5 %, first class – 8%, master class – 10 %. For conscripts: second class – 30 %, first – 50 %.</p>
<p><u>Conclusion on the basis of the comparison:</u> in accordance with the existing MA Procedure, class bonuses can be paid both to contractees and to conscripts. Under the draft federal law no class bonuses for conscripts are envisaged – most probably because the term of service is one year only, while the post occupied by a conscript, as it is stipulated, will not ‘determine combat readiness’.</p>		
3	<p>Monthly bonus for special conditions of military service (up to 50 % of RPMP)</p>	<p>Monthly bonus and additional payments for special conditions of service, including the manifold coefficient applied to RPMP for the CA staff (up to 10-fold)</p>

No	Money allowances suggested in the new draft law	Existing money allowances
	<p>The existing procedure envisages numerous monthly additional payments which depend on specifically defined conditions of service (as % of RPMP) or in absolute terms:</p> <p>Monthly money allowance (differs for the CA staff and for all other servicemen).</p> <p>Monthly bonus for complexity, strenuousness and special regime of military service.</p> <p>Monthly bonus for commandship (supervision) of military units and military formations</p> <p>Monthly bonus to servicemen with university degrees in law and occupying army posts relating to juridical specialties.</p> <p>Monthly additional payments for an academic degree (or an academic rank), or military posts of a Professor (or Docent (Senior Lecturer)).</p> <p>Bonus for special conditions of combat training service (introduced as an incentive for contractees serving as privates and sergeants).</p> <p>Bonus for special conditions of service in military ships or sea vessels.</p> <p>Bonus for special conditions of service to the personnel of medical units, army medical institutions and formations.</p> <p>Bonus for special conditions of service in some types of the AF and in some fighting arms.</p> <p>Monthly bonus for special conditions of service paid to the personnel engaged in refueling the nuclear reactors of ships, handling nuclear fuel and radioactive waste. Here, some payments are also envisaged for conscripts.</p> <p>Bonus for special conditions of service payable to the servicemen engaged in the search for and (or) defusing (or destruction) of explosive devices in field (or on sites), and money bonus for each identified and (or) defused (or destroyed) explosive device. Here, some payments are also envisaged for conscripts</p> <p>Money bonus for special conditions of service paid to servicemen on combat duty.</p> <p>Trainee post-related bonus.</p> <p>Monthly bonus to servicemen enlisted from the cohort of orphaned children and children left without the care of their parents.</p>	
4	<p>Premium of the RF Minister of Defense for the performance of especially important and complex tasks (up to 3 MRMA per year)</p>	<p>Premium for exemplary performance of military duty (up to 3 MRMA per year).</p> <p>Lumpsum money allowance for honest performance of the duties of military service. By the results of a calendar year (3 MRMA per annum).</p>
<p><u>Conclusion on the basis of the comparison:</u> neither the existing Procedure nor the newly developed draft law contain any stipulations concerning anything resembling 'Serdiukov's premiums'.</p>		
5	<p>Lumpsum payment at the moment of concluding the first contract and any new contracts: for 3 years - 3 MRMA, for 5 years - 5 MRMA, for 10 years - 10 MRMA,</p>	<p>Lumpsum bonus on entry into service under a first contract - 1 MRMA.</p> <p>When concluding subsequent new contracts, the lumpsum bonus is paid in the following amount: for 3 years - 1 MRMA, for 5 years - 2 MRMA, for 10 years - 5 MRMA.</p>
<p><u>Conclusion on the basis of the comparison:</u> the payments received on the conclusion of contracts will be substantially increased. OR WILL THEY BE CUT?.</p>		
6	<p>Monthly bonus for work with secret document (% or RPMP) 'OV' - 25 %, 'SS' - 20 %, 'Secret' - 10 %.</p>	<p>Monthly % bonus to servicemen with permanent access to state secrets. 'OV' - from 50 to 75 % и 'SS' - from 30 to 50 %.</p> <p>'Secret' - from 10 to 15 % depending on the schedule of checks.</p> <p>Percentage long-service bonus for service in structural units responsible for the protection of state secrets.</p> <p>Paid monthly as % of RPMP depending on length of service: from 1 to 5 years - 10 %, from 5 to 10 years - 15 %, from 10 years and longer - 20 %.</p>
<p><u>Conclusion on the basis of the comparison:</u> the payments will no longer differ depending on the place of service, and the amount of payment will be lower.</p>		
7	<p>Annual material aid (1 MRMA)</p>	<p>Material aid . 2 MRMA per annum.</p>

No	Money allowances suggested in the new draft law	Existing money allowances
<p><u>Conclusion on the basis of the comparison:</u> the amount of aid will be lower, but even these lower payments will have to be properly substantiated.</p>		
8	In-field (or at-sea) money 500 Rb /day.	At-sea MA: monthly 100 % of RPMP. In-field money – 100 Rb / day.
<p><u>Conclusion on the basis of the comparison:</u> no comparison is possible for at-sea MA because incomparable values are defined in the legislative acts. In-field money will be substantially increased under the new federal law.</p>		
9	To the persons undergoing military service as contractees in the Far North, the territories equated to the Far North and other regions with unfavorable climatic or environmental conditions, including in remote regions, at high altitudes, in deserts and in arid territories, money allowances are paid with adjustment to the coefficients established by the RF Government (from 1.1 to 1.5).	Percentage bonus for service in regions remote from the base. Coefficients (regional, for military service at high altitudes, for military service in deserts and in arid territories) are applied to the money allowances paid to servicemen. Additional percentage payments for military service in the Far North and in the territories equated to the Far North and other regions with unfavorable climatic or environmental conditions. (Chapter VI of the MA Procedure)
<p><u>Conclusion on the basis of the comparison:</u> no comparison is possible because the draft federal law contains no stipulations as to which particular payment a coefficient needs to be applied, and which would be the precise value of the coefficient in each specific case.</p>		
10	To the persons undergoing military service under contracts outside of the RF territory MA is to be paid in foreign currency and in Rb in the procedure and amount determined by the RF Government.	Payment for business trips in the territories of foreign states. (Articles 334 - 338 of the MA Procedure)
<p><u>Conclusion on the basis of the comparison:</u> no comparison is possible due to absence of a detailed list of payments in the new federal law.</p>		
Other payments (Article 2)		
11	The servicemen dispatched on business trips receive payments to cover their travel costs in the procedure and amounts determined by the RF Government.	Payment for the business trips in the territory of the Russian Federation. (Articles 316 - 333 of the MA Procedure)
<p><u>Conclusion on the basis of the comparison:</u> no comparison is possible due to absence of a detailed list of payments in the new draft federal law.</p>		
12	In the event of resettlement of contractees they receive the following payments: - allowance on appointment – 1 MRMA per serviceman and 0.25 of MRMA per family member moving with the serviceman; - per diem payments in the amount established by the RF Government for each day of travel per serviceman and each family member moving with the serviceman.	Kit allowance – 12 MRMA. Allowance on appointment during service-related travel: per serviceman – 2 MRMA, per wife (husband) – 1 MRMA, for each other family member – 0.5 MRMA. Per diem allowance: 100 Rb / day.
<p><u>Conclusion on the basis of the comparison:</u> no complete comparison is possible due to absence of a detailed list of payments in the new draft federal law. However, the amount of traveling allowances as stipulated in the draft federal law is evidently less, and no allowance for purchasing first necessities is envisaged.</p>		

No	Money allowances suggested in the new draft law	Existing money allowances
13	<p>To the contractees discharged from military service in connection with retirement, poor health, or scheduled army personnel rearrangement, a lumpsum bonus in the amount of 5 MRMA is paid.</p> <p>In the event of a discharge from military service for other reasons – 2 MRMA.</p> <p>If during the period of service a serviceman was awarded with an order or an honorary title of the RF. the amount of the lumpsum bonus is increased by 1 MRMA.</p>	<p>A lumpsum bonus is paid to contractees discharged from military service.</p> <p>When the total period of military service is less than 10 years – 5 MRMA, from 10 to 15 years – 10 MRMA, from 15 to 20 years – 15 MRMA, over 20 years – 20 MRMA.</p> <p>If during the period of service a serviceman was awarded with an order or an honorary title of the RF. the amount of the lumpsum bonus is increased by 2 MRMA.</p>
14	<p>The lumpsum bonus paid to conscripts discharged from military service is 1 MRMA, and the amount of bonus paid to the servicemen belonging to the categories of orphaned children or children left without the care of their parents is 5 MRMA.</p>	<p>The lumpsum bonus paid to conscripts discharged from military service is 1 MRMA, and the amount of bonus paid to the servicemen belonging to the categories of orphaned children or children left without the care of their parents is 5 MRMA.</p>
<p><u>Conclusion on the basis of the comparison:</u> nothing has been changed with regard to conscripts, and under the new draft law there is no sense in long-term service for contractees because the amount of bonus paid at discharge does not depend on the number of years of military service.</p>		
	<p>Other payments envisaged as incentives in accordance with Item 10 of Article 1.</p> <p>These payments differ depending on the subordination of a serviceman, the complexity, volume and importance of the duties performed.</p>	<p>Money allowance for parachute jumps (or air movement and landing technical equipment).</p> <p>Money allowance for underwater work.</p> <p>Lumpsum money allowance for uninterrupted military service to officers whose service involves parachute jumps.</p> <p>Lumpsum money allowance for emergency-free performance.</p> <p>Money allowance for long and uninterrupted service in ships, sea vessels and in the control bodies of their forces (or commands).</p> <p>Lumpsum money allowance for graduation from military educational establishments for professional training.</p>
<p><u>Conclusion on the basis of the comparison:</u> there is no clarity in the draft law concerning payment of other money incentives.</p>		

Other Conclusions from the Analysis of the Draft Law

The text of the draft law posted to the website of the RF Ministry of Defense contains no substantiations that usually must accompany any draft law being prepared to submitting to the State Duma for consideration and approval. Therefore an additional comparative analysis of the draft law will be required, in order to set it properly against the existing MA Procedure and the Orders of RF Minister of Defense Serdiukov designed to supplement the Procedure.

Deputy RF Minister of Defense for financial and economic issues V. Chistova and other officials from the RF Ministry of Defense have been stating in the mass media that under the new federal law the share of monthly allowance – that is, the amount applied as a base for calculating pension for a serviceman – will be no less than 50 % of the total amount of the money allowance that will be paid to a serviceman on a monthly basis. However, the draft federal law in no way confirms the truth of such statements. ●

REVIEW OF MEETINGS OF THE GOVERNMENT OF THE RUSSIAN FEDERATION

M. Goldin

In July at the meetings of the Presidium of the RF Government among other issues the changes to the RF Tax Code and Federal Law “On licensing of some kinds of activities” were considered.

On **July, 5th** the project of the Federal Law submitted by the RF Ministry of Finance “On making changes to article 346.29 of part two of the Tax Code of the Russian Federation” was considered, which suggested changes to taxation systems in the form of the single tax on the imputed income for some kinds of activities, established by chapter 26.3 of the RF Tax Code, which envisages unified approach to taxation of entrepreneurial activity with the use of vending machines. According to article 346.27 of the Tax Code, for the purposes of chapter 26.3 of the RF Tax Code retail trade with vending machines can be regarded as stationary distribution network or retail delivery trade. Basing on this, different physical indices and rates of basic profitability per month are applied when calculating the single tax on the imputed income. For instance, basic profitability of RUR 9000 per one point of sale is applied if the area of the point is less than 5 sq m. Basic profitability of RUR 1800 is applied if the area of the POS is more than 5 sq m. Basic profitability of RUR 4500 per one employee is applied for retail delivery trade. Besides, vending machines can provide catering services, which chapter 26.3 of the RF Tax Code regards as retail trade. In this connection the bill envisages that the new version will list the types of entrepreneurial activity, physical characteristic corresponding to them and values of basic rates used to calculate the single tax on the imputed income. The basic profitability rate for the mentioned type of entrepreneurial activity is suggested to be established at the level of RUR 4500 per month per one vending machine. This rate of basic profitability is equal to the rate of basic profitability applied to entrepreneurial activity in the form of retail delivery trade and peddling (RUR 4500 per one employee) for the purposes of chapter 26.3 of the RF Tax Code.

The bill was approved by the RF Government and submitted to the RF State Duma. On **July, 19th** at the meeting of the Presidium of the RF Government the project of the Federal Law “On licensing of some types of activities” submitted by the RF Ministry of Finance was discussed.

The bill envisages changes to the Federal Law from August 8, 2001 No 128-FZ “On licensing of some kinds of activities”, providing unification and simplification of licensing procedures, introduction of unlimited effect of licenses, considerable contraction of the list of types of activities subject to licensing as well as establishing of the single procedure for licensing control implementation.

Further decrease of the list of licensed types of activities was one of bill’s innovations. For instance, it was suggested to abolish licensing for the following types of activities with the simultaneous introduction of notification procedure for the start of entrepreneurial activity: medicinal, pharmaceutical activity, weapons exposition and collecting, air security activity, special games equipment production and sale, orthopaedic goods production upon order of citizens, production and repair of instruments, restoration of cultural heritage monuments. It was also suggested to cancel licensing medical goods production and technical maintenance, shipping and transfer of freights by water in connection with the substitution of licensing with other forms of regulation.

Besides that, the bill envisaged changes in definition of names for many types of activities subject to licensing, which is aimed at prevention of free interpretation of goods and services meant by them. The designations for major kinds of licensed activities (cryptographic activity, protect from unauthorized access to information, production and turnover of some kinds of goods etc.) should now include works and services comprising them, the full list of which will be established in the statements concerning licensing of separate types of activities, approved by the RF Government. Thus, the total number of licensed kinds of activities being reduced, the opportunity for choice of particular works and services which an economic entity plans to carry out upon license receipt is expanded. The bill also introduces novelties aimed at simplification of licensing procedures, for instance, unlimited action of license if established, which will allow excluding the procedure for prolongation of its action. ●

REVIEW OF ECONOMIC LEGISLATION

I.Tolmacheva

This July addenda were introduced in legislative acts concerning the activity of microfinancial organizations and changes to the Law “On veterans”.

I. Federal Laws of the Russian Federation

1. “ON MAKING CHANGES TO SOME LEGISLATIVE ACTS OF THE RUSSIAN FEDERATION IN CONNECTION WITH THE ADOPTION OF THE FEDERAL LAW “ON MICROFINANCIAL ACTIVITY AND MICROFINANCIAL ORGANIZATIONS” from 05.07.2010 No 153-FZ.

Some legislative acts were supplemented with statements concerning the activity of microfinancial organizations.

Legal grounds for activity of the organizations mentioned are established by the Federal Law “On microfinancial activity and microfinancial organizations”. A microfinancial organization is defined as a legal entity filed in the microfinancial organizations register that has a right to issue microloans (loans of less than one million rubles).

In connection with the adoption of the Law mentioned the RF Tax Code is supplemented with the statements, establishing the sums of state dues for filing the information on such an organization to the register of microfinancial organizations (RUR 1000), for issuance of duplicate certificate on filing this information (RUR 200). The RF Code on Administrative Violations is supplemented with two new articles. For instance, administrative responsibility is introduced for violation of legislation requirements on microfinancial activity (the fine can vary from RUR 10000 to RUR 30000). Microfinancial organizations are now also mentioned in the Federal Laws “On small- and medium-scale entrepreneurship development in the Russian Federation” and “On counteraction against legalization (laundering) of criminally received incomes and terrorism financing”.

2. “ON MAKING CHANGES TO ARTICLE 14 OF THE FEDERAL LAW “ON VETERANS” from 02.07.2010 No 149-FZ.

Starting with January 1, 2011 the social support in the form of 50% payment for utilities will apply to members of disabled war veterans families that live with them. This addendum is introduced to the Federal Law “On veterans”. Currently social support in the form of 50% utilities payment (water supply, water draining, rubbish removal, gas, electricity and heat – within the standards for consumption of the services mentioned, established by local government bodies), regardless of housing fund is granted only to the disabled veterans of war.

II. Decrees of the Government of the Russian Federation

1. “ON ESTABLISHING THE MINIMUM SUBSISTENCE LEVEL PER CAPITA AND FOR MAIN SOCIO-DEMOGRAPHIC GROUPS OF POPULATION ON THE WHOLE THROUGHOUT THE RUSSIAN FEDERATION IN THE 1ST QUARTER 2010” from 15.07.2010 No 529.

In the 1st quarter 2010 the established minimum subsistence level is above that in the 4th quarter of the previous year.

On the whole throughout the Russian Federation the minimum subsistence level per capita will make RUR 5518 (earlier – in the 4th quarter 2009 – RUR 5144), for able-bodied population - RUR 5956 (earlier – RUR 5562), for pensioners - RUR 4395 (earlier – RUR 4091), for children - RUR 5312 (earlier - RUR 4922). ●

REVIEW OF REGULATORY DOCUMENTS CONCERNING TAXATION OVER JUNE–JULY 2010

L.Anisimova

1. According to the Letter of the RF Ministry of Finance from June 1, 2010 No 03-07-07/32 in connection with the abolition of the obligatory certification of goods the questions on identification of foodstuffs codes are clarified for the purposes of application of the reduced VAT rates.

The RF Ministry of Finance has explained that in concordance with the Federal Law from 27.12.2002 No 184-FZ “On technical regulation” the obligatory certification of goods as conforming to requirements of technical regulations, articles of standards, code of rules or agreement conditions is fulfilled either through the adoption of the declaration on conformance or during compulsory certification. Declaration on conformance and the certificate of conformance have equal legal force. Upon abolition of compulsory certification for some kinds of goods the declaration on conformance becomes the documental proof.

The codes of types of goods subject to VAT at 10% rate are defined by the RF Government in concordance with the All-Russian Classifier of Types of Production and with the Foreign Economic Activity Commodity Nomenclature (list approved by the Decree of the RF Government from 31.12.2004 No 908).

The correspondence between All-Russian Classifier of Types of Production with the Code given in the List may, in the opinion of the RF Ministry of Finance, serve as a reason to identify privileged goods and apply lowered VAT rate.

2. Letters from June 2, 2010 No 03-07-11/231 and from June 23, 2010 No 03-07-11/267 clarify the position of the RF Ministry of Finance concerning VAT charging for the sum of compensation (bonus) transferred to the customer by the supplier after purchasing a certain volume of goods and the accounting of compensation (bonus) sums when forming the profit tax base at the seller and the customer. The RF Ministry of Finance is basing its position on the fact that VAT taxation object is goods (works, services) selling. The mechanism for price correction and corresponding changes introduction in invoices is explained in the letter of the RF Ministry of Finance from 26.07.2007 No 03-07-15/112. In the opinion of the RF Ministry of Finance when a supplier transfers compensation (bonus) to the customer for purchasing a certain amount of goods changes in invoices should not be introduced and bonus sums are not subject to VAT.

The position of the RF Ministry of Finance is based on the fact that although bonus payments for purchasing a certain amount of goods is not a gift (according to paragraph 2, clause 1, article 572 of the RF Civil Code), but has a status of posterior premium. In concordance with paragraph 4 article 9 of the Federal Law from 28.12.2009 No 381-FZ the bonus is not included in the goods price. That is why the RF Ministry of Finance rejects prices correction by the sum of bonus and holds that VAT should not be applied to the sum of the bonus paid to the customer. Such an opinion does not correspond to the decisions of supreme courts. The Presidium of RF Supreme Arbitrary Court, considering the case of Cadbury Russia & CIS Ltd. bonus revising for surveillance the decisions of courts of inferior jurisdiction explained with the decision from December 22, 2009 No 11175/09 that regardless of the way the parties defined bonus system – granting of the discount determining the possible decrease in goods basic price mentioned in the contract of by granting a bonus, which is an additional compensation given to the customer by the seller for completion of deal’s requirements- and regardless the procedure of discounts and bonus granting – transfer to the account or regarding as advance payment or off-setting the debt – when defining taxation base the profit sum is to be defined taking discounts into account, and if it is necessary , profit should be corrected for the taxation period in which goods (works, services) sale is reflected. Considering the question of justification of price correction when paying the bonus (considering that the right of property for the goods has already been transferred and bonus is paid after that), the Presidium of the RF Supreme Arbitrary Court noted that the transfer of the property rights for the sold goods

does not influence the nature of expenses for the purposes of application of RF Tax Code Chapter 25 (manufacturing expenses, accepted for deduction when forming profit tax base) or the right of the company to claim corresponding tax deduction from VAT.

This practically means that in case a bonus is paid (is it is stipulated in the contract) the contract is regarded as concluded only after such a payment and with the prices that take this bonus into account.

3. According to the Letter of the RF Ministry of Finance from June 7, 2010 No 03-11-11/157 it is clarified, that two basic schemes of personal incomes tax payment are applied for a natural person – these are tax on profit from entrepreneurial activity and tax on other incomes. Tax deduction is not applied to the incomes from entrepreneurial activity (such a deduction is applied only to other incomes levied with 13% tax). Incomes from entrepreneurial activity for the taxation purposes are calculated according to the general scheme of profit tax base calculation. In case the entrepreneur transfers to single tax on the imputed income payment, his entrepreneurial activity is not levied with the personal incomes tax, since it is substituted with the single tax on the imputed income. Other incomes of a natural person (levied with 13% rate) are subject to personal incomes tax, and, correspondingly to property deduction, including that at the sum of really made expenses, for instance for property (house, flat, room or share(s) in them) purchase in the territory of the Russian Federation (subparagraph 2 paragraph 1 article 220 of the RF Tax Code).

4. The Letter of the RF Ministry of Finance from June 8, 2010 No 03-03-06/1/386 once again states the discrepancy between the personal incomes tax base and insurance contributions to social off-budget funds in connection with single social tax abolition. Every insignificant technical difference in the bases can result in sanctions applied in practice. In our opinion, the consequence will be that the administrative burden on taxpayers (payers of insurance contributions to state social funds) will increase, since they will have to monitor such minor differences in bases, while administration efficiency will correspondingly fall.

For instance, the RF Ministry of Finance notes that the gifts of up to RUR 4000 are not included in the personal incomes tax base, and it is recommended to refer to the RF Ministry of Health Care and Social Development for explanations concerning the insurance contribution charging of gift value.

The position of the RF Ministry of Health Care and Social Development upon the inclusion of value of gifts for employees into insurance contributions base calculation is stated in the Letter from 5.03.2010 No 473-19. In the opinion of the RF Ministry for health Care and Social Development in case the gift (including that in monetary form) is given to the employee according to the deed of the gift concluded in written form, there is no object subject to insurance contributions according to part 3 article 7 Law No 212-FZ. Thus, according to the position of the Ministry, the sum of the gift does not influence insurance contributions charging, but conclusion of the deed of the gift in written form is an important requirement.

5. The Letter of the Federal Financial Markets Service from June 8, 2010 No 10-VM-02/12945 clarifies the question on who can participate in exchange biddings during which contracts regarded as derivatives for the purposes of the RF Tax Code are concluded.

The Federal Financial Markets Service gave the following explanation. According to article 12 of the Law “On securities market” only brokers, dealers, managers and the RF Central Bank can participate in biddings at stock exchange.

In concordance with article 23 of the Law on commodity exchange, derivatives contracts with exchange goods as basis assets can be concluded by dealer and brokers having licenses issued by the federal financial markets executive body. Securities and foreign currency cannot be regarded as exchangeable goods for the purposes of the Law “On goods exchange”, since in concordance with the legislation on securities market and foreign currency legislation securities and foreign currency are bidding objects at stock and currency exchanges, correspondingly.

6. According to the Letter of the RF Ministry of Finance from June 9, 2010 No 03-05-04-03/62 it is explained that grounds and procedure for recovery or offset of the state dues are defined by article 333.40 chapter 25.3 of the RF Tax Code. The state dues are to be recovered in case the persons that

paid them refused from the legally important action before they applied to the representative body (official). In case the authorized body, fulfilling its functions, refused to comply with the applicant's request, the state due is not recovered or set off against future payments.

7. According to the Letter of the RF Ministry of Finance from June 10, 2010 No 03-04-05/2-320 it is explained that the transfer of losses from the operations with securities to the forthcoming periods when calculating personal incomes taxation base is made starting with the taxation base for 2010. When calculating taxation base for 2009 such a transfer is not made.

8. According to Letters of the RF Ministry of Finance from June 10, 2010 No 03-04-06/2-115 and from June 11, 2010 No 03-04-06/2-117 some question on tax liabilities concerning personal incomes tax for operations with securities and futures are explained:

1) period of tax calculation, collection and payment by a tax agent (broker) should not exceed one month from the end of the taxation period or from the date of monetary fund receipt (securities transfer);

2) sums of incoming aggregated coupon yield included in bonds cost when they are purchased are accounted by a tax agent when calculating personal incomes tax of the client in the list of expenses for the purchase of the mentioned bonds regardless of whether they were sold before or after coupon payment;

3) transfer of securities from tax agent's custody account (bank account) or taxpayer's custody account (bank account), for which the tax agent has a right to manage, to the taxpayer is recognized as incomes receipt by the taxpayer for the purposes of paragraph 18 article 214.1 of the RF Tax Code. When securities are transferred from one subaccount to another subaccount of one custody account within one bank according to the client's order no taxable income arises;

4) profit in the form of lucre mentioned in subparagraph 3 paragraph 1 article 212 of the RF Tax Code is defined as the difference between the market price of securities or futures and real sum of taxpayer's expenses for their purchase. Market value of securities that are not publically traded is defined on the basis of the calculated price of securities taking into account upper limit of its fluctuations (within 20%). After 2010 the procedure for calculated price definition should be established by the federal executive body for securities market upon endorsement with the RF Ministry of Finance. Before that the tax agent has a right to use the procedure for definition of the calculated price established in its accounting policy and collect the tax from client's incomes.

9. According to the Letter of the RF Ministry of Finance from June 15, 2010 No 03-11-06/2/92 it is clarified that taxpayers applying simplified taxation system pay the minimum tax in case the sum of the tax over the taxation period is lower than the sum of the minimum tax (1% of incomes envisaged by articles 249 and 250 of the RF Tax Code deduced by expenses listed in article 251 of the RF Tax Code). The difference between the minimum tax and real tax liabilities can be accounted (deduced) when defining taxation base for following taxation periods. At the same time the RF ministry of Finance draws attention to the fact that deduction is not applied to the results of accounting periods, since such a procedure is not envisaged by the RF Tax Code. It should be remembered that accounting period for profit tax comprises a quarter, taxation period – a year.

10. The Letter of the RF Ministry of Finance from June 16, 2010 No 03-11-06/2/93 explains that when applying simplified taxation system profits listed in article 251 of the RF Tax Code Advance payments received from the customers are not mentioned in this article. Taking into account the fact that the cash method of incomes and expenses acknowledgement is applied in the simplified taxation system, advance payment received from the customer for goods shipping should be included by organizations using simplified taxation system to the taxation object in the same taxation period when it was received. Advance payments returned by suppliers should be distinguished from received advance payments. Returned advance payments are not accounted in incomes despite the fact that they are also not mentioned in article 251. Differences in accounting for the purposes of taxation of advances received from the customers and returned by suppliers

can be explained by the fact that the returned advance payments cannot be regarded as incomes by their own nature.

When applying cash method the paid advance or prepayment sums in case there is no signed act on executed works should not be reflected in expenses of a taxpayer applying simplified taxation system. The expenses also do not include VAT sums for advance payment or prepayment. Only after the act is signed and upon condition that the payment is really made the costs become expenses. Since the advance sums are not taken into account in the expenses when defining taxation base, the sums of returned advance payments should not be included in incomes of a taxpayer that applied simplified taxation system.

11. According to the letter of the RF Ministry of Finance from June 16, 2010 No 03-08-05 clarifies the question on the documents confirming payments of taxes to the budgets of foreign countries by a Russian taxpayer or facts of tax agents withholding taxes from incomes received in the territory of other countries. For instance, the RF Ministry of Finance notices the absence of compulsory form: it is required to submit written confirmation of payments certified by a tax body of the corresponding foreign country and (or) confirmation from the tax agent on withheld sums (for instance, the letter from the tax agent signed by an official supplemented with payment order on transfer of the corresponding sum of the tax withheld from the source). It is not necessary to certify documents with stamps if the legislation of the foreign company does not envisage stamping the documents on payment and withholding of taxes.

12. The Letter from the RF Ministry of Finance from June 16, 2010 No 03-03-06/1/414 clarifies that upon application of linear method of fixed assets objects amortization that were used a taxpayer has a right to define the amortization norm taking into account the period of exploitation reduced by the number of years of object exploitation by preceding owners.

In the opinion of the RF Ministry of Finance, it is document filled in concordance with the legislation of the foreign country in which the previous owner resided, traditions of paper turnover applied in this foreign state and (or) documents that indirectly confirm the period of exploitation of the fixed assets by the previous owner that can serve as documents proving the period of exploitation by previous owners – foreign contractors.

13. According to the Letter from June 16, 2010 No 02-04-10/2195 the RF Ministry of Finance explains the measures adopted to eliminate collision between tax and budget legislation concerning recovery of tax payments transferred by a budget institution to the account of the regional body of the Federal Treasury by mistake and were intended for transfer to the corresponding account of another Federal Treasury body.

The RF Ministry of Finance clarified that according to the current budget legislation the chief superintendants are not authorized to define the procedure for the recovery of erroneously transferred taxes by department managers and funds recipients and the RF legislation on taxes and duties prohibits the chief administrator of tax budget revenues to organize interregional set-off in budget tax revenues between dependent administrators, since it envisages only return of tax revenues. The RF Ministry of Finance explained that the problem can be solved within the developed bill which passed the first reading in the State Duma.

14. The Letters of the RF Ministry of Finance from 04.06.2010 No 03-03-05/123 and the RF Federal Tax Service from June 16, 2010 No ShS-37-3/4248@ clarify the question on procedure for referring interest for debt liabilities of any kind for incomes and expenses in order to form the profit tax base.

Referring to paragraph 8 article 272 of the RF Tax Code, paragraph 1 article 328 of the RF Tax Code etc. the RF Ministry of Finance substantiates the conclusion that the interests for contracts of loan which period of action embraces more than one accounting period should be included in the list of incomes or expenses when defining profit taxation base monthly during the whole period of loans use (granting of loans for use) regardless of the date for their practical payment. Within the

framework of analytic accounting a taxpayer should account interests as broken by kinds of debt liabilities independently.

15. According to the Federal Law from June 17, 2010 No 119-FZ services of developers are exempted from VAT on the basis of the contract on participation in share construction of apartment blocks and other objects of immovable property (excluding services of contractors rendered when construction production purpose objects).

16. The decision of the Customs Union Committee from June 18, 2010 No 293 defines transition measures in connection with the Agreement on principles for tax collecting during goods export and import, work execution and services rendering in the Customs Union and Protocols for them coming into effect on June 1, 2010. For instance, it is decided that it is the customs bodies of the Party in which territory goods are imported that collect indirect taxes on goods imported from the territory of the members of the Customs Union in case customs procedures have not been completed as on July 1, 2010.

The goods which import had been preliminary declared to the customs bodies of the importing country before July 1, 2010 and for which the declaring party had paid indirect taxes, while the goods are imported after July 1, 2010, the importer in order to prove the justly application of zero VAT rate and (or) exemption from excises payment should submit to the taxation body a copy of Customs declaration filled when goods were cleared.

According to the Agreement, further on the indirect taxes for goods imported from the third countries will be collected on the boundaries of the Customs Union. The information exchange between the taxation bodies of Customs union member countries will be made in the e-form on the basis of the Application for goods import and indirect taxes payment with the mark on indirect taxes payment by the taxation body of the Customs Union member country in which territory the goods are imported.

When goods are imported into the territory of one state participating in the Customs Union from the territory of another participant of the Customs Union the indirect taxes are collected by tax bodies of importing country.

17. According to the Letter of the RF Ministry of Finance from June 21, 2010 No 03-04-05/3-345 the question on personal incomes concerning payments received for the unemployed self-employment was clarified. It concerns a special procedure of taxation of budget funds that are allocated for stimulation of new work places creation for employment of the unemployed citizens. The procedure of taxation under consideration came into effect on January 1, 2009.

According to it, within the first three years (taxation periods) the sums received from the budget are reflected in taxpayer's accounting simultaneously as a part of incomes (to the full extent) and as a part of expenses (within expenses really made by a taxpayer in concordance with the conditions for these allotments receipt). In case these conditions are violated the received sums are reflected in the incomes of corresponding taxation period but are not reflected in the expenses.

If at the end of the third year the payments received will be larger than expenses the allotments that are not accounted by the end of three-year period of receipt are reflected in the list of taxable incomes of the final taxation period.

18. The Letter of the RF Ministry of Finance from June 24, 2010 No 03-03-06/1/428 clarifies the question on accounting expenses and losses for the purposes of profit taxation when an organization is restructures.

Briefly and generally speaking, explanations can be worded as the following. If expenses of restructured organization evolved before the restructuring was completed (date of registration of newly formed organizations or on their apportionment from the restructures organization or on suspension of restructures organization activity by its merging with another organization) and were not accounted in formed taxation base of restructures organization they can be accounted by its legal successors when forming their taxation bases. It seems necessary to specify that the

expenses should be connected with particular incomes and property transferred to legal successors as a result of restructuring.

The losses of the previous years of the restructures organization can be accounted by a legal successor only in case the restructured organization is liquidated. In case of restructuring in the form of apportioning the restructured organization does not stop operating in connection with which the losses of restructured organization are not transferred for the future by the apportioned organizations (this position also corresponds to the principle of connection between expenses and incomes).

19. The RF Ministry of Finance from June 24, 2010 No 03-11-06/2/102 clarifies the question on accounting of the property received according to the exchange contract among the incomes when the simplified taxation system is applied. The explanation can be summarized as the following. The simplified taxation system taxation base includes incomes from sale (article 249) and outstanding incomes (article 250) except those mentioned in article 251 of the RF Tax Code. The exchange contract is a variety of contract of sale, i.e. incomes from it are subject to article 249 of the RF Tax Code. In concordance with paragraph 1 article 40 of the RF Tax Code is not proved otherwise for the purposes of taxation base formation for the simplified taxation system the price of goods, works and services stated by the parties of the deal is recognized as market price.

20. The letter of the RF Ministry of Finance from June 24, 2010 No 03-11-11/173 states the opinion on the possible transfer to the simplified taxation system for the incomes from property lease (sublease).

The position is not unambiguous and results in internal collision in the RF Tax Code. The Chapter devoted to VAT establishes that VAT is paid from the earnings from goods (works, services) sale, i.e. incomes from property lease are included in taxation object. According to the general rule the taxpayers under the simplified taxation system do not pay VAT. Since the RF Tax Code is the unified legal document it should not contain internal contradictions. Thus, the RF Ministry of Finance has two options: either to exempt property lease from VAT or to acknowledge that the tax on profit from the lease should be paid according to the general scheme and the simplified taxation system is not applicable in this situation.

21. In the Letter from June 24, 2010 No 03-07-10/10 the RF Ministry of Finance expresses its position concerning one of the most burning issues of taxation: VAT deduction by an organization that is simultaneously the investor and client-developer and which has signed the contract for object construction with a general contractor when the main contractor bills it for utilities consumed during construction; and the inclusion of the expenses mentioned in the initial cost of the constructed object for the purposes of taxation.

In the opinion of the RF Ministry of Finance, if water and electricity supply to the construction is conducted according to contracts signed by a developer and supplying organizations, expenses for purchase of utilities (electricity and water) used for object construction are not included in estimated cost of works executed by main contractor. On the basis of this statement VAT is accepted for deduction (compensation) by a developer which is levied on utilities expenses made during construction regardless whether there is an object taken off and on the books of object developer (i.e. regardless of whether the object is built or not). The expenses for utilities (VAT excluded), in the opinion of the RF Ministry of Finance, are included in the initial cost of the object. The RF Ministry of Finance does not clarify on which balance expenses for utilities should be kept before the object is put into commission. Such an approach creates a precedent requiring juridical research. As a matter of fact, the RF Ministry of Finance abstracts away from the fact that up to the finish of construction cycle utilizes are transferred from the developer to main contractor in natural terms for them to be used during construction process. The position of the RF Ministry of Finance allows acceleration VAT compensation period, but in case there are delays in putting the object into commission the funds will be unjustly diverted from the budget. The procedure suggested requires detailed description in accounting registers and it should be directly reflected in the RF Tax Code.

22. According to the Letter of the RF Ministry of Finance from June 25, 2010 No 03-03-06/1/431 the question on acknowledgement of insurance contribution paid by a Russian organization to a foreign organization according to the contract of property insurance not connected with the activity of the permanent representative, incomes from the sources in the Russian Federation was clarified.

The RF Ministry of Finance notices that in concordance with paragraph 2 clause 2 article 309 of the RF Tax Code premiums form reinsurance and bonuses paid to a foreign partner are not recognized as incomes from the sources in the Russian Federation. Consequently, all other kinds of incomes paid to foreign organizations according to insurance contracts are recognized as incomes from the RF sources and are subject to taxation according to the procedure envisaged by article 310 of the Tax Code taking into account international contracts of the Russian Federation regulating taxation issues.

If the contract on double taxation avoiding does not mention directly that the sum of insurance contribution paid to a foreign organization is not levied with taxes in the Russian Federation the tax should be withheld by the source of payment – a Russian organization.

However, as a rule, international contracts contain a standard proviso on so called “other incomes” – incomes not mentioned in the agreement. According to such a proviso kinds of incomes from persons with the permanent residence in the negotiating state regardless of the source of its evolution which are not specified in the preceding articles of the contract are to be levied with the tax only in that country.

On the basis of such wording the sum of insurance compensation paid by a Russian organization to a foreign partner according to the property insurance contract are not levied with tax in the Russian Federation. It is certainly quite a significant channel for capital transfer in other countries. The RF Ministry of Finance clarifies that is the international agreement (treaty) is applied, a foreign company should submit to a Russian tax agent confirmation of its tax status by a foreign country government body, in which it is recognized as a taxpayer for competent use of the agreement.

It should be remembered that according to the general taxation scheme in the Russian Federation the sums of insurance compensation are regarded as taxable incomes. The neutrality of the taxation system is accounted for by the fact that the losses from writing off of the property to which damage was caused are referred to the reduction of taxation base.

23. According to the Letter of the RF Ministry of Finance from June 28, 2010 No 03-07-07/42 the question on VAT application when transferring property rights to the authorized capital stock of a filial company is clarified.

In concordance with paragraph 2 article 38 of the RF Tax Code property rights are not included in the property for the purposes of taxation. That is why chapters devoted to particular taxes (for instance, VAT) can be supplemented with property rights mentioning (see subparagraph 1 paragraph 1 article 146 concerning VAT). Paragraph 2 of the same article mentions, however, contribution to authorized capital stock as an operation which is not levied with VAT. Nevertheless this technical contradiction does not result in VAT taxation base reduction since it does not influence the general procedure for paid VAT recovery when transferring property or property rights in the form of contribution to the authorized capital stock. Subparagraph 1 paragraph 3 article 170 directly mentions that in case property rights are transferred as a contribution to authorized (statutory) capital of economic entities VAT sums accepted for deductions for property rights are to be recovered to the full extent (for reference – paid VAT for fixed assets and non-material assets are recovered to the share which refers to their residual value).

24. According to the Letter of the RF Ministry of Finance from June 30, 2010 No 03-11-06/3/96 the question on taxation of budget allotments received by the payers of the single tax on the imputed income is clarified. For instance, the RF Ministry of Finance explained that budget allotments received in concordance with paragraph 1 article 78 of the RF Budget Code on gratuitous and non-repayable basis are aimed at compensation of expenses or underreceived incomes in connection with application of regulated prices (tariffs) for production (sale) of goods, work execution, services rendering. Monetary funds received in the form of subsidies are regarded as outstanding incomes

not referring to the activity which was transferred to the single tax on the imputed incomes taxation system by the RF Ministry of Finance. That is why such subsidies are to be levied with taxes within other taxation regimes.

25. Within the framework of the Budget Address of the RF President from June 29, 2010 “on budget policy in 2011-2013” a number of measures concerning partial changes of the current taxation system are envisaged. It should be noted that there being certain exceptions on the whole the tax policy is planned to be quite reserved in the forthcoming time: it mainly concerns assignments that mainly concern pending but not yet fulfilled measures, including, for instance, introduction of new scheme of property taxation, including speeding up the work on cadastre forming. It should be noted that transfer to self-regulation and collection of real estate tax (instead of land and property taxes) is recognized as one of the main directions in creation of taxation base in financially insecure RF subjects and municipalities. The attention is justly focused on the necessity to solve the problem of acceleration of VAT compensation, amortization write-off, increase in tax administration efficiency.

At the same time the problem connected with the fact that granting tax privileges is burdened with the liability of the federal budget to compensate to regional and local budgets the lost earnings – i.e. it is practically recognized that granting tax privileges not only reduces federal budget revenues, but also additionally increases its expenses. The RF Government was commissioned with the definition of the ways to solve this problem including developing of step-by-step plan of gradual privileges abolition.

Nevertheless, in order to support innovative development it was declared that tax privileges and privileges for other compulsory payments would be grants. The organizations that use primarily intellectual work will receive the reduction of insurance contributions to 14% for 3-8 years. In order to stimulate innovation activity in innovative center Skolkovo privileges will be introduced: project participants should pay 14% insurance contributions, 0% organizations property and land taxes. The fact that the privileges are not envisaged for permanent use but for particular period or in order to achieve some figures of profitability and turnover by the Address of the RF President should be regarded positively.

Note. At the first glance it seems that there being insufficient budget funds, substitution of budget allotments with tax privileges for participants is the easiest solution. However there is a trap for the economy in such simplicity.

Tax privileges artificially change profitability in different sectors of the economy. The capital is redistributed towards the sector where the costs are lower, money are invested in the production, but the result is that the producer comes off worst, since the production cannot function without privileges since it is initially non-competitive at the global market in comparison with the similar productions. At the same time investments in inefficient production have already been made ... Fixed assets created for such production turn into the dead weight, since they cannot be sold or restructured since they are non-liquid at the open market ...

26. The Letter of the RF Ministry of Finance from July 1, 2010 No 03-04-06/8-138 clarifies the question on the procedure for transfer of personal income tax sums collected by the employer when paying wages to the budget. The RF Ministry of Finance explained that in concordance with the RF Tax Code the employer executing the functions of a tax agent collects personal income tax from the incomes paid to natural persons and transfers withheld tax to the account of a taxation body of its tax registration place. If there are separate structural divisions located in other municipal formations the employer has to register these branches at tax bodies of corresponding municipal formations. The personal incomes tax withheld from the incomes of the employees of corresponding separate structural divisions is directed to accounts of taxation bodies of the place in which these structural divisions are registered.

27. According to the letter of the RF Ministry of Finance from July 2, 2010 No 03-11-06/3/97 it is explained that the prohibition for simplified taxation system application by organizations that have branches or representatives (subparagraph 1 paragraph 3 article 346.12) does not apply to

separate branches not situated in the place where the legal entity is located. The RF Ministry of Finance draws attention to the fact that branches and representatives are given property by the legal entity that created them and act in concordance with the statement approved by this entity and are mentioned in founding documents of the legal entity. Separate branches are not mentioned in founding documents and can be defined as workplace located out of the place of taxpaying organization location.

28. According to the Federal Law from July 2, 2010 No 151-FZ new notion of microfinancial activity is introduced. It is defined as issuing loans to legal entities of up to RUR 1 million. The persons engaged in such an activity are to be registered by the state specifically. In this connection the Federal Law from July 5, 2010 No 153-FZ makes amendments to the RF Tax Code, for instance, it establishes the due for making an entrance for a company to the state register of microfinancial organizations of RUR 1000 for issuing certificate duplicate to replace a lost or worn one of RUR 200.

29. The RF Ministry of Finance with the letter from July 2, 2010 No 03-11-11/182 answering a private enquiry explained that when the criterion of transfer to the simplified taxation system in the form of fixed assets residual value of less than RUR 100 million is applied one should not that this value is defined taking into account interests for purchase of the property in installments.

In our opinion, this question is not that unambiguous.

This is true that in concordance with paragraph 6 subclause clause 3 article 346.16 of the RF Tax Code in case a taxpayer applies simplified taxation system from the moment of registration at taxation bodies, the value of organization's fixed assets and non-material assets are acknowledged at the initial value of this property defined according to the legislation on accounting (according to accounting rules the value of fixed assets includes interests for credits and loans for purchase, including interests for purchasing in installments). However when transferring to the simplified taxation system from other taxation regimes, in concordance with paragraph 7 of the same subclause another procedure for determining fixed assets value is applied: for instance, there is a reference for the procedure of fixed assets evaluation according to the rules of chapter 25 of the RF Tax Code (general procedure for profit taxation). Within this general procedure interests are considered as outstanding incomes and expenses. That is why when transferring to the simplified taxation system from the general profit taxation system criterion of fixed assets value does not in our opinion envisage accounting of expenses for interest payment when purchasing property in installments. It seems that the RF Ministry of Finance has in general correct approach to the problem – the current taxation should not depend on which taxation system was applied earlier, before the transfer to the simplified taxation system. However, in our opinion, the existing contradiction can only be eliminated by making changes to the RF Tax Code. ●

CHANGES IN REGULATORY BASE OF BUDGET PROCESS

M. Goldin

In July the following events took place in the regulatory base of the budget process: the Program of the RF Government on the increase of budget expenses efficiency for the period up to 2012 was approved, the Federal Law “On investment activity in the Russian Federation carried out in the form of capital investments” was brought in concordance with the budget legislation.

According to the Decree of the RF Government from June 30, 2010 No 1101-r the Program of the RF Government on the increase of budget expenses efficiency for the period up to 2012 (further referred to as the Program) was adopted.

The following documents serve as a legal base when creating the Program: Address of the RF President to the federal Assembly from November 12, 2009, Budget Address of the RF President to the federal Assembly from May 25, 2009 “On budget policy in 2009-2012”, as well as the main statements of the concept of long-term socio-economic development of the Russian Federation for the period up to 2020, approved according to the decree of the RF Government from November 17, 2008 No 1663-r.

The Program aims at creating conditions for the increase in efficiency of the public legal formations in executing government (municipal) functions and providing for the need of citizens and society in them, as well as at fulfilling long-term priorities and goals of socio-economic development. The main measures that allow reaching the goals set are, among others, the following: definition of the areas of responsibility of public and legal formations, government and local government bodies; securing the connection between strategic and budget planning, goal-setting for budget expenses, monitoring the achievement of the declared goal; expansion of the federal budget role when solving problems of modernization and innovative development of the Russian economy. Guaranteeing of long-term balance and stability of RF budget system is a necessary condition for solving the tasks set. The RF Government has also established the plan of measures to fulfill the Program in 2010, which contains a list of measures, schedule times and responsible executing officers.

Federal Law “On investment activity in the Russian Federation carried out in the form of capital investments” was brought into concordance with the budget legislation by the Federal Law “On making changes to article 11 of the Federal Law “On investment activity in the Russian Federation carried out in the form of capital investments”.

The Law mentioned substitutes the notion of “list of construction sights and objects of technical re-equipment for the federal state needs” as one of the forms of capital investment with the notion of “federal targeted investment program”.

According to article 179.1 of the RF Budget Code budget investments in the objects of capital construction at the expense of the federal budget funds are carried out on condition that they are included in the Federal Targeted Investment Program (FTIP). FTIP represents consolidated reference document, containing information on the objects of capital construction, for which construction (reconstruction, technical re-equipment) funds are allocated from the federal budget. ●