



RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES 10'2011

MONTHLY BULLETIN:

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RUSSIAN ECONOMY IN OCTOBER: TENTATIVE INDICATORS AND BASIC TRENDS

Political background: more clarity and even less enthusiasm

Political and economic background was governed in October by the start of the Duma and presidential pre-election campaign. Herewith, clarifying the future power structure (President Putin, Prime Minister Medvedev), which was announced in early September, has not changed the attitudes of the population and economic agents. Capital outflow in September 2011 was a record one since 2009 (\$13bn), while the “tandem” ratings continued to decline.

Thus, the index of loyalty to the first persons (Putin and Medvedev integrated trust ratings), assessed by FOM (Public Opinion Fund), in late October for the first time demonstrated the 50 to 50 ratio of loyal and disloyal population (at the end of 2010, that ratio was steadily maintained at the value of 70 to 30); the continued decline of Putin’s rating is demonstrated by the October data of “Levada-Center”. The “United Russia” rating got stabilized (as assessed by FOM) and even started to grow (estimated by “Levada Center”). This is based, apparently, on the beginning of an active campaign at the regional level: responsible for the party results in the December elections regional authorities actively execute budgets for social expenses under the brand name of “United Russia”. This strategy was spilled out in a scandal with the Mayor of Izhevsk, whose public statements about the dependence of funding of veterans’ organizations as per the outcome of the “United Russia” elections was disclosed in the Internet. According to “Levada-Center” assessments, the rating of “United Russia” growth was observed in September and October in the ratings of Governors and the balance of the general assessment of the situation in the country (from -2 points in August to +5 points in October). It is noteworthy, that the negative trends of V. Putin and D. Medvedev ratings were sustained, which is characteristic for the entire year of 2011.

In October, the conflict between the federal government and Yuri Luzhkov, the former Mayor of Moscow has been newly escalated. Luzhkov’s speech for “Radio Liberty” with criticism of the new leadership in Moscow, “United Russia” and its campaign leader Dmitry Medvedev. Kremlin has reacted with explicit threats of criminal prosecution of the former Mayor (Luzhkov was summoned for questioning as a witness). The acuteness of the reaction is based on the fact that actually we are talking about loyalty to Moscow and increasingly – to regional bureaucracy, which plays a key role in ensuring “smooth” election, and what is happening with Luzhkov is an important indicator.

In October, there has been a decisive progress in the issue of Russia accession to WTO: under pressure from European countries, Georgia has agreed to significant concessions in the issue of border control. Russian authorities announce the completion of the accession process by the end of the year.

Macroeconomics: an outflow of capital and disinflation

Macroeconomic environment in October was based on the global instability, domestic situation and specific factors.

After a sharp decline in September, Euro rate against the USD has been growing since the beginning of October and at the end of the month has almost come back to the values of early September. Traditionally, in line with a weakening dollar, oil prices, declined in September, were winning back their former position. Strictly following those indicators, the ruble exchange rate and the Russian stock market indices were changing (MICEX: 1,265 points at the lowest level on October 5 and 1,526 points on October 28). However, in late October the market enthusiasm about the plan to overcome the debt crisis in the Euro zone was replaced by a growing skepticism, which predefined a new reversal of markets in the last days of the month. In general, the October “boom” has not changed the overall long-term trend for strengthening of the dollar against Euro and a mild decline in oil prices, observed since April of this year. This trend is reflected in the dynamics of the Russian stock market: the indicators of the first week of October were the worst ones over all the time of the

downward trend after the peak in early April 2011 (1,850 points); for the last time such index values were observed in July 2010.

However, a significant impact on the macroeconomic situation in Russia against the background of instability in foreign markets was provided also by the domestic factors, which include the Bank of Russia policy of curbing the monetary supply growth and a massive outflow of capital, which amounted in January-September to \$ 49.3bn.

The restrained growth in monetary supply in 2011 (growth rate of M2 in annual terms has slowed down from 36.3% as of September 1, 2010 to 20.9% versus September 1 of the current year), as well as a weak demand have contributed to the further inflation reduction. In September, inflation was zero, resulting in the annual 7.2% inflation in September. In October, inflation has somewhat accelerated, having reached 0.2% in the first three weeks of the month and 0.2% more in the last week. Monthly inflation, which is approximately 0.4%, reflects the slowdown in falling prices for fruit and vegetables; alongside with the annual rate, inflation was not accelerated (in October 2010 it was 0.5%). Curbing inflation is largely a political issue during the election period, and for the same reason indexing of regulated prices is postponed from early 2012 to the summer.

However, since the beginning of July, an increased tension with bank liquidity, which was backed up by an unexpected large outflow of capital (\$18.7bn in quarter III) was noted. In September, against a background of instability in foreign markets, the demand for dollars has sharply increased, and the Bank of Russia was forced to carry out a large-scale intervention (over the month there were sold \$6,765,68 and Euro590, 91), simultaneously withdrawing rubles in view of the above. The increased demand of banks for liquidity led to the growth rates in the interbank market rates: the interest rate on ruble loans for one a day rose to 4.5%, being the maximum value from the end of 2009. As a result, the Bank of Russia had to replenish the banks' liquidity through the deposit auctions and direct repo auctions, as well as announcing the list of possible expansion of the refinancing instruments and commencement to use those of them used during the liquidity crisis in 2008. The situation gravity was noted by Moody's Agency, which worsened the October 24 estimates of the Russian banking system from "stable" to "negative".

Despite some stabilization in October, which was reflected, in particular, in the dynamics of foreign current reserves stabilization (those reserves in October even rose slightly – up to 514.6bn as of October 21), the Bank of Russia, apparently, is preparing to repeat the attack of ruble in November.

Real sector: the growth in stock

In September 2011, the situation in the real sector was not too favorable. As compared with August, there was noted a reduction in raw materials' production by 2.5% and in manufacturing by 0.4%, at the background of reduced turnover in wholesale and retail trade. As a result, in September industrial production amounted to 99.2% against the August level, but with the exception of seasonal factors, even to 99.7%. By September 2010, industrial production growth made 3.9% (5.2% over the same period last year as per January-September).

The results of quarter III look more promising in general. GDP growth rate has accelerated and reached 5.1% against 3.4% in the quarter II and 4.1% against the first quarter. However, economic growth in 2011 is recovering in nature, and the base effect largely determines the dynamics of the current year. Thus, the strong quarter II of 2010 (an increase of 5% in annual terms) has predetermined the poor results of quarter II of 2011 (3.3%) and, as opposed to that, the modest results of quarter III of 2010 (3.1%), which were reflected in accelerating growth in annual terms of quarter III of this year (5.1%).

It is worth noting the structural features of the economic growth in the current year. In July-September there recorded an acceleration of investment growth in fixed capital, scope of work in construction and agricultural production (capital investments within January-September have increased by 4.8%, the scope of construction works – by 7.9%, agricultural production – by 15.9%). Those factors have partly offset the trend to slow the pace of domestic demand for industrial products and infrastructure services.

Despite the further decline in the trend of population to save (the share of savings in the incomes declined to 9.3% versus 14.1% in January-September 2010) and the growth of consumer lending (by

1.27 times in August as compared with August 2010), the dynamics of consumer demand remains weak and unstable. This trend was urged by a negative growth value in real disposable income over January-August (-0.2% against the relevant period of 2010); in September, real disposable income made 103.2% versus September 2010. However, the peculiarity of September was a marked increase in the share of population spending on the purchase of foreign currency: from 3.5% in January-September 2010 to 4.2% in the same period in 2011. Overall, the retail trade turnover in September has reduced to 0.4% as compared with September 2010, the growth of wholesale trade also tends to slow down (in the first quarter its growth was 3.4%, in the second quarter – 3.1%, in the third quarter – 2.7%). As a result, the specifics of the third quarter of this year was the rapid growth in inventories at the background of the slowdown in sales of goods. The dynamic growth of the stocks remains one of the key factors, determining the retention of GDP growth estimates as per 2011 results at the level of 104.1% and maintaining the dynamics in the coming year. ●

THE POLITICAL AND ECONOMIC RESULTS OF OCTOBER 2011

S.Zhavoronkov

By comparison with the eventful September 2011, October was characterized by significant inertia in the internal political sphere. The electoral campaign was gearing up without undue haste. According to voter preference polls, United Russia, the CPRF and Fair Russia retained their positions in the pre-election race, while the three non-parliamentary parties showed no signs of becoming even marginally competitive. The most hotly debated issues were the ratings of United Russia fluctuating between 65% (or close to its previous results) and 50% or even lower, which could reflect a considerable drop in its popularity, and the ratings of Fair Russia teetering on the brink of losing its parliamentary representation. The number of electoral topics was increased by Vladimir Putin's putting forth the idea that Russia should intensify her integration with CIS countries. A draft budget for 2012 – 2014 was submitted to the State Duma and adopted by it in the first reading. In many respects, the Draft is structurally identical to the current budget, for example, in continuing its tendency to boost public expenditures, first of all in the military sphere. In October, a major privatization tender was held for the first time in many years. The property sold by tender was a controlling block of shares in First Cargo Company, an important rail freight operator.

In October, RF Prime Minister Vladimir Putin gave an interview to the heads of three Federal TV channels. His answers to some of the questions were practically identical to his statements at the September congress of United Russia. “It is absolutely normal in politics and practice when people form political alliances and agree on some principles of joint operation and conduct. We agreed years ago – four years ago, in fact – that this scenario is quite possible if both of us manage to survive this period of trials and tribulations. [...] And so when this time came and we announced our decision, we presented it not as a settled matter but as an issue which our compatriots must decide. We proposed the structure, but it is the Russian people who must support it at the elections. Elections are the ultimate gauge!” As regards his differences from Medvedev and the divergence in their opinions on some issues, Putin said that “at some stage Dmitry Medvedev decided that it would be sensible to humanize some spheres of life in Russia” and that “we need to see how these changes will work out” and whether the voters would accept these initiatives, etc. Putin affirmed that United Russia had set an example for democratic countries by representing a mechanism of direct democracy work such as preliminary voting and discussions (which are, by the way, absolutely not binding under the Charter of United Russia). On the whole, this lengthy interview has brought nothing new. It is rather interesting that so far Putin has abstained from any far-reaching pre-election promises regarding economics (four years ago, United Russia's campaign was focused on promises to increase wages, pensions and public expenditures in general). Putin was equally vague on the electoral results that he wanted United Russia to achieve, and simply noted that “United Russia must remain the leading political force in the country and in the State Duma. That would be a good result”. One can point out, however, that the party may still remain “the leading force” regardless of how many seats in parliament it actually captures – 40% or 65%. So far, the forecast that the authorities would pay less attention to the electoral results of the ruling party in connection with its possible worsening seems to be confirmed.

The only theme that drew attention and stood out against the backdrop of traditional stories about the situation in the country being good, was the idea of increasing cooperation within the framework of the CIS. It was first expressed by Vladimir Putin in his article published in the Izvestia newspaper under the heading “A new integration project for Eurasia: A future in the making”. Then the said integration initiatives were supported by the leaders of Belarus, Ukraine, Kazakhstan, Kyrgyzstan and Armenia in the course of a number of public events devoted to this theme. The problem is that these initiatives are devoid of real content – the Customs Union has already been created, Ukraine's accession to it remains very problematic. Same is true of the

future of the Joint Peacekeeping Forces: in fact, no other country except Russia has so far been willing to participate, and its rules of engagement still remain unclear.

Dmitry Medvedev put forth two initiatives: the proposal to create “a larger, expanded government” with participation of experts and public figures¹, some of whom would be included in the real government; and the proposal, voiced by him during a meeting with young people, that graduates of higher educational establishments could be granted a deferment from military service, provided they work in the area of expertise as specified in their degree certificates. The latter initiative also envisaged the possibility that some time in the future Russia would switch to a fully professional army. It cannot be said that these proposals have drawn much interest, mainly because far more attention has been paid – and will inevitably be paid – to statements coming from Vladimir Putin who will certainly return to the Russian presidency.

The first month of the electoral campaign brought no major surprises, either: the ruling party was diligently served by the state-controlled mass media (from TV channels to local newspapers) and by the means of visual agitation, while the CPRF, LDPR and Fair Russia have limited their electoral efforts to issuing and distributing printed mass media. CPRF and LDPR press organs circulated in several million copies, while the printed mass media of Fair Russia enjoyed a more modest circulation. Yabloko, Patriots of Russia and Right Cause stayed absolutely inactive, thus confirming their “outsider” status in the ongoing electoral campaign. As regards the four leaders of the electoral race, the main polling centers widely differed in their finding, with the most controversial ratings being gained by United Russia (for example, from 45% according to the All-Russian Center for Public Opinion Studies to 60% according to the Levada Center) and Fair Russia (from 5% to 8%). The ratings shown by the CPRF (over 14%, sometime up to 19%) and the LDPR (about 10%) did not vary in the main from one polling agency to another. As far as the March regional elections are concerned, the lowest ratings of United Russia and the highest ratings of Fair Russia seem to be more plausible, even when taking into account the factor of possible falsifications (which have also marred the previous regional elections).

The RF Government introduced in the State Duma a draft law on the 2012 – 2014 budget and a number of draft alterations in the current budget that were concerned with the revenue and expenditure sides of the 2011 budget. Contrary to preliminary forecasts, this year’s budget promises to be close to being deficit-free – the deficit is expected to amount to just 0.1% of GDP due to the considerable additional revenues generated by the high prices of hydrocarbons: throughout most of the year the price of oil was 20 to 30% over the forecast. The corresponding laws were approved by the State Duma in the first reading. Experience shows that they will be adopted in the final reading without any principal alteration.

In the next year, expenditure will rise by almost 6%, the forecasted budget deficit will climb to Rb 869.2bn or 1.5% of GDP. In 2013 it will reach 1.6% of GDP and will slide to 0.7% of GDP in 2014. It is planned that defense expenditures will rise to 19% of budget expenditure, while expenditures on public health care, education, the housing and utilities sector and the economic policy will all be reduced. We believe that only one of these initiatives is worthy of approval – that is, the planned cut in expenditures on the economic policy, i.e. in the state support for various enterprises. The growth in defense spending caused by Russia’s declared need to modernize its armaments (Russian defense expenditures as a percentage of GDP almost equal those of the USA) takes place in conditions when the main military threats are generated by the terrorist activity in the North Caucasus (with the countermeasures being financed under other expenditure categories unrelated to Defense, first of all under the Law Enforcement Activity expenditure category). The rationality of these expenditures is hard to analyze because of their high corruption capacity – bearing in mind the “top-secret” nature of R&D in the sphere of armaments and their supplies it is very difficult to understand which hardware is really new and state of the art, and which is not. It should also be mentioned that, for two years in succession, plans of armament purchases have been frustrated, contracts have not been concluded or implemented – and nothing happens: despite all the loud scandals, nobody cares to take a moment to ponder whether or not such growth

¹ It is significant that one of the main media-related consequences of this statement was the discussion of whether Dmitry Medvedev would become head of the real government, as it was promised by Vladimir Putin, or of that ‘larger, expanded’ and merely consultative government.

is advisable. As regards the cuts in spending on the socially-oriented budget items, experience indicates that although such cuts, especially those targeting pension reform, have been discussed for a very long time, the decision to resort to them will be politically very costly and difficult.

In this connection, the detailed proposals put forth by former RF Minister of Finance Aleksey Kudrin have drawn lots of interest. In his article published in the Russian newspaper *Kommersant*, Kudrin outlined five key points of a correct budget policy. These points are as follows: a deficit-free federal budget (at a relatively low oil price forecast of \$ 90 per barrel which takes into account possible price fluctuations); a set of rigid rules for spending surplus oil revenues that would prevent the lobbyists from laying claim to them; a reduction in military expenditures (Aleksey Kudrin has delicately phrased it as “the rearmament program should be extended to 15 years, from the 10 planned now”); the development of a sound strategy for social and pension insurance (in particular, including the pegging of pension indexing to the rate of inflation for quite a long time – until the pension system becomes deficit-free) and a general reduction in the budget burden on Russia’s GDP; a cut in expenditures and the country’s refraining from rises in “major taxes”¹. If all this is implemented, Russia will obtain a model of economic growth “based on a rise in private investments augmented by a stable financial system with low inflation and the lowest crediting rate”. According to Kudrin, the negative alternative to this scenario will be money emission and inflation, or a worsening of Russia’s debt problems. It is interesting that Kudrin’s article has been indirectly mentioned by both Dmitry Medvedev (who remarked that it would be erroneous to reduce defense spending because Russia ‘is not a banana republic’) and Vladimir Putin (who, on the contrary, made a reference to the importance of social policies and to the social protests in the West).

In October, a major privatization tender was held for the first time in many years, which resulted in 75% minus 2 shares of OJSC First Freight Company being bought by Vladimir Lisin’s UCL Holding company for Rb 125.5bn. As soon as the starting price went up a tiny bit, the other contestants, Gennady Timchenko’s structures and CJSC Neftetransserver, threw in the towel. Most probably, bearing in mind the company’s value was close to its market value, the winner and the rest of the bidders had reached some agreements on the subsequent re-selling of part of the carriage fleet (Gennady Timchenko’s business is almost entirely concentrated in the oil and gas sphere and therefore he is primarily interested in railway oil tanks, while the afore-said Russian metallurgists are mostly concerned with freight cars and gondola cars). However beneficial for the market, this sale of a controlling block of shares in one of the largest companies cannot be seen as a proof of any major alterations being introduced in the government’s course – in recent years, despite the numerous promises of upcoming large-scale privatization, the Government has been selling only non-controlling blocks of shares. Moreover, in a number of sectors (the energy sector and the banking business) state companies have been openly increasing their presence. At the same time, this transaction indicates that the private sector is really interested in such acquisitions and is ready to pay considerable amounts of money for such properties, notwithstanding all the risks dealing with the state regulation of carriage tariffs.

In October, Arcady Dvorkovich, Assistant to the President of the Russian Federation, announced that the process of Russia’s accession to the World Trade Organization (WTO) could be completed on 15 December 2011 (meaning the adoption of the corresponding decision by the WTO, to be ratified later by Russia). In order to validate this optimistic statement, Dvorkovich referred to the negotiations held between the authorities of Switzerland (the country that represents Georgia in diplomatic relations with Russia) and Georgia. After the radical worsening of Russo – Georgian relations in the mid-naughties, Georgia had withdrawn her consent to Russia’s accession to the WTO, thus creating an unprecedented special case (all the countries participating in the negotiations on the accession of an applicant country to the WTO must give their consent to its admission to this organization, but no WTO document specifies what exactly should be done if one of the member countries “withdraws its consent”). Previously, Georgia had demanded that the Georgian customs regime should be restored on the Russo-Georgian frontier, thus, in fact, creating an impasse in the accession negotiations with Russia because of the differences in opinion on Georgia’s contested borders, which emerged against the background of the problem of “the

1 In the context of Kudrin’s article, it can be understood that “major taxes” are taxes paid by the majority of taxpayers, and not some special dues like excise taxes.

unrecognized republics". On the other hand, in the past few months there occurred a number of information leaks indicating that in the event Georgia rejected a compromise solution, the WTO administration could introduce some new rules and admit Russia to the WTO even without Georgia's consent. However, the veracity of these revelations has never been confirmed. In recent months, the Russian side repeatedly indicated that it was ready to lift sanctions on Georgia's agricultural products, first of all wine and mineral water, thus setting the parameters of the compromise it was ready to accept. If the compromise is reached, it would be a major diplomatic coup for Russia. Nevertheless, there are fears that no compromise will be achieved: the issue of the status of the "lost territories" is the centerpiece of Georgia's political life and her policy, so any compromise on this issue is fraught with political losses on the eve of Georgia's forthcoming elections, while the share of Georgian exports to Russia in the foreign trade of Georgia is relatively small. ●

INFLATION AND CREDIT AND MONETARY POLICY

N.Luksha

In September 2011 consumer prices did not grow up (a year before the CPI made 0.8%). In October, inflation has again become positive – 0.2% on October 24. As a result, cumulative inflation since the beginning of the year reached 4.9% (against 6.8% in 2010). In September, a net outflow of capital has accelerated: according to the tentative estimates of the Central Bank, it was \$13bn, which is the highest monthly value since the beginning of 2011. According to the first nine months, capital outflow reached \$49.3bn (against \$14.3 bn for the relevant period in 2010). In September, the ruble weakening was observed: The exchange rate of the Russian currency fell against the dollar by 14%.

In September 2011 consumer prices on average in the Russian Federation did not grow. This was possible due to seasonal food deflation, as well as lower prices for commercial services. In addition, monetary inflation also remained low.

In September, foodstuffs became cheaper by 0.6%. If a year ago as a result of negative aggregate supply shock, cereals and beans were the leaders of a rise in prices, in September of this year they became the leaders in the list of downgrading goods (-10.6%). In addition, in September, there was continued the decline in prices for fruit and vegetables (-9.8%), as well as granulated sugar (-9.9%).

In September, for the first time in this year, deflation for commercial services was observed (-0.1%). In connection with the scheduled changes in railway tariffs, passenger tickets fell down by 4%. In the first month of autumn there was a decreased demand for health resorts' services and foreign tourism, and as a result, prices have decreased by 2.4 and 0.2% respectively. At the same time, at the beginning of the new academic year prices have grown for physical training and sports (+2.8%) and educational services (+2.7%).

In September, there was continued the growth rate of prices for industrial goods (+0.7%). The greatest contribution to the price growth was made by tobacco products (+2.2%). They have become the absolute leader in the consumer price growth in the first three quarters of the year: during this period tobacco products prices grew by 17.5%. No reduction was observed in non-food goods prices.

In September, inflation in annual terms continued to decline, having reached 7.2%, which is only by 0.2 percentage points higher than in the last year (see Fig. 1).

The basic consumer price index¹ in September 2011 amounted to 0.5% (against 1.1 in 2010).

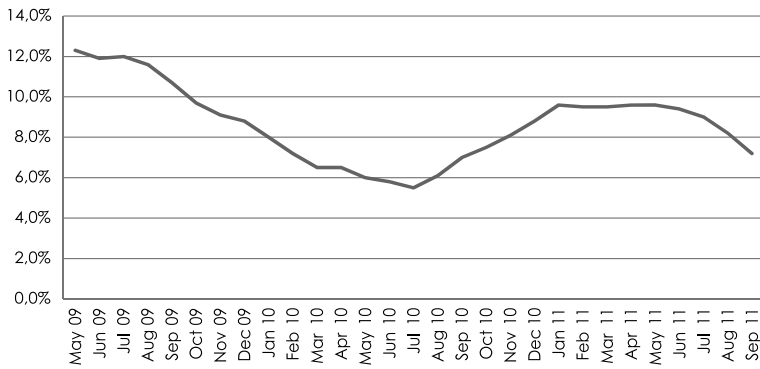
In October, inflation has somewhat accelerated, as expected. After four weeks of zero growth since the second week of October, consumer prices started to grow. In less than three weeks the CPI reached 0.2% on October 24 (0.5% for the same period in 2010). As a result, since the increase in consumer prices was 4.9% (6.8% in 2010).

By the end of the year, inflation is traditionally increasing. The main drivers of growth in prices will be the usual pre-holiday upsurge in consumer demand and the depletion effect of cheaper agricultural products. The weakening of the ruble, which occurred in August and September of this year, will also affect the prices of imported goods at the conclusion of new contracts.

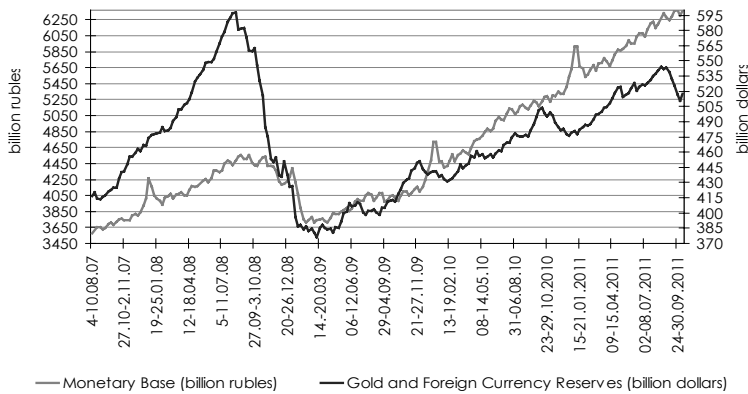
At the same time, a limiting factor in inflation will be a slow growth in monetary supply: M2 growth rate at an annual rate has slowed down from 36.3% on September 1, 2010 to 20.9% on September 1 of this year. We would like to note also, that the traditional upsurge of inflation in early 2012 is likely to be mitigated due to the transfer of the annual increase of tariffs for natural monopolies and housing utilities from January 1, 2012 to July 1.

In September, the growth of monetary base in broad definition has reached its maximum since the beginning of the year and made Rb 7,407.9bn. Expansion of the monetary base in the broad definition was based in the first place, on the 20% growth of commercial banks' correspondent

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



Source: RF Statistical Service.
 Fig. 1. CPI growth rate in 2009–2011 (% year to year)



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

accounts with the Bank of Russia: they rose to Rb 781.6bn. Other components of the monetary base were also growing: for example, cash in circulation, taking into account balances in credit institutions increased by 1.6% to Rb 6.06 trillions, the banks' deposits with the Central Bank – by Rb 6.5% up to Rb 209.5bn, mandatory reserves – by 1.3% up to Rb 347 bn, the bonds of Central bank with credit institutions – by 1% up to Rb 10.3 bn.

Since July of this year the intensity of bank liquidity began to grow, which is associated with accelerated outflow of capital and currency from the country and growth of the RF CB foreign currency growth. After a two-month reduction in September, excessive reserves of commercial banks¹ managed to recover to some extent: within the month they increased by 16.9% to Rb 1.0014 trillion. The main sources of liquidity replenishment were the deposit auctions of the Ministry of Finance and direct REPO auctions, conducted by the Central Bank. In early October, the Bank of Russia also declared a possibility of expanding the list of refinancing instruments and the start of using those ones used during

the liquidity crisis in 2008. The banks' increased demand for liquidity has led to an increase in the rates on the interbank market: the rates for ruble loans in 1 day in the interbank market rose to 4.5%, which became the maximum value since the end of 2009.

The scope of monetary base in narrow definition (cash plus required reserves)² has continues its growth: on October 1, it has grown by 1.6% and made Rb 6406.6bn (see Fig. 2).

Within September and first week of October international reserves have dropped sharply. Only over the month the reserves have decreased by 5.3%, amounting by October 7 to \$510.4bn. The reduction in reserves was provoked by smoothing the exchange rate dynamics by the Bank of Russia. In addition, the reduction was due to the revaluation of the reserves denominated in Euro and U.S. dollar growth rate against the European currency.

In September, for the first time since late the last year the Central Bank entered the market with the sales of foreign currency. In the framework of foreign exchange interventions, there were sold \$6,765.68m and EURO590.91m (see Fig. 3).

In September, a net outflow of capital due to investors' concerns about growth prospects for the global and Russian economies was the highest within this year. According to the tentative estimates of the Bank of Russia, he has reached \$13bn, having reached nearly fourfold level as compared with the summer months. At the end of quarter III, 2011 capital outflow amounted to

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

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

\$18.7bn, which has exceeded twice the rate of quarter II and more than 6 times – the indicator of the same period in 2010.

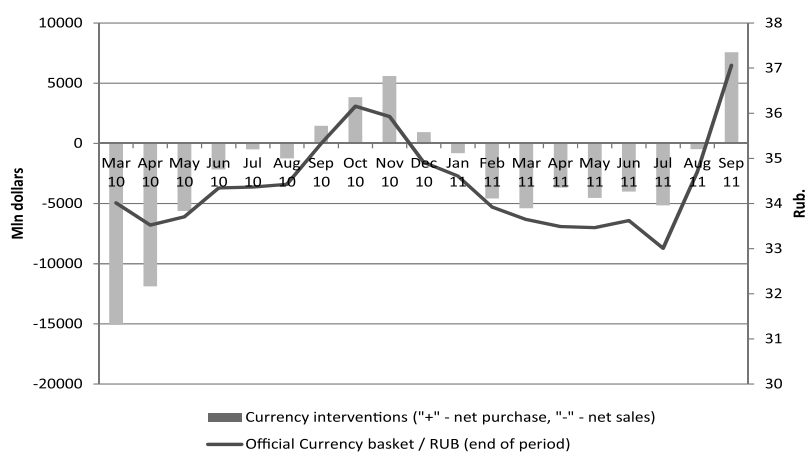
We would like to recall that in the first quarter of 2011 there was recorded an export of \$21.4bn, in the second quarter — \$9.2bn. As of the results of the first three quarters of this year, net capital outflow reached \$49.3bn (against \$14.3bn over the first nine months of 2010).

The main reason for the acceleration of capital outflow was increased instability in the global financial markets. Growth of capital flight is also associated with an increased demand for foreign currency on the part of banks and companies, which in the last quarter of the year must implement peak foreign debt repayments. However, external factors continue to play a key role – investors withdraw funds from risky assets.

According to the draft Guidelines for monetary policy in 2012-2014, annual outflow of capital should amount to about \$36bn. However, in the second half of October, the Bank of Russia announced the possible revision of the forecast and raising the level to \$50bn. In our view, under conditions of high uncertainty in the global financial markets, private capital outflow in the last quarter of 2011 is likely to continue and exceed the estimated rate of the Bank of Russia. In September, the real effective exchange rate of ruble continued to decline. During the month ruble has declined by 3.3%.

Accordingly, the real effective exchange rate fell to 143.74¹ (see Fig. 4).

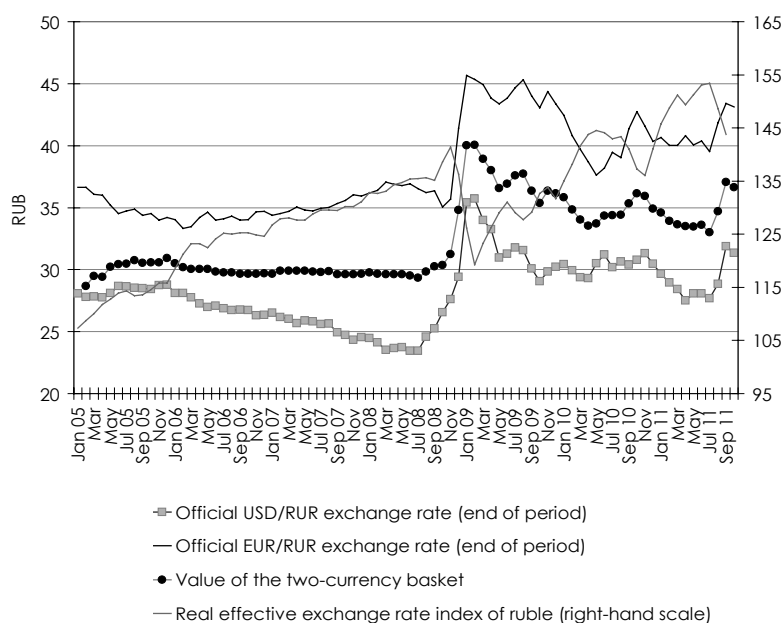
From late August to early October, due to falling oil prices and investors' escaping from risky assets, gradual ruble decline was observed in the developing countries. Slightly more than over one month the rate of the Russian currency against the U.S. dollar weakened by 14%. In the second half of September, the ruble has fallen down against Euro as well (-6.2%). In October the Russian currency exchange rate has somewhat regained the lost position due to the decision of the European countries to address the debt problem in Greece. Further dynamics of the ruble exchange rate will depend primarily on external factors, in particular, on developments in the Euro zone. ●



Note. The level of January 2002 is accepted as 100%.

Source: RF Central Bank, author's estimates.

Fig. 3. Central Bank Currency Interventions and Dynamics of Ruble Exchange Rate in March 2010 – September 2011.



Source: RF Central Bank, author's estimates.

Fig. 4. Indicators of ruble exchange rate dynamics in January 2005 – October 2011 r.

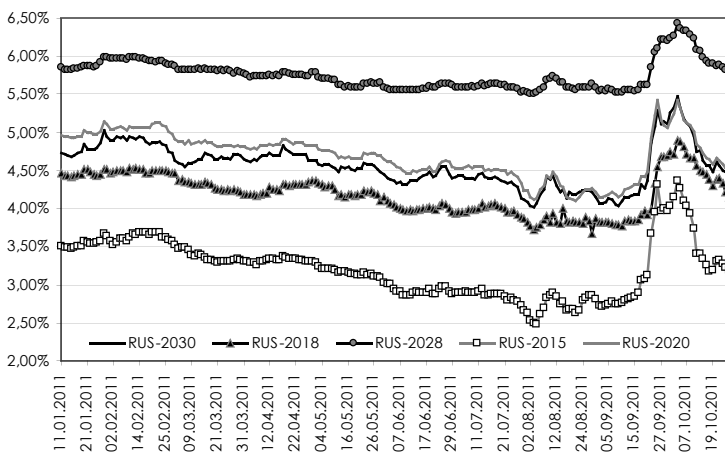
1 The level of January 2002 is accepted as 100 per cent.

FINANCIAL MARKETS

N.Burkova, E.Khudko

In October, the situation on the Russian financial market notably improved, largely in response to the decisions to adopt a number of additional measures in support of the financial systems of the USA, the Eurozone countries and the United Kingdom. In October, the government debt market and share market indices were moderately growing. On the contrary, the futures market experienced a slump in turnover. The Russian domestic corporate bond market demonstrated stabilization of the following key indices: the bond market index, the effective yield index and the corporate bond portfolio duration index. There was one purely negative phenomenon – a record-high number of the corporate bond issues cancelled due to failure to float even a single security.

The Government Securities Market



Source: Data released by the Finmarket information agency.

Fig. 1. The Yields to Maturity of the Russian Eurobonds Maturing in 2010, 2015, 2018, 2020, 2028 and 2030 (January – October 2011)

The growth of world markets resulted in a strengthening activity on the market and a decline in the yield to maturity on the government securities market. These trends continued throughout the whole of October.

According to data as of 26 October 2011, the yield to maturity of Russian Eurobonds notably reduced by comparison with 27 September. The heaviest drop in the yield to maturity was experienced by Eurobonds RUS-15 (-19.59%), the “shortest” securities offered on the government securities market (Fig. 1).

Over the period from 28 September to 26 October 2011, the combined turnover of the secondary market of OFZ bonds amounted to Rb 73.24bn,

while the average daily turnover amounted to about 13.7%, which corresponds to the 13.7% growth of the average monthly turnover increased by comparison with the previous period.

Between 28 September and 26 October, two primary placement auctions of OFZ bonds were held in Russia. The first auction, of OFZ 26206, which took place on 5 October, was declared failed. Another auction, of OFZ 25079, was held in its stead on 26 October. The volume of the bond issue put for auction was Rb 10bn, the actual volume of placement was Rb 9.72bn, while the weighted average yield amounted to about 7.94% per annum. The placement auctions of OFZ 25079, 26205 and 25079 planned for 28 September, 12 October and 19 October respectively, were cancelled because of an unfavorable situation on financial markets.

Also, on 30 September the RF Ministry of Finance placed, via a closed subscription, a special issue of OFZ bonds, maturing on 23 July 2026, at a coupon rate of 8.16% per annum. The whole issue was bought by one investor. The corresponding bond purchase contract includes an additional condition which limits the circulation of these bonds: the selling of these instruments on the secondary market within one year from the date of their placement can be carried out only after being approved by the RF Ministry of Finance. No additional placement auctions of OFZ bonds were held.

The Stock Market

Factors in the dynamics of the Russian stock market

On 29 September 2011 world stock indices went up considerably. Their growth, which included a climb in Russia's stock indices, came as a result of positive US news (according to final data, in Q2 2011 US GDP expanded 1.3% at an annual rate on the previous quarter, and there was a drop in initial claims for state unemployment benefits) and the approval, by all EU member-states, of increased state guarantee commitments and an expansion of the powers of the European Financial Stability Facility (EFSF), a temporary structure created to support the Eurozone countries especially hard-hit by financial difficulties. However, the optimism of investors was short-lived. On the next day the gloom set in once again with negative macroeconomic news coming from Europe (it turned out that Eurozone inflation climbed much higher than expected – to 3% at an annual rate) and China (where production volumes went down). The downward trend in stock markets' dynamics continued until 4 October. Its persistence was caused by a number of factors, including a drop in the price of oil, the postponement until 4 October of the final decision concerning the next tranche of financial assistance to Greece, and by Greece's failure to meet her financial obligations towards the EU and the IMF. To make matters worse, on 3 October the international rating agency Fitch Ratings downgraded its GDP growth forecasts for all major developed economies for 2011-2013 (from 3.1 to 2.6% for 2011). From 5 October to the end of the month, world markets generally demonstrated an upward trend. This rebound in market activity was to a great extent triggered by the US Fed's announcement that it was ready to take additional measures designed to stimulate the US economy, the release of positive data on the state of the US labor market in September 2011, the statement, by the ECB and the Bank of England, that their key rates should remain unchanged, and these banks' decision to resume their assistance to the financial systems of the Eurozone and the UK.

Thus, on the whole, despite a considerable drop in late September and early October, that month was the time of growth for both developed and emerging markets. The only exception to this trend was Turkey's ISE National 100 Index, which dropped by 4.8% in October (see Table 1 and Fig. 2).

Table 1

THE DYNAMICS OF WORLD STOCK EXCHANGE INDICES (DATA AS OF 26 OCTOBER 2011)

Index	Value	Change over month (%)*	Change since year's beginning (%)
MICEX (Russia)	1,499.79	8.65	– 11.15
RTS (Russia)	1,530.11	11.69	– 13.57
Dow Jones Industrial Average (USA)	11,869.04	6.06	2.52
NASDAQ Composite (USA)	2,650.67	4.08	– 0.08
S&P 500 (USA)	1,242.00	5.67	– 1.24
FTSE 100 (UK)	5,553.24	4.90	– 5.88
DAX-30 (Germany)	6,016.07	6.89	– 12.99
CAC-40 (France)	3,169.62	4.84	– 16.69
Swiss Market (Switzerland)	5,700.50	2.44	– 11.43
Nikkei-225 (Japan)	8,748.47	1.61	– 14.47
Bovespa (Brazil)	57,143.79	5.98	– 17.55
IPC (Mexico)	35,818.58	6.02	– 7.09
IPSA (Chile)	4,167.31	6.16	– 15.43
Straits Times (Singapore)	2,769.94	1.62	– 13.17
Seoul Composite (South Korea)	1,894.31	9.14	– 7.64
ISE National-100 (Turkey)	55,469.92	– 4.79	– 15.96
BSE 30 (India)	17 288.83	4.63	– 15.70
Shanghai Composite (China)	2 427.48	0.51	– 13.55
Morgan Stanley Emerging&Frontier Markets Index	759.65	7.27	– 16.68

* As a percentage of an index's value on 27 September 2011.

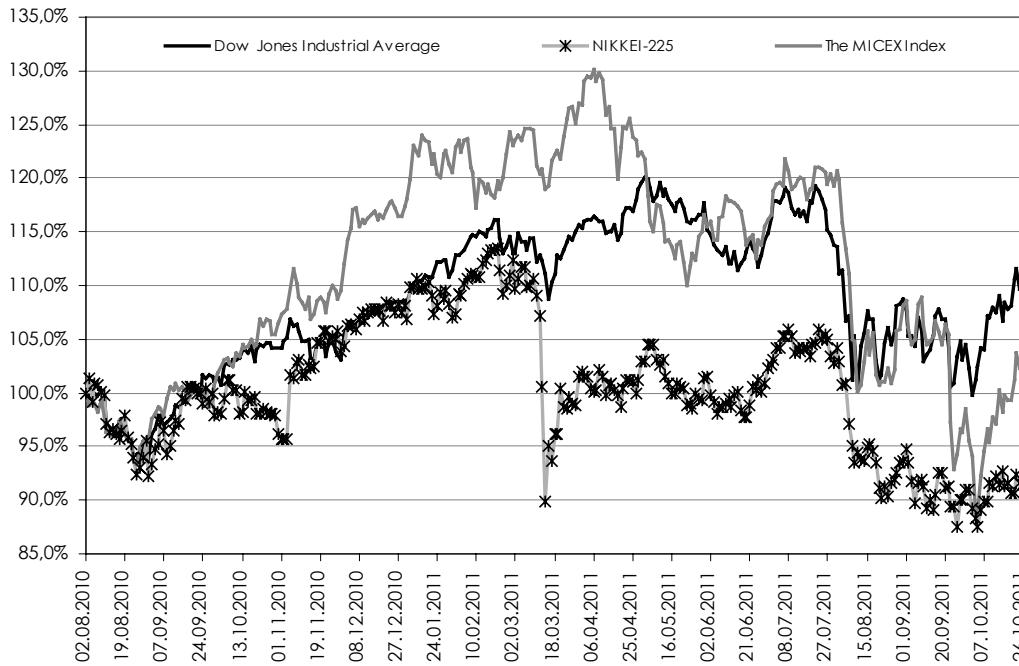


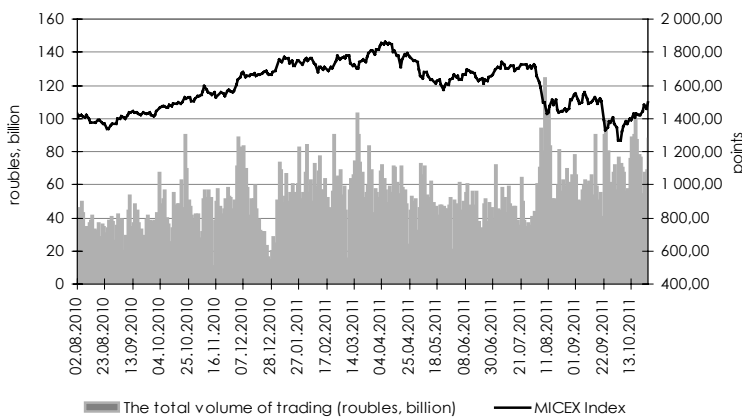
Fig. 2. Dynamics of the Main USA, Japanese and Russian Stock Indexes (As a Percentage of Their Values on 1 August 2010)

Among the domestic factors in the dynamics of the Russian stock market, we should note information on the three-fold increase in the net outflow of private capital from the Russian Federation over the first nine months of 2011 by comparison with the same period of 2010, and on the drop in the volume of Russia’s international reserves, as well as the decision, by the international rating agency Moody’s Investors Service, to downgrade its outlook for the Russian banking system from “stable” to “negative”. On the other hand, in October the market was propped up by the release of data on a rise in Russia’s current account surplus over the period of January-September 2011, and on a drop, over the aforesaid period of time, in the number of unemployed in Russia (by 11.7% at an annual rate).

The situation on the share market

The MICEX Index reached its October 2011 peak on 26 October when it hit 1,499.79 points (vs. 1,556.46 points a month earlier). The MICEX Index dropped to its lowest October 2011 level on 5 October when it dwindled to 1,265.67 points (vs. 1,327.19 points a month earlier) (Fig. 3).

On the whole, over the period between 28 September and 26 October 2011, the MICEX Index



rose by 8.65%, or by 119.37 points in absolute terms (between 27 October 2010 and 26 October 2011 the MICEX Index dropped by 0.5%), while the trading volume of the shares included in the MICEX Index climbed to Rb 1,554.4bn. By comparison with the previous period, in October 2011 the average daily level of investor activity climbed by 17%.

In the period from 1 January to 26 October 2011, the biggest price losers among the blue chips were shares in Mosenergo and VTB Bank, which shed 40.97% and 29.73% of their value respectively (Fig. 4).

Source: MICEX.

Fig. 3. The Dynamics of the MICEX Index and the Trading Volume

According to MICEX data, as of 26 October 2011 the five Russian companies holding leadership in terms of market capitalization were as follows: Gazprom – Bn 4,140.24bn; Rosneft – Rb 2,240.89bn; the Savings Bank of the Russian Federation – Rb 1,804.24bn; Lukoil – Rb 1,508.22bn; and GMK NorNickel – Rb 1,192.38bn.

The futures market

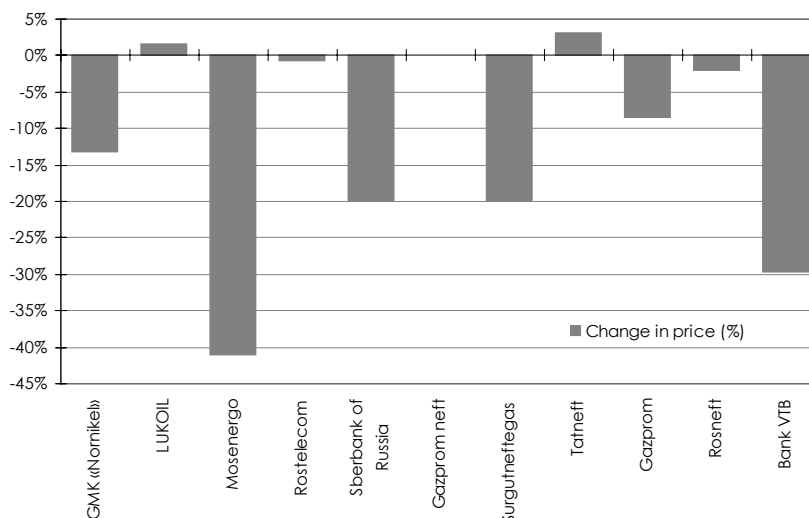
On 12 October 2011 the stock exchanges of the developing BRICS markets declared the creation of an alliance designed to attract international investors and increase the liquidity of the member states' exchange floors. So far, the alliance has been

joined by the Brazilian stock exchange BM&F BOVESPA, the Russian stock exchange MICEX (currently in the process of integration with the RTS Group), Hong Kong Exchanges and Clearing Limited (HKEx, China) and the Johannesburg Stock Exchange (JSE, South Africa). The National Stock Exchange of India (NSE) and the Bombay Stock Exchange (India) are also ready to join the alliance at a later date.

In October 2011 (from 28 September to 26 October), the average daily trading volume in the MICEX futures market declined by 12% on the previous month. Just like in September, the highest trading volume – Rb 13.7bn (48,500 transactions) – was recorded by funds futures. By the trading volume in this section of the MICEX futures market, the first place belonged to cash-settled futures contracts on the MICEX Index, with delivery futures contracts on shares in Gazprom, LUKOIL, NorNickel and the Savings Bank of the Russian Federation coming second. It should be noted that the value of the MICEX Index (the price of the concluded transactions) for December 2011 was, on average, within the limits of 1270 to 1490 points, which means that most of the market participants expected that the MICEX index would drop by 1 to 15% by comparison with its value as of 26 October 2011.

In October, the second place in the trading volume (Rb 9.4bn) belonged to transactions with foreign exchange futures. The first place in the trading volume in this section of the MICEX futures market belonged to cash-settled US dollar futures contracts, followed by euro-ruble currency pair futures contracts and euro-US dollar currency pair futures contracts. The prices of the ruble-US dollar currency pair futures contracts with the date of execution in December 2011 concluded in the futures market in October 2011 were, on average, within the limits of 30.8 to 33.3 rubles per US dollar, which means that participants of this MICEX market also expected that the ruble will decline by 1 to 9% by comparison with its value as of 26 October 2011 (30.5 rubles per US dollar). Over the period under consideration, the trading volume of interest bearing instruments amounted to Rb 1.6bn. The next best performer was commodity futures (Rb 81m).

In October, the RTS FORTS futures market also saw a slump in investor activity (by 6% on the previous month). The first place in the volume of futures trading belonged to futures contracts on the RTS Index, followed far behind by ruble-US dollar currency pair futures contracts, futures contracts on shares in the Savings Bank of the Russian Federation (Sberbank) and Gazprom, and euro-US dollar currency pair futures contracts. The prices of the latest transactions concluded under ruble-US dollar currency pair futures contracts with the date of execution set for 15 December, were, as a rule, within the limits of 30.9 to 33 rubles per US dollar, which means that market participants expected that the ruble would decline by 1 to 8% by comparison with its value as of



Source: MICEX.

Fig. 4. The Dynamics of Russian Blue Chip Stocks from 1 January 2011 to 26 October 2011

26 October 2011. Judging by the prices of the latest concluded transactions, the value of a futures contract on the RTS Index with the date of execution set for 15 December 2011 was, on average, within the limits of 1210 to 1500 points, which means that market participants expected that the RTS Index would drop by 2 to 21% by comparison with its value as of 26 October 2011. Options were in much less demand, with the options turnover amounting to just Rb 194.17bn (while the futures turnover was Rb 4,824.03bn). Among the important events of October we should mention that on 30 September 2011 FORTS started trading in a cash-settled futures contract on the MICEX Index. The move took place within the process of integration between Russia's two largest exchanges, MICEX and RTS.

The Corporate Bond Market

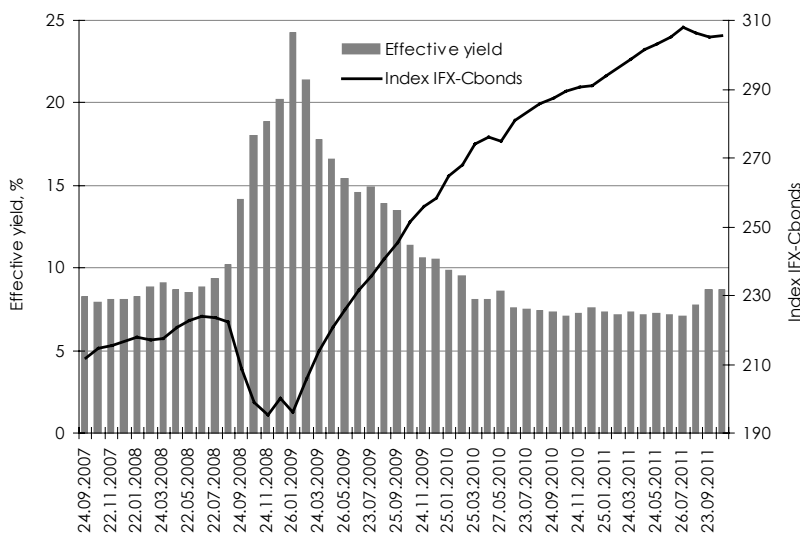
In late October, the volume of Russia's domestic corporate bond market (by the nominal value of ruble-denominated securities in circulation) amounted to about Rb 3,237.4bn, or almost 1% less than in late September¹. As in the past, the contraction of the market was caused by both the ongoing decline in the number of bond loans (747 issues of bonds denominated in the national currency vs. 753 emissions as of the end of the previous month) and a fall in the number of the emitters represented in the debt market (from 334 to 331). Of all the issues denominated in foreign currencies, only one, yen-denominated, issue of bonds still remained in circulation.

The secondary corporate bond market's trading indicators continued their fall: thus, the combined volume of transactions carried out on the MICEX stock exchange in the course of three weeks, from 4 to 26 October, amounted to Rb 73.3bn (for reference: in September, the trade turnover was Rb 115.8bn, while in August it hit a record high of Rb 200.9bn), and the number of transactions dwindled to 16 thousand (from 24 thousand in September)².

The IFX-Cbonds index of the Russian corporate bond market remained approximately at same level throughout October, rising only 0.4 point (or 0.1%) from the end of September. In late October, the weighted average effective yield amounted to 8.65% against 8.69% in late September, although in early October profitability rose to over 9%, a record high since the beginning of 2010 (Fig. 5). Thus, in the past two or three months, the level of yield in the debt market was persistently higher than the refinancing rate, although previously it had been 0.3 to 0.5 p.p. below the RF CB rate since mid-2010. The corporate bond portfolio duration index decreased slightly to 834 days by the end of the month (a 21-day drop on the end of September). Despite this drop, it has remained high enough, which proves that the corporate

bond market has a sufficiently high proportion of long-term bonds (bond loans maturing in more than 5 years constitute almost one third of the total amount of bond issues in circulation).

Despite the stabilization of the weighted average yield of the corporate bond market, October saw a decline in the interest rate of the most liquid bond issues. The biggest losers with regard to the yield of their securities (by more than 2 p.p.) were the industrial companies OJSC LUKOIL (BO-03 series bonds), OJSC Mechel (BO-03 series bonds), Russian Railroads (15 series bonds) and OJSC Lenenergo (02 series bonds)³.



Source: According to data released by the Cbonds company.

Fig. 5. The Behavior of the IFX-Cbonds Index of the Russian Corporate Bond Market and the Dynamics of its Weighted Average Effective Yield

- 1 According to data released by the Rusbonds company.
- 2 According to data released by the Finmarket information agency.
- 3 According to data released by the Finmarket information agency.

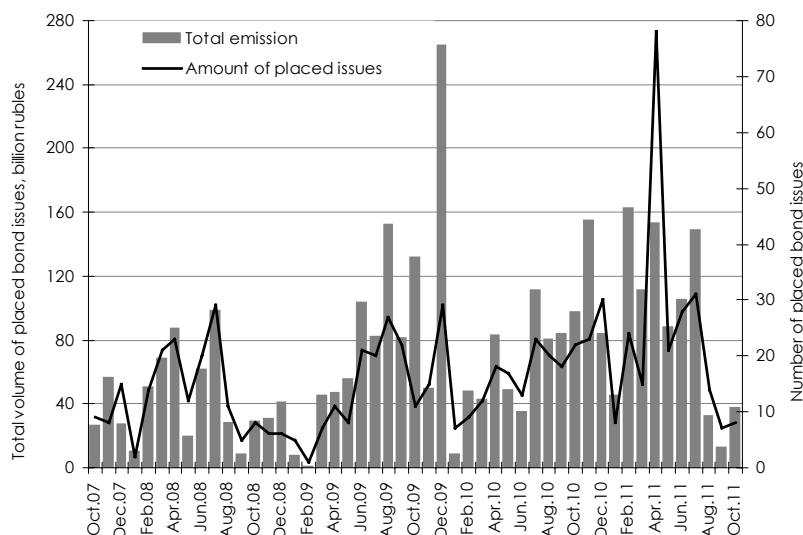
Also, there was a drop in the yield of bond loans. The exceptions to this trend were Agency for Housing Mortgage Lending, Alpha Bank and Renaissance Capital Commercial Bank (a reduction in bond profitability by more than 1 p.p.), and MDM Bank and Gazprombank whose bond yield increased.

In spite of a relatively unfavorable situation on the stock market in October, the number of newly registered bond issues continued to be relatively high, although definitely lagging behind the August and September figures. However, there were only 6 issues of exchange bonds – the type of securities that are registered in a simplified procedure by big emitters long represented on Russia’s stock market. It should be especially noted that state registration was granted to several inaugural bond issues with a face amount of about Rb 300m each. The largest bond issues were registered by OJSC Federal Hydrogenerating Company – RusHydro (four series of bonds with a combined face amount of Rb 40bn), OJSC Bashneft (two series of bonds with a combined face amount of Rb 20bn) and CJSC Absolut Bank (two series of bonds with a combined face amount of Rb 10bn)¹. It was reported that four long-term bond issues with a combined face amount of up to Rb 22bn were being prepared for state registration by OJSC Agency for Housing Mortgage Lending. The bond issues would be secured by a state guarantee².

Although lagging behind the registration figures, investor activity in the primary bond market was still higher than in September. From 24 September to 25 October, 7 emitters placed 8 bond issues with a combined face value of Rb 37bn (vs. only 7 bond issues with a combined face value of Rb 13bn placed from 27 August to 23 September) (Fig. 6). The biggest bond loans were placed by OJSC Vneshekonombank (Bank for Development and Foreign Economic Affairs) (one series of bonds with a combined face amount of Rb 15bn) and LLC North-Western Concession Company (two series of bonds with a combined face amount of Rb 10bn). Moreover, the afore-listed emitters managed to place their bond issues for a very long term: the circulation period of the securities issued by LLC North-Western Concession Company is 20 years, while that of OJSC Vneshekonombank’s securities is 10 years.

The indicators of the initial placements could have been higher if a record-high number of bond issues had not been annulled due to failure to place even a single security. Thus in the period from 24 September to 25 October, the Federal Financial Markets Service of Russia annulled 24 securities issues of 5 emitters, including such major companies as OJSC LUKOIL and OJSC GAZ (September saw the annulment of 11 bond issues, and only 4 bond issues were annulled in August)³. However, it should be said that, as far as the most reliable emitters are concerned, this situation arose not because of a lack of investor interest in their securities issues but by a change in the plans regarding external funding (the worsening of the market situation), which was the real reason for the issues to be annulled one year after having been granted state registration.

During the period from 24 September to 25 October 15 emitters had to redeem their bond loans in the total amount of Rb 46.6bn. However, one of the emitters failed to meet its



Source: According to data released by the Rusbonds company.
Fig. 6. The dynamics of the Initial Placement of Corporate Bond Issues Denominated in the National Currency

1 According to data released by the Rusbonds company.
2 According to data released by the FINAM investment company.
3 According to data released by the Federal Financial Markets Service of Russia.

obligations on time and declared a technical default on the redemption of a securities issue in the amount of Rb 2bn (in the previous one-month period, 2 emitters failed to timely meet their financial obligations). It is expected that November 2011 will see the redemption of 11 corporate bond issues in the amount of Rb 22.4bn¹.

As regards actual defaults (a situation when the emitter is incapable paying the coupon to the securities holders even within the next few days after the record date), the situation remained rather complicated throughout the month, although without any radical changes for the worse. In the period from 24 September to 25 October, 4 emitters failed to pay the coupon to the securities holders (vs. 2 emitters in the period from 27 August to 23 September)². Actual default on redeeming the face value of securities was declared by 2 emitters (vs. 1 emitter in September). One of the emitters managed to come to terms with the bondholders in regard to payment of the coupon and to redemption of the face value of the bond issue. As far as redemption of the bonds before their maturity by means of a buyback offer is concerned, the situation of the past few months repeated itself and all emitters met their obligations either on time or within the framework of a technical default. ●

1 According to data released by the Rusbonds company.

2 According to data released by the Cbonds company.

REAL ECONOMY: TRENDS AND FACTORS

O.Izryadnova

In January-September 2011 expansion of the internal market owing to simultaneous growth of both consumer and investment demand had a positive effect on the economic situation. In the 3rd quarter 2011 investments in the fixed assets went up by 7.8%, the works in construction and implementation of the residential floor area increasing by more than 15% versus the corresponding period of the previous year. The growth of the GDP by 5.2% in the 3rd quarter, and by 4.2% as a result of January-September 2011 versus the corresponding periods of the previous year was determined by the acceleration of import growth and the accumulation of the working assets reserves.

At the same time in September 2011 as compared with August of the current year the output in raw materials production is observed to reduce by 2.5%, as well as the output in manufacturing industries – by 0.4% – while the turnover of wholesale and retail trade decreased.

According to the preliminary data of the Ministry for Economic Development, over January-September 2011 GDP growth rate made 104.2% versus the corresponding period of the previous year. Such an increase in the GDP in the 3rd quarter 2011 is connected with the structure of economic growth. In July-September 2011 the investments in fixed assets, workload in construction and agriculture production growth rates were observed to accelerate versus the corresponding period of the previous year (table 1). As a result of January-September 2011 investments in fixed assets went up by 4.8% versus the corresponding period of the previous year, workload in construction – by 7.9%, agriculture production – by 15.9%. The impact of these factors was sufficient to weaken the trend towards the deceleration of the internal demand for industrial goods and infrastructure services growth rates.

The industrial production growth in 2011 is of recovery nature and the dynamics of the current year is to a large extent determined by the base effect. Industrial production index made 105.2% over January-September 2011 versus January-September 2010 and 103.9% in September of the current year versus September 2010. The dynamics and structure of the industry was primary influenced by the anticipating rates of manufacturing industries development. Manufacturing industries index went up to 107.2% over the first nine months of the current year versus January-September 2010 and 104.4% in September versus September 2010, the figures for extractive industries being 102.4% and 101.4%, correspondingly.

Table 1

MAIN MACROECONOMIC INDICES IN 2010-2011, AS PERCENTAGE TO THE PREVIOUS YEAR

	2010				2011			
	January-September	Quarters			January-September	Quarters		
		I	II	III		I	II	III
Gross domestic product	103.8	103.5	105.0	103.1	104.2*	104.1	103.4	105.1*
Investments in fixed assets	102.9	95.2	105.6	105.3	104.8	99.2	105.0	107.7
Construction	96.0	88.9	96.7	98.9	107.9	101.6	101.0	115.5
Implementation of the residential floor area	94.2	91.1	107.3	85.7	102.8	97.8	95.1	115.0
Volume of industrial production	108.9	109.5	110.9	106.4	105.2	105.9	104.8	105.1
Minerals extraction	104.1	106.4	104.9	101.3	102.4	103.3	101.7	102.2
Manufacturing industries	112.6	112.1	116.3	109.5	107.2	110.6	105.8	105.7
Gas, water and electricity production	105.1	107.7	102.6	103.9	100.6	99.0	101.9	101.4
Agriculture production	87.0	100.5	98.6	79.2	115.9	100.7	100.6	116.9

Table 1, cont'd

	2010				2011			
	January-September	Quarters			January-September	Quarters		
		I	II	III		I	II	III
Freight transportation turnover	108.5	111.6	113.0	101.7	103.8	103.9	105.2	102.3
Retail trade turnover	106.0	102.2	106.9	108.4	106.2	105.0	105.8	107.6
foodstuffs	105.6	103.7	105.7	107.3	102.1	101.3	101.1	103.7
non-food goods	106.3	100.9	108.1	109.5	110.4	108.7	110.6	111.5
Foreign trade turnover	135.5	144.1	139.0	126.3		129.8.5	139.5	
Real disposable monetary incomes	105.0	107.3	103.7	104.5	99.8	99.8	98.0	101.7
Real wages	104.8	103.1	106.1	105.1	102.7	101.6	102.7	104.1
Real volume of accrued pensions	138.8	144.1	138.9	134.3		102.7	99.4	
Total number of the unemployed	90.1	96.2	86.6	86.8	88.3	85.7	88.1	91.8
Number of officially registered unemployed	94.9	114.2	91.1	81	75.3	73.1	75.4	78.0

*) Preliminary data.

Source: Federal State Statistics Service.

In January-September 2011 the dynamics of the internal market was defined by the simultaneous growth of both the consumer and the investment demand. Retail trade turnover made 106.2% versus January-September 2010 and 109.2% versus September 2010, the volume of paid services rendered to the population – 103.3% and 104.1%, correspondingly. A dramatic acceleration of the non-food retail market growth rates was a characteristic feature of the current year. Over nine months the index of the non-food market turnover made 110.4% versus January-September 2010 and 112.1% in September versus September 2010, the figures for foodstuffs market being 102.1% and 106.2%, correspondingly.

The consumer behavior of the population is traditionally much influenced both by the level of the inflation and the risks connected with the changes in currencies exchange rates. In September 2011 consumer prices index made 104.7% versus the beginning of the year, nominal dollar exchange rate index- 107.4%, nominal euro exchange rate index -106.7%. The population reacted to the ruble exchange rate weakening on one hand with the increase in the expenditures for foreign currency purchase from 3.5% of the total incomes of the population in January-September 2010 to 4.2% in the corresponding period of the current year and on the other hand – with the decline in the propensity to save. The proportion of savings in the incomes of the population decreased to 9.3% versus 14.1% in January-September 2010, savings in the form of deposits and securities – to 3.9% versus 6.7%.

The growth of the retail trade turnover – the same as throughout the whole year – is based on the decrease of the propensity to save and the expansion of the consumer crediting. Credits issued to natural persons in August 2011 made Rb 4721.8bn and increased by 1.27 times as compared with the corresponding month of 2010.

The trend towards the decrease in the real incomes of the population and deceleration of the real wages growth is worrying. On the whole over January-August of the current year the real incomes of the population decreased by 0.2% while real wages went up by 2.7% versus the corresponding period of the previous year. In September real disposable incomes made 103.2% versus the figure of the previous year and real wages went up by 6.2% in year terms.

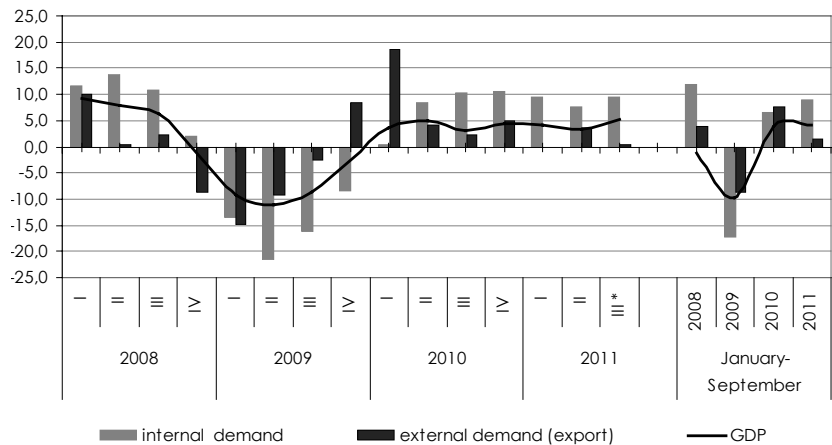
Determination of the factors for the internal market development is of fundamental importance for estimating the situation in the Russian economy and the prospects of the development.

In 2010-2011 macroeconomic situation was formed in the environment of the decrease in the external demand contribution to the GDP. As a result of the 1st half of 2011 export (as calculated by national accounts methodology) went up by 1.7% versus 11.0% in the 1st half of 2010. Under existing external demand and level of prices for Russian goods at the world market

export increased by 100.5% in the 3rd quarter 2011 as compared with the corresponding period of the previous year which secured achievement of pre-crisis volume of export of January-September 2008. According to the estimation of the Ministry for Economic Development in 2011 GDP growth making 4.1% internal demand will increase by 8.5% (7.7% in 2010), internal production – by 3.9% (2.8%), external demand – by 4.6% (7.1%) versus the previous year.

Noting the importance of internal market expansion as a dominating factor for the post-crisis development of the economy in 2009-2011 the following should be taken into account. The current situation in the economy is characterized by the trend for the anticipating growth of import as compared to export. The proportion of the import in the retail trade resources as a result of the 1st half of 2011 made 42%, being 33% for foodstuffs and 51% for non-food goods. The expansion of the import supplies proportion is also observed at the market of production for industrial and technical purposes. The shifts in the general structure of import supplies are defined by the formation of the trend towards the expansion of proportion of intermediate and investment goods import. In the 1st half of 2011 the proportion of investment goods import made 19.2% versus 17.8% a year ago, the proportion of intermediate goods import – 42.9% versus 40.7%. The dynamics of the domestic production development in particular industrial assembly productions increasingly depends on the import supplies. In this connection taking into account the specifics of development and modernization of the particular types of manufacturing industries in the Russian economy the problems of activation of import-substitution processes and localization are becoming more acute. “Forecast for socio-economic development of the Russian Federation for 2012 and for the planning period of 2013 and 2014” declares that in the middle term it is the increase in competitive ability of the domestic produce compensating ruble exchange rate strengthening and not the expansion of investments and consumption volumes that should be the leading factor for the economic growth. The forecast for the internal market dynamics for 2012-2014 is, however, still based on the rapid recovery import growth.

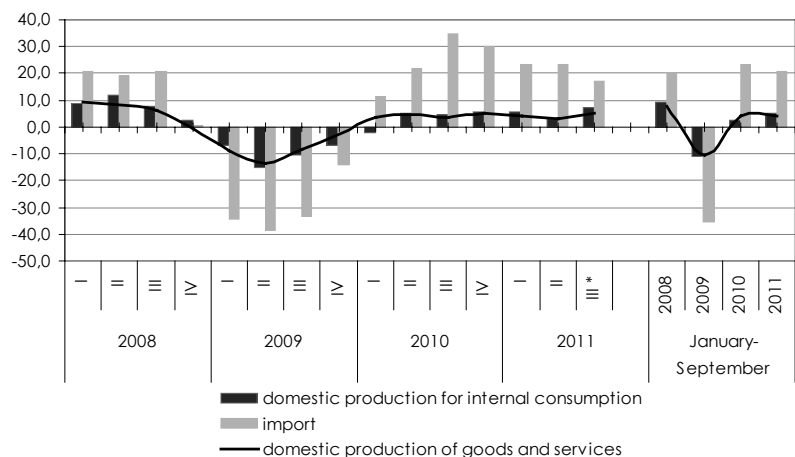
Analyzing the dynamics of internal market expansion this year one should take into account



* Preliminary data.

Source: Federal State Statistics Service, RF Ministry for Economic Development.

Fig. 1. Changes in GDP Dynamics as Broken by Components of Internal and External Demand in 2008-2011, as Percentage to the Corresponding Period of the Previous Year



* Preliminary data

Source: Federal State Statistics Service, RF Ministry for Economic Development.

Fig. 2. Dynamics of Internal Consumption as Broken by Components in 2008-2011, as Percentage to the Corresponding Quarter of the Previous Year

the change in the demand for the domestically produced goods¹. The 3rd quarter of the current year was specifically characterized by the intensive growth of the working assets reserves while the dispose of commodities rates decelerated. After the retail trade turnover growth rates acceleration in July-August, the figure of September 2011 dropped by 0.4% as compared with August. Wholesale trade turnover growth rates in July-September were also observed to decelerate as compared with the previous month of the current year. As compared with August 2011 in September 2011 industrial production growth rates also went down by 0.8%, the decrease in the minerals extraction being 2.5% and in the manufacturing industries – 0.4%.

All other conditions being equal, thee dynamic growth of the reserves in one of the main factors determining the conservation of the GDP growth estimation at the level of 104.1% and maintenance of the dynamics net year. It should be noted that in 2012 the Ministry for Economic Development forecasts the deceleration of the economy growth down to 103.7% one of the reason for which is the exhausting of the reserves contribution. ●

1 See: Russian Economy: Trends and Perspectives – September 2011. Gaidar Institute for Economic Policy. Moscow. P. 25.

FOREIGN TRADE

N.Volovik, K.Kharina

Russia's foreign trade is on the upsurge despite the global economy running out of steam. The RF Government introduces a new mechanism to calculate the copper export duty. In the framework of negotiations on its accession to WTO, Russia basically found consensus with its counterparts with regard to access to the market for goods; however, the country has so far failed to come to terms with Georgia.

Calculated by the balance-of-payments methodology, Russia's foreign trade turnover stood at \$74.5bn in August 2011. On a month-on-month basis it added 6.3%, while on a year-on-year one -33.8%.

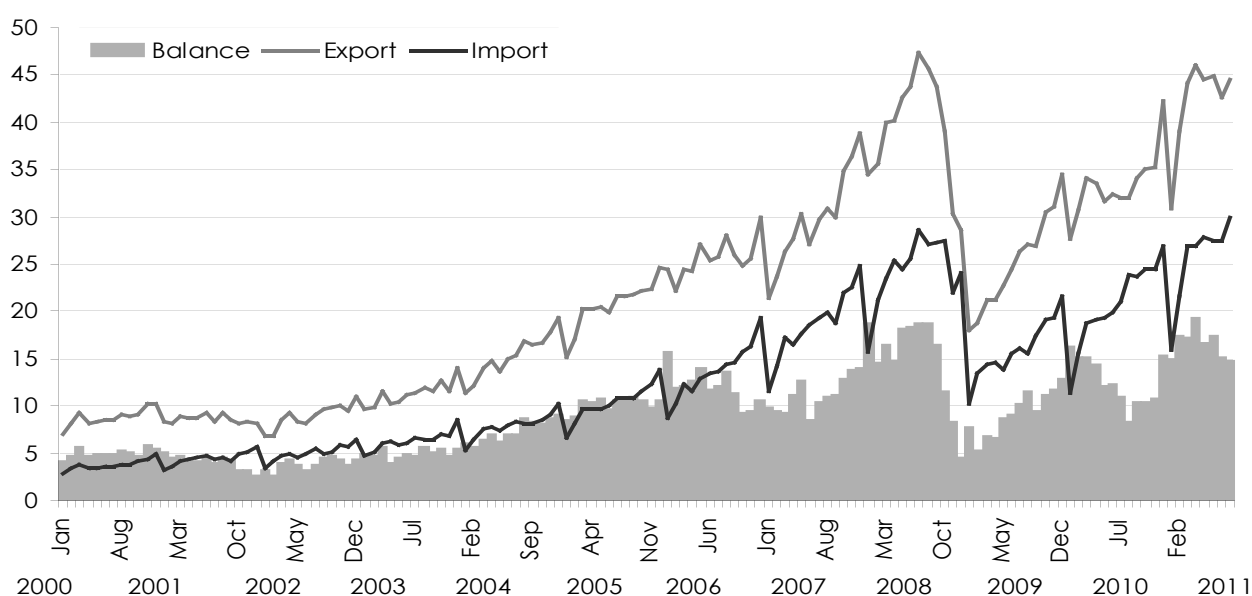
Exports in the month of question were worth \$ 44.6bn, or up by 40.1% on a year-on-year basis, while imports added 25.5% and accounted for \$ 29.9bn over the same period, thus being at their highs over the whole period of observations, despite a notable fall in their growth rates compared with indices reported in H1 2011.

The increase in the value volume of Russian export in August 2011 vis-à-vis its indices back in August 2010 was at 100% fueled by price rise for exports. Over the period in question the unit value index of export hit 136.7%, while its volume index made up 99.4%.

Meanwhile, increase in the unit value of import was driven chiefly by growing physical volumes of imports, rather than their unit value. The unit value index of import in August 2011 relative to August 2010 added 110.7%, while the volume index was up by 123.3%.

Because of the price rise rate for exports outpacing the one for imports, the foreign trade conditions improved against those in August 2010. The terms of trade index in August 2011 accounted for 123.5 points (119.8 points in August 2010).

Despite some drop in international oil prices due to exacerbation of debt problems in the global economy, the average monthly Brent price has not slid below \$100/b since May 2011. In August, it stood at \$109.93/b, and in September – at 109.97/b. After hitting on 1 October its bottom value of



Source: Central Bank of Russia.

Fig. 1. Main Indicators of Russia's Foreign Trade (as \$bn)

\$100.2/b, which became the lowest one since February 2011, it had bounced back to \$114.68/b on 14 October.

Urals was traded at the level of \$109.5/b in August, thus adding 44.7% on a year-on-year basis and being down by 5.8% on a month-on-month basis.

The average oil price over the period of monitoring – that is, between 15 September and 14 October 2011 – accounted for \$108.06/b, and the RF Government is anticipated to adopt its Resolution on lowering the oil export duty rate from 65% (of the difference between the price of the monitoring and the oil price of \$182.5/t) to 60%. Accordingly, the oil export duty due to on 1 November is estimated at the level of \$393/t, while in accordance with the previous methodology of its calculation, it would have made up \$423.3/t. As a result of the reduction of the upper marginal rate in the course of calculation of oil export duty rates, the decline in the federal budget revenues is estimated at the amount of Rb 158.8bn.

The preferential export duty on oil produced at a number of fields in East Siberia and the Northern part of the Caspian basin will be lowered by \$13.8, ie. from \$204.5/t in October to \$190.7/t effective of 1 November. The uniform export duty rate on oil products in November should make up \$259.3/t vs. \$271.5/t in October, while the export duty rate on gasoline should be down to \$353.7/t from \$370.2/t in October.

In August 2011, practically all quotations of metals traded at LME tumbled on investors' concerns about prospects of the global economy. The average aluminum prices were down by 4.8%, while those of nickel and copper – by 6.9 and 6.0%, respectively.

Table 1

AVERAGE WORLD PRICES IN AUGUST OF RESPECTIVE YEARS

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Oil (Brent), \$/bbl	29.4	25.7	27.2	29.9	42.8	61.9	71.7	72.1	118.3	73.06	77.18	109.9
Natural gas*, \$/MMBTU	4.01	3.79	3.01	3.98	4.34	6.56	8.71	8.34	14.64	6.92	8.45	10.81
Gasoline, \$/gall	0.9021	0.776	0.834	0.935	1.152	1.811	2.073	1.968	2.93	1.971	1.94	2.77
Copper, \$/t	1941.7	1499.4	1480.0	1731.0	2835.8	3800.0	7689	7510.5	7645.6	6165.3	7284	9001.0
Aluminum, \$/t	1546.4	1374.9	1292.0	1457.0	1694.3	1868.0	2460	2515.2	2780	1933.8	2118.4	2379.0
Nickel, \$/t	8092.9	5554	6720.0	9365.0	13723	14894	30872	27600	18581	19642	21413	21845

* European market, average contractual price, border price.

Source: Calculated on the basis of the LME and IOE data (London).

The average value of the FAO Food Price Index hit 231 points in August, thus having remained practically unchanged since July and adding 26% on a year-on-year basis.

Russia's foreign trade turnover between January and August accounted for \$541.2bn, or 34.7% up on a YoY basis. That said, Russian exports were 33.1% up (\$336.6bn), while imports added 37.5% and stood at \$204.6bn. The trade balance remained positive and accounted for \$132.bn (\$104.4bn between January and August 2010).

The proportion of fuel and energy products in the structure of the nation's export was on the rise and accounted for 69.3% in the period in question (vs. 68% reported in January to August 2010).

The import pattern continued seeing increase in the share of machinery, equipment and means of transportation, which in the period of question rose up to 46.8% vs. 42.1% in the same period of 2010. Meanwhile, shares of other imports were down.

With its Resolution of 17.10.2011 № 840 the RF Government replaces the current flat 10% export duty on refined copper with the progressive one. The document holds that the rate in question shall be determined with account of the average copper price at LME over the period of its monitoring and it shall be calculated using a string of formulas, depending on the average price level. In all, three formulas shall be used: for a price below \$6,000/t; for the one between \$6,000 and \$8,000/t; and for a price above 8,000/t. With the price below \$6,000/t, the export duty rate shall be zero one.

The task of the quarterly monitoring will be assigned to the RF Ministry of Economic Development. The Ministry shall submit its proposals to the Cabinet no later than on the 20th day of the calendar month following the end of the monitoring period. The period of monitoring is between the first day of the first calendar month through the last day of the last calendar month of the quarter. The copper export duty rate shall come into effect as of the fifth day of the third calendar month following the end of the monitoring period.

The progressive export duty rate on yet another exchange-listed metal, nickel, was introduced back in spring 2011. In a similar manner, the previous flat 10% rate was replaced with the one calculated by a formula which factors into average LME quotations over a prior quarter, with zero rate under a price below \$12,000/t.

The 2008 crisis evidenced that progressive scale allows a prompter reaction to exchange price oscillations and facilitates adjusting the burden on corporations and budget revenues. Overall, such a system appears more flexible than flat scale, as the duty rate is modified following the state of affairs on global markets.

In December 2010, EU unofficially approved Russia's accession to WTO. But in the same very month the RF Government unveiled new legislation aiming at support of employment in the automotive industry and restrictions on import of agricultural products. That triggered a hard-line response from EU, and a new round of negotiations on conditions of Russia's admission into the Organization followed. In September 2011 a framework agreement was reached in Geneva: the negotiations resulted in a draft document relating to legal acts that regulate investment in the national automotive sector.

In October 2011, Russia succeeded in obtaining the US's consent for keeping the current industrial assembly regime with regard to passenger cars for a long period of time.

The regime in question has been in place in Russia since 2005, with modifications therein in 2011. In a nutshell, the new rules imply tighter requirements to foreign corporations operating in Russia: the localization level was raised from c 30 до 60%, the minimum investment threshold should account for no less than \$500,000, and the annual output was raised from 25,000 to 300,000 units. Already today Volkswagen-GAZ, Sollers-Ford, AvtoVaz-Renault-Nissan-Izhavto, KamAz-Daimler General Motors and FIAT operate in accordance with the new conditions of industrial assembly, and it is only Mazda that received preferences and still operates in accordance with the earlier established conditions.

Having come to agreement with EU and the US, the only obstacle to Russia's accession to WTO was Georgia. Despite WTO, G-20, the World Bank and the US's strive for having Russia join the Organization until the end of the year, negotiations with Georgia, which took place in October 2011, ended with no deal.

In late April 2008, Georgia walked away from the negotiation process in protest against the RF President's executive order to lift economic sanctions against Abkhazia and South Ossetia. After the August 2008 war and Russia's recognition of the said territories in a unilateral order, Tbilisi severed diplomatic ties with Moscow.

The negotiation on WTO between Russia and Georgia resumed in March 2011 with Switzerland as the intermediary. The Georgian side made legalization of customs offices at the Abkhazian and South Ossetian sections the critical issue. Tbilisi insists on having Georgian customs officers present at the said customs offices, as the aforementioned territories de-jure lie along the Georgian part of the border between the two nations and, consequently, they should function accordingly. The Georgian authorities assert the issue is not a political one – rather, this is dictated by the WTO Charter. The Russian side in turn believes that Georgia's claims do not fall under the purview of WTO.

The Georgian problem aside, all the parties have come to terms with regard to issues pertaining to Russia's entry into WTO. There still is a string of technical details, which are now being coordinated.

As a reminder, according to the WTO rules, a country may join the Organization, provided consent thereto of all its 153 member nations, so the question as to when Russia will be finally admitted to WTO still remains unanswered. ●

STATE BUDGET

T.Tischenko

The federal budget for the first 9 months of 2011 was performed with a surplus, while the difference between revenue and expenditures of the budget was consistently increasing over the years, both in absolute terms and as a share of GDP. A marked reduction was observed in the non-oil budget deficit by 2.0 percentage points of GDP. The budget surplus increased by 5.6 percentage points of GDP as compared with the same period of the last year. The RF government in the first quarter of October has submitted to the State Duma the draft law “On Amendments to the Federal Law “On the Federal Budget for 2011 and for the planning period of 2012 and 2013”, which was approved by the lower Chamber in three readings. The adopted amendments enforce balanced budget in 2011, but an opportunity to reach the budget surplus of 3% of GDP is questionable.

The surplus of the federal budget for the first 9 months of 2011 gives hope that as a result, the federal budget will be executed without deficit, while as to the most optimistic estimates – even with a surplus (up to 3% of GDP¹). These estimates are based on the following factors:

– the likelihood of the global world oil prices falling to critical for the fiscal system sustainability (to \$60-75 per barrel) is low;

– excess of the growth rate of revenues over expenditures of the federal budget, whereas the difference between the budget revenue and expenditure has consistently increased during the year both, in absolute terms and in regard to GDP;

– sustained surplus of the RF Subjects consolidated budgets and extra-budgetary funds for the 8 months of this year.

In view of the results of the federal budget execution for the first 9 months of this year, as well as the indicators of the adjusted forecast of socio-economic development of Russia, the Russian government in the first decade of October has submitted to the State Duma the draft law “On Amending the Federal Law “On the Federal Budget for 2011 and planning period for 2012 and 2013”, which was approved by the lower House in three readings at a time.

Analysis of the basic indicators of the federal budget execution in January-September 2011

According to tentative estimates the Russian Ministry of Finance, federal budget revenues for the first 9 months of 2011 amounted to Rb 8,211.0bn, or 24.7% of GDP, which exceeds their value over the same period in 2010 by up 5.9 percentage points of GDP (see Table 1). Expenditures in January-September have increased as compared with the same period in 2010 by 0.2 percentage points of GDP and amounted to Rb 7,121.6 trillion.

Table 1

KEY INDICATORS OF THE RF FEDERAL BUDGET IN JANUARY-SEPTEMBER 2010–2011

	January-September 2011		January-September 2010		Change, p.p. of GDP
	Rb, bn	GDP %	Rb, bn	GDP %	
Revenues, including:	8211.0	24.7	6 006.9	18.8	+5.9
Oil and gas revenue	3989.9	12.0	2730.8	8.6	+3.4
Expenditures, including:	7121.6	21.4	6729.2	21.2	+0.2
Percentage expenditures	215.5	0.7	165.1	0.6	+0.1
Non-percentage expenditures	6906.1	20.7	6564.1	20.6	+0.1
Federal budget surplus (deficit)	1089.4	3.3	-722.3	-2.3	+5.6

¹ Head of the Federal Tax Service: Budget 2011 may be implemented with a surplus of about 3% of GDP. <http://www.rbc.ru/rbcfreenews/20111024135535.shtml>

Table 1, cont'd

	January-September 2011		January-September 2010		Change, p.p. of GDP
	Rb, bn	GDP %	Rb, bn	GDP %	
Non-oil and gas deficit	-2900.5	-8.8	-3453.1	-10.8	+2.0
GDP estimate	33278.8		31968.2		

Source: Russian Federal Treasury, Gaidar Institute estimates.

For the first 9 months of 2011 the federal budget was executed with a surplus, while the difference between the budget revenues and expenditures has consistently increased over the year both, in absolute terms and as a share of GDP (as per 5 months' results, the surplus amounted to Rb 385.3bn, or 2.0% of GDP and as per 7 months' results – to Rb 722.7bn, or 2.5% of GDP).

There is observed a growing oil and gas revenue as compared with the first 9 months of 2010 results by 3.4 percentage points of GDP up to Rb 3,989.9bn. This is based on both, increased rates of customs duties on crude oil and petroleum products, and maintaining high global commodity prices throughout the year. There is also observed an expressed reduction in the non-oil budget deficit by 2.0 percentage points of GDP. The budget surplus increased by 5.6 percentage points of GDP versus the same period of the last year.

Table 2

REVENUE OF THE FEDERAL BUDGET FROM THE MAIN TAXES DYNAMICS
IN JANUARY-SEPTEMBER 2010–2011

	January-September 2011		January-September 2010		Change, p.p. of GDP
	Rb, bn	GDP %	Rb, bn	GDP %	
1. Tax revenue, including:					
Corporate income tax	260.8	0.8	182.9	0.6	+0.2
VAT for the goods sold in the RF territory	1340.8	4.1	980.0	3.1	+1.0
VAT for the goods imported to the RF territory	1056.7	3.2	802.1	2.5	+0.7
Excise duties on goods manufactured in the RF territory	170.7	0.6	83.5	0.3	+0.3
Excise duties on goods imported to the RF territory	31.1	0.0	20.0	0.0	-
MET	1483.6	4.5	1027.5	3.3	+1.2
2. Revenues from foreign economic activity	3224.5	9.7	2274.8	7.2	+2.5

Source: RF Ministry of Finance, Russian Statistical Service, Gaidar Institute estimates.

Total revenue from corporate income tax, VAT and MET for the nine months of 2011 amounted to Rb 4,414.9 trillion, which is by Rb 1,422.2 trillion more than in the same period of the last year. In general, tax and non-tax revenues grew by 36.7%.

The analysis of the federal budget execution in terms of expenditures over January-September 2011 shows a slight increase as compared with the same period of the last year by 0.1-0.3 percentage points of GDP (see Table. 3) in the majority of the budget expenditure lines, except for expenditures on social policy (+1.5% of GDP) and national economy (+0.9 p.p. of GDP). In regard to Federal issues expenditures have declined by 0.4 percentage points of GDP.

Revenues of the federal budget from the main taxes for the 9 months of this year have also increased (see Table 2). The growth of revenue from foreign trade and MET, which form oil and gas revenues is explained by external reasons. Growth in income from excise taxes is based on changes in fiscal policy. The increase in VAT revenue on products sold in Russia, by 1.0 percentage points of GDP demonstrates the growth of activity of economic entities.

Table 3

FEDERAL BUDGET EXPENDITURES DYNAMICS IN JANUARY-SEPTEMBER 2010–2011

	January-September 2011		January-September 2010		Change, p.p. of GDP
	Rb, bn	GDP %	Rb, bn	GDP %	
Expenditures, total:	7121.6	21.4	6729.2	21.2	+0.2
Including					
Federal issues	489.4	1.4	591.0	1.8	-0.4
National defense	942.4	2.8	812.3	2.5	+0.3
National defense and law enforcement	790.8	2.4	710.4	2.2	+0.2
National Economy	968.9	3.0	670.2	2.1	+0.9
Housing and public utilities	158.0	0.5	120.3	0.4	+0.1
Environmental protection	10.3	0.03	8.5	0.03	0
Education	346.5	1.0	258.7	0.8	+0.2
Culture, cinematography and mass media	88.0	0.3	73.5	0.2	+0.1
Health care, physical culture and sports	299.3	0.9	189.3	0.6	+0.3
Social policy ¹	726.6	2.2	230.9	0.7	+1.5
National and Physical Culture municipal debt servicing	215.5	0.6	165.1	0.5	+0.1

Source: RF Ministry of Finance, Russian Statistical Service, Gaidar Institute estimates.

If the current economic growth, an acceptable level of global prices for hydrocarbons and the current rate of growth of budget revenues are sustained¹, we can expect that by the end of the year revenues will amount to about Rb 11.5 trillion, which in principle, complies with recent amendments to the Budget Law for 2011 (see Table 4). Thus, according to the amendments, the revenue will increase by Rb 818bn, or by 1.6% of GDP and expenditures – by Rb 98.9bn, or 0.2% of GDP. Herewith, the revenue growth is provided mostly by non-oil revenue growth (by 1.1% of GDP). The upper limit of the domestic public debt is planned to be reduced by Rb 177bn, external debt to be reduced by about Rb 100bn. The approved amendments ensure the execution of the balanced budget, but the opportunity to reach the budget surplus of 3% of GDP is questionable, since when comparing key indicators of the federal budget for the first nine months of this year and for the same period of the last year one should take into account the gaps in performance level of income and expenditure parts of the budget.

Thus, the amount of tax and non-tax revenue for the first nine months of this year amounted to almost 80% of the estimated values, and approved expenditures of federal budget – only 64%. At the same time, in January-September 2010 budget was executed in terms of revenues by 77%, while in terms of expenditures by 66%. Thus, the increase in surplus in January-September 2011 as compared with January-September 2010 is associated with a significant increase of budget revenues ahead of the dynamics of funding for expenditure commitments. It is clear that this gap will be reduced due to the necessity of spending the allocated limits of budgetary commitments in the remainder of the fiscal year. This fact is quite capable to adjust the positive growth trend of the budget surplus.

Table 4

AMENDMENTS, INTRODUCED IN THE KEY INDICATORS OF THE RUSSIAN FEDERAL BUDGET IN OCTOBER

Indicator	Budget law	Draft law	Amendment (+/-)
Revenues, Rb bn	10,303.4	11,121.4	+818.0
% of GDP	19.3	20.9	1.6

¹ Over the period of June-September revenues have grown by 4.1%..

Table 4, cont'd

Indicator	Budget law	Draft law	Amendment (+/-)
Oil and gas revenues, Rb bn	5,228.2	5,477.0	+248.8
% of GDP	9.8	10.3	0.5
Non-Oil and gas revenues, Rb bn	5,075.2	5,644.4	+569.2
% of GDP	9.5	10.6	1.1
Expenditures, Rb bn	11,022.5	11,121.4	+98.9
% of GDP	20.7	20.9	0.2
Deficit, Rb bn	- 719.1	0.0	+7,19.0
% of GDP	-1.3	0.0	1.3
The upper limit of the state internal debt of the Russian Federation at the end of the year, Rb bn	4,732.3	4,555.0	-177.3
The upper limit of the state external debt of the Russian Federation at the end of the year, \$,bn (Euro, bn)	43.8 (31.5)	40.8 (28.9)	-3.0 (-2.6)

Source: RF government.

Presented above changes in the basic indicators of the federal budget (see Table 4) imply that the Russian government still had some prudence, when making decisions to increase expenditures, and continues the policy under which the planned growth in revenues is above the growth rate of extra expenditure commitments.

Analysis of the main indicators of the RF Subjects consolidated budget execution in January-September 2010-2011

The tendency to maintain a positive balance the federal budget within a year and growth of revenue of the RF Subjects consolidated budget for January-August 2011 have ensured a surplus of the RF Subjects consolidated budget in the amount of Rb 922.6bn (2.8% of GDP). As of January-August 2011, the consolidated budgets of RF Subjects have received revenue amounting to Rb 5,079.4 trillion (15.3% of GDP), which is by 3.3 percentage points of GDP is higher than in the same period of 2010. Revenue growth of the consolidated budgets of the RF Subjects took place in all kinds of revenue, and the largest increase was obtained from corporate profit tax (by 1.2% of GDP) and personal income tax (by 0.6 p.p. of GDP). Consolidated budget expenditures for eight months of the current year rose by 2.5 percentage points of GDP, as compared with January-August 2010 and amounted to Rb 4,156.7 trillion or 12.5% of GDP. The growth of consolidated budget of the RF Subjects in the share of GDP has occurred in almost all fields, including articles of "Health, Physical Education and Sport" – by 1.0 percentage points of GDP, "National Defense" – by 0.3 percentage points of GDP, "National Economy", by 0.5 percentage points of GDP, "Housing and communal services" – by 0.3 percentage points of GDP, "Education" – by 0.5 percentage points of GDP, "Social Policy" – by 0.3 percentage points of GDP, "National Security and Law Enforcement" – by 0.1 percentage points of GDP. Service costs of the state and municipal debt have been reduced by Rb 2.2bn.

To maintain a surplus of consolidated budget of the RF Subjects, the RF Ministry of Finance has issued in late October of this year the Draft Law "On the distribution of donations to the budgets of the Subjects of the Russian Federation in support of measures to balance the budgets of the Russian Federation Subjects in 2011". Donations in the total amount of Rb 22.3bn are offered for allocation, including Rb 15.1bn for financial support of the execution of expenditure commitments of the RF Subjects in case of deficiency of the own revenues of consolidated budgets of the Subjects of the Russian Federation and Rb 7.2bn on the basis of special directives of the President and (or) the orders of the Prime Minister.

With an overall positive dynamics of indicators of the consolidated budgets of the Subjects of the Russian Federation, as per eight months' results of this year, it should be noted, that the situation with the cash execution of budgets of the RF Subjects is even worse than with the federal budget execution. If by the result of eight months, the cash execution of federal budget expenditure

amounted to 58.4%, the cash execution of the consolidated budgets of the Subjects of the Russian Federation over the same period made 51.7%.

Despite the fact that the federal budget and the consolidated budgets of the RF Subjects are executed with a surplus, in October amendments were made to extend the effect of certain provisions of the budget legislation of the Russian Federation, adopted as a temporary measure during the financial crisis in 2008. For example, there were extended provision for formation and execution of the federal budget without differentiation between oil and gas and non-oil revenues, as well as the provisions on suspension of the federal budget deficit limitation, including the issues of forming and using oil revenues, oil and gas transfer, the Reserve Fund and national Welfare Fund. ●

RUSSIAN BANKING SECTOR

S.Borisov

The continuing growth in the banking system's assets in August was accompanied by a record-breaking rate of increase of the corporate credit portfolio. The increase in the retail portfolio since the beginning of the year approached a 20% mark. Increase in the volume of funds attracted from the population is explained by a positive revaluation of the forex denominated part of deposits, which is associated with depreciation of the national currency exchange rate. Exacerbation of the state of affairs on stock markets substantially reduced the domestic banks' monthly profits due to a negative revaluation of investment in securities.

Table 1

MAIN INDICATORS OF THE RUSSIAN BANKING SYSTEM, AS RB BN.

	As of 01.09.2010	As of 01.01.2011	As of 01.09.2011		
			Face- value	Increase rate from the beginning of the year, %	Increase rate on a year-on- year basis, %
Assets	30 953.7	33 804.6	36 427.7	7.8	17.7
Loans to non-financial organizations	13 239.1	14 062.9	15 887.8	13.0	20.0
Loans to private individuals	3 804.5	4 084.8	4 887.0	19.6	28.5
Loans to banks	2 692.4	2 921.1	3 351.1	14.7	24.5
Investment in bonds	4 257.4	4 419.9	4 387.1	-0.7	3.0
CBR deposits	382.5	325.7	309.0	-5.1	-19.2
Banks' deposits	3 265.0	3 754.9	3 914.2	4.2	19.9
Legal entities' deposits	5 544.6	6 035.6	6 978.9	15.6	25.9
Population's deposits	8 721.9	9 818.0	10 720.9	9.2	22.9
Bank loan loss provisions	2 316.1	2 192.0	2 273.7	3.7	-1.8
Profit (the current year)	320.1	573.4	575.9		79.9

Source: The Bank of Russia.

Main stock market indexes were in decline in August: specifically, the MICEX one plunged from 1,725 points as of 2 August to 1,546 points as of 31 August. The financial results of the month in question fueled the rise of pessimistic expectations and various assessments of the probability of a new wave of crisis. But the domestic banking system was late to react to possible challenges facing the economy.

The domestic banking sector's assets increased by Rb 838bn (+7.8% since the beginning of the year) in August. The month proved a record-breaking one in 2011 in terms of monthly assets growth rate. The significance of such an increase is further strengthened by its credit nature: growth in working assets formed a major factor of the increase in Russian banks' assets over the past months of the year and August was no exception. A substantial share of increase in the balance-sheet totals in August was secured by an unprecedented surge of the corporate loans portfolio (by Rb 517bn), which more than doubled vs. its July figures and more than tripled on a year-on-year basis.

The corporate sector was not the only one to see a robust advancement of lending. Increase in the retail credit portfolio over the 8 months of 2011 nearly hit a 20% mark and, according to the CBR data, already stood at 19.6% as of 1 September. Meanwhile, the level of arrears in loans to the population was declining steadily over the past six months: the data as of 1 September suggest a meager 6.1% in this regard. Fig. 1 exhibits the dynamic of the narrowing of the gap between arrears in the corporate credit portfolio and the retail one since the beginning of the year.

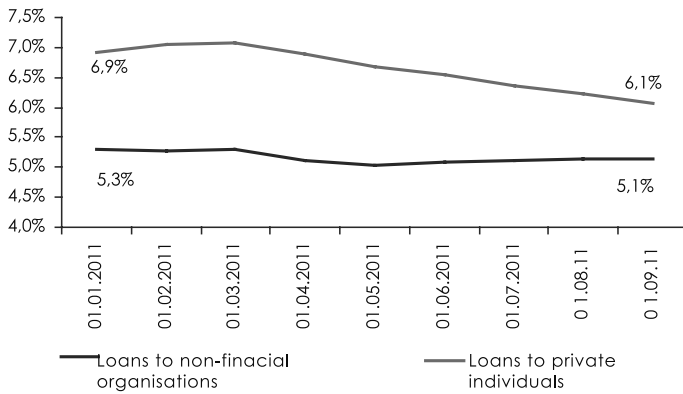


Fig 1. The Dynamic of Shares of Arrears in the Corporate and Retail Credit Portfolios, as %

As far as the liabilities column of the balance-sheet is concerned, the last August was signified by banks being unusually active in attracting non-financial organizations' capital. Legal entities deposited Rb 354bn with domestic banks over the month in question, with 73% of the attracted funds being denominated in Rb, of which Rb 204bn were formed by resources received from the RF Ministry of Finance, state, regions and local self-government bodies' extrabudgetary funds. Capital-raising term-wise, the bulk (55%) of the August capital inflow fell on Rb-denominated deposits with the term between 30 days and 1 year. That is to say, in August, the domestic banking sector received relatively inexpensive resources for the

term of up to one year in the amount of some 1% of the balance-sheet totals.

By contrast, the increase in the portfolio of the population's deposits in August was fueled by growth in the volume of "long" money (attracted for the term of more than 1 year) in tandem with contraction of the portfolio of the "demand" deposits. That said, the bulk of the increase of private individuals' capital fell on forex-denominated deposits Rb 75bn out of the Rb 132bn-worth monthly increase (57%). The cause behind the surge in balances of forex-denominated deposits became depreciation of Rb against major currencies in August. More specifically, Rb plunged by 4.9% vis-a-vis \$ in August. As a result, the positive revaluation of funds placed on forex-denominated deposits secured an increase in volumes of portfolios of private individuals' deposits with the term of up to 1 year and over 1 year by a value comparable to the Rb. depreciation one- that is, 4% and 5.6%, respectively. A small increase in balances of loan loss provisions (+Rb 25 bn over the month), which is comparable with the respective figures of May and June 2011, evidences the absence of any serious signals to deterioration of the quality of assets. That notwithstanding, in August, the domestic banking sector's profit tumbled twice compared with average monthly figures reported since the beginning of the year (Fig. 2).

The main cause for such a dramatic decline in the monthly increase rate of accumulated profit became negative revaluation of banks' investment in securities valued by fair value through profit and losses. A substantial decrease in the banking sector's interest in August appears unlikely because of two factors: for one, proceeding from the dynamic of balances of the credit portfolio as of the beginning and the end of the month, a critical decline in the average volume of the portfolio during the month is unlikely to happen; second, the dynamic of average-weighted lending rate over the past 6 months does not at all characterize a substantial rise in the value of liabilities or a drastic fall of lending rates over a single month. Whether the revaluation of investment in securities would seriously arrest a further surge in the banking sector's profits is still unclear.

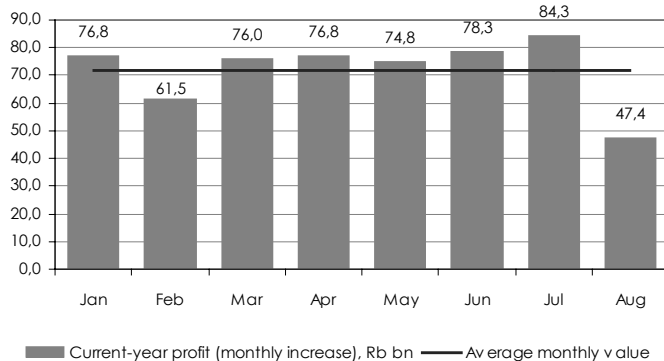


Fig. 2. Dynamic of the Accumulated Profit of the Banking Sector, as Rb Bn.

Due to the mounting uncertainty in the financial sphere and the sovereign debt crisis in the European economies gaining momentum, the assessment of the degree of the Russian banking sector's reliance on effects caused by a possible withdrawal of funds by non-residents has become particularly important. The format of this paper does not allow a detailed evaluation of such a scenario; however, the Bank of Russia's official statistics give an overall picture of how active Russian banks now are in using access to international money markets. First, during 2011 Russia's banking system has remained a net creditor to non-residents. Since the beginning of H2, the

excess of the credit portfolio over the volume of attracted capital has accounted for no less than Rb 1 trillion. (Fig. 3).

As of 1 September, the proportion of capital raised from non-residents in the domestic banking sector's liabilities accounted for 11%, while the share of placed capital – for 14%. That said, the structure of capital attracted from non-residents is such that more than a half of that (51% as of 1 September) falls on funds attracted on the international interbank market. These funds, except for investments parent banking structures make in their daughter banks in RF, can become subject to an early recall by non-residents, should they sense their financial standing on the domestic market is at risk. Another 38% of non-residents' capital (or Rb 1.5 trillion) is formed by capital non-financial organizations placed on deposits and other accounts (exclusive of certificates of deposit). This kind of liabilities is prone to fluctuations to a far lesser degree than foreign banks' capital.

As of 1 September, loans to non-residents accounted for 70% of the aggregate volume of Russian banks' funds placed with non-residents. Meanwhile, 40% of the total volume of capital placed with non-residents was formed by loans to banks and another 30% – loans to non-financial organizations. As of the same date, the proportion of loans to non-residents in the aggregate corporate portfolio stood at 9.4%. It is worth noting that in August the aggregate volume of placed (credit) capital to the aggregate attracted capital ratio in Russia' banking system still did not exceed 94%, which speaks about the remaining liquidity stock amounting to a total of some Rb 1.6 trillion. According to the Bank of Russia, as of 1 September investment in non-residents' securities accounted for 16.4%, of which 15% were investments in debt securities and just 1.4% – investments in non-residents' equity instruments. According to the CBR data, the bulk of Russian banking sector's investment in both kinds of papers falls on a handful of largest Russian banks. A relatively low integration of Russian banking sector in the international market forms a cause for a low concentration of potentially risky foreign assets on the domestic banks' balance sheets. Presently, Russian banking system exhibits no high dependence on devaluation of foreign assets in.

So, the current structure of raised from, and placed with non-residents capital allows one to conclude that an abrupt recall of funds by the latter is unlikely to trigger grave consequences in the form of liquidity shortages, for such a recall can be counterbalanced by contraction of the volume of active operations on the international market and a huge volume of the Rb-denominated liquidity in stock. That said, Russian banking system remains in high risk posture due to a possible deterioration of the situation on Russian stock market, downgrading the quality of borrowers, and confidence crisis in the banking sector.

Below, we cite milestone developments in the domestic banking sector in October:

The Supreme Arbitration Court rendered verdicts on protecting private borrowers' rights. More specifically, from now on a bank may not demand a prescheduled repayment of credit in the event of deterioration of the client's financial standing. As well, SAC recognized that an item in the credit agreement which stipulates a fine for refusal to take the credit contravenes the consumer rights. Furthermore, the banks will be banned to modify a string of provisions of the credit agreement in a unilateral order. According to SAC, the bank may not change any tariffs at its discretion by notifying the borrower by e-mail or posting the information on its Internet portal;

The State Duma passed in the third reading a bill which allows a prescheduled repayment of credit by private individuals without the creditor's consent and payment of extra fines. Respective amendments are introduced to art. 809 and 810 of the Civil Code of RF. The bill stipulates the citizen's right of an early release from debt obligations on condition he/she has notified the creditor of his/her intention to return the credit no less than 30 days prior to the intended date of its repayment. ●

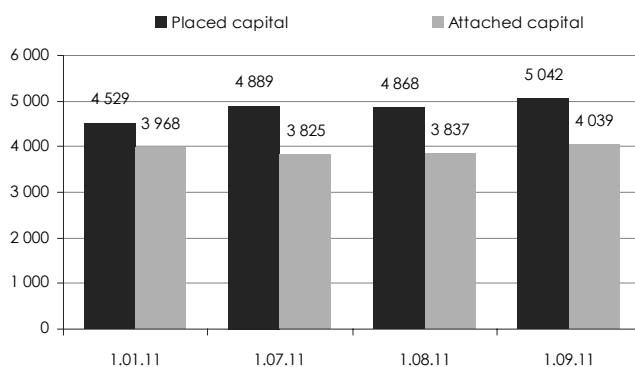
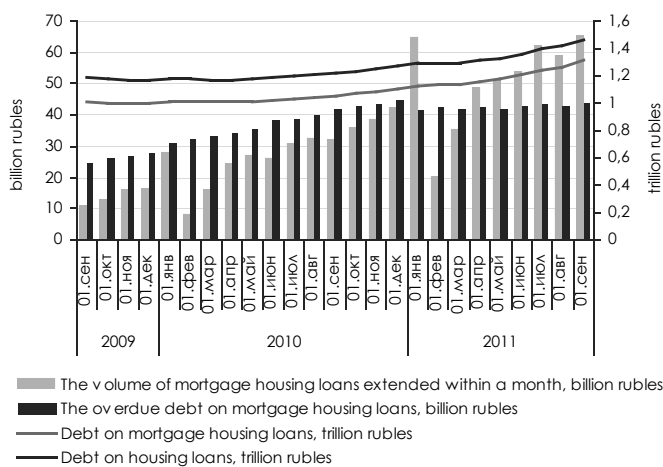


Fig. 3. Dynamic of Volumes of the Russian Banks' Capital Attracted from and Placed with Non-Residents, as Rb bn.

MORTGAGE IN THE RUSSIAN FEDERATION

G.Zadonsky

As of September 1, 2011, the volume of the extended mortgage housing loans in the amount of Rb 396.6bn exceeded by 100% the lending volume in the respective period of 2010, while the outstanding debt in the amount of Rb 1,312 trillion, by 24.2% that as of September 1, 2010. A positive trend towards reduction of the share of the overdue debt in the outstanding debt keeps prevailing. The President of Russia has signed a Law (which has a retroactive force) on Individuals' Indisputable Right to Early Repayment of a Loan.



Source: On the basis of the data of the Central bank of Russia.

Fig. 1. The dynamics of provision of mortgage housing loans

According to the data of the Central Bank of Russia, as of September 1, 2011 337,261 housing loans for the total amount of Rb 433,982bn were extended, including 288,257 mortgage housing loans for the total amount of Rb 396.6bn which figure exceeds by 100% in value terms the volume of the extended housing loans as of September 1, 2010. In August 2011, the outstanding debt on housing loans rose by 2.8% to Rb 1.46 trillion, while that on mortgage housing loans, by 3.48% to Rb 1.31 trillion. As of September 1, 2010, the latter exceeds by 24.2% the debt on mortgage housing loans. As of September 1, 2011, the overdue debt on housing loans increased to Rb 50,134bn, while that on mortgage housing loans, to Rb 43,701bn (Fig. 1). According to the data of the Central Bank of Russia, the debt on mortgage housing loans with a period

of delay for over 180 days (the defaulted loans) as a percentage of the total amount of the debt (Table 1) decreased by 0.05% to 3.95% as of September 1, 2011 as compared to August 1, 2011. The debt without overdue payments keeps growing both in value terms and as a percentage of the total amount of the debt (Table 1). As compared to the data as of August 1, 2011, the overdue debt on mortgage housing loans as of September 1, 2011 increased by 2.2% in value terms, while as a percentage of the outstanding debt fell in the same period from 3.37% to 3.33% (Table 2).

Table 1

GROUPING OF THE DEBTS ON MORTGAGE HOUSING LOANS BY THE PERIOD OF DELAY IN PAYMENTS

2011	The total amount of the debt on mortgage housing loans, million rubles	Without overdue payments		With overdue payments					
				from 1 day to 90 days		from 91 to 180 days		over 180 days	
		Million rubles	%*	Million rubles	%*	Million rubles	%*	Million rubles	%*
01.Jan.	1 129 373	991 928	87.83	66859	5.92	12 875	1.14	57 711	5.11
01.Feb.	1 132 482	981 409	86.66	84936	7.50	12 344	1.09	53 793	4.75
01.Mar.	1 138 413	986 663	86.67	87088	7.65	11 953	1.05	52 709	4.63
01.Apr.	1 158 153	1 018 711	87.96	73659	6.36	12 276	1.06	53 507	4.62
01.May	1 178 114	1 044 516	88.66	68684	5.83	11 074	0.94	53 840	4.57

2011	The total amount of the debt on mortgage housing loans, million rubles	Without overdue payments		With overdue payments					
				from 1 day to 90 days		from 91 to 180 days		over 180 days	
		Million rubles	%*	Million rubles	%*	Million rubles	%*	Million rubles	%*
01.Jun.	1 208 285	1 095 672	90.68	54373	4.50	7 371	0.61	50 869	4.21
01.Jul.	1 242 362	1 126 574	90.68	56900	4.58	7 454	0.6	51 434	4.14
01.Aug.	1 267 597	1 157 316	91.30	52225	4.12	7 352	0.58	50 704	4.00
01.Sept.	1 311 653	1 214 328	92.58	38694	2.95	6 821	0.52	51 810	3.95

*) % of the total amount of the debt.

Source: Data of the Central Bank of Russia.

Table 2

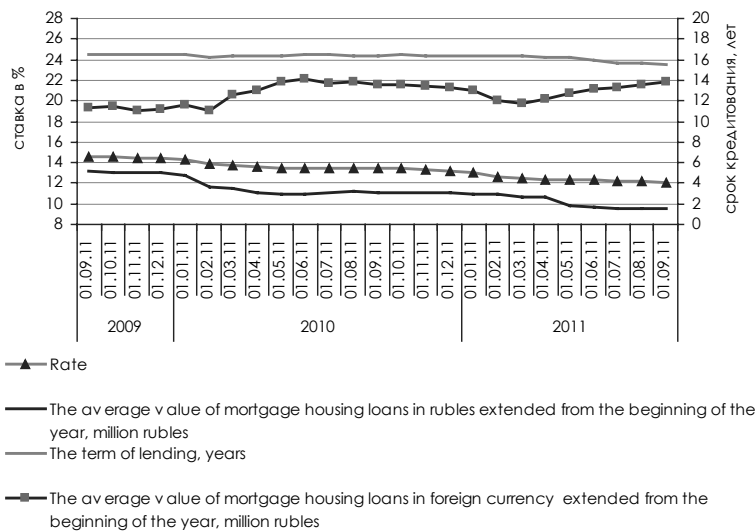
BREAKDOWN OF THE REGIONS BY THE NUMBER OF MORTGAGE HOUSING LOANS EXTENDED FROM THE BEGINNING OF THE YEAR PER THOUSAND PERSONS

Region	Number of mortgage housing loans per thousand persons	The rating of the region by the number of mortgage housing loans per thousand persons		The rating of the region by the overdue debt as a percentage of the outstanding debt		Overdue debt as a percentage of the outstanding debt
		01.09.2011	01.09.2010	01.09.2011	01.09.2010	
Khanty-Mansiisk Autonomous Region	5,932	1	4	8	9	0.43
Yamalo-Nenets Autonomous Region	5,841	2	3	9	6	0.46
Tyumen Region	5,181	3	5	18	17	0.74
Republic of Tatarstan	4,113	4	6	33	60	1.32
Nenets Autonomous Region	3,570	5	2	3	1	0.06
Republic of Sakha (Yakutia)	3,361	6	32	5	8	0.24
Urals Federal District	3,266	7	9	44	43	1.70
Irkutsk Region	3,147	8	16	52	59	2.05
Chelyabinsk Region	3,122	9	11	76	78	3.90
Tomsk Region	3,104	10	15	40	45	1.53
Povolzhsky Federal District	2,544	22	33	62	69	2.59
Siberian Federal District	2,412	25	22	68	70	2.87
Far Eastern Federal District	2,179	33	37	34	38	1.33
The Russian Federation	2,031	39	40	74	75	3.33
North Western Federal District	1,958	45	49	60	52	2.49
St. Petersburg	1,886	50	62	67	57	2.87
Moscow Region	1,696	59	66	88	88	6.26
Central Federal District	1,580	65	64	85	85	5.32
Southern Federal District	1,439	73	68	72	74	3.10

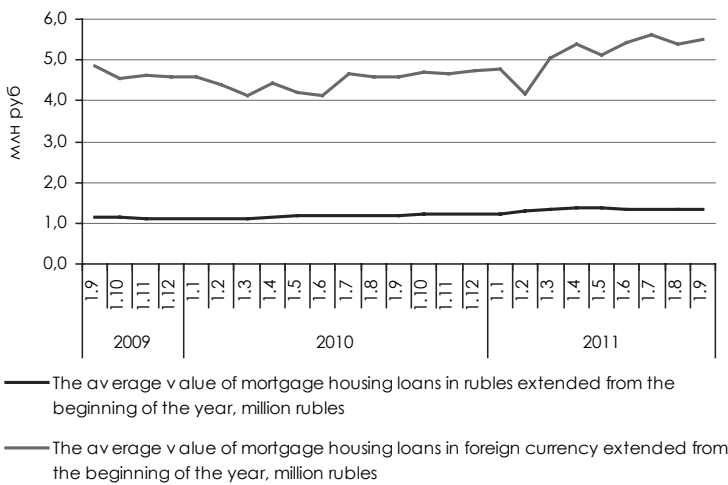
Table 2, cont'd

Region	Number of mortgage housing loans per thousand persons	The rating of the region by the number of mortgage housing loans per thousand persons		The rating of the region by the overdue debt as a percentage of the outstanding debt		Overdue debt as a percentage of the outstanding debt
		01.09.2011	01.09.2011	01.09.2010	01.09.2010	
Moscow	1,193	78	72	90	89	6.82
North Caucasian Federal District	0,612	87	85	81	79	4.60

Source: on the basis of the data of the Central Bank of Russia.



Source: on the basis of the data of the Central bank of Russia. Fig. 2. The Dynamics of average weighted rate and term of lending on mortgage housing loans extended from the beginning of the year



Source: on the basis of the data of the Central Bank of Russia. Fig. 3. The dynamics of the average value of mortgage housing loans

As regards the number of mortgage housing loans extended from the beginning of the year per thousand persons, as of September 1, 2011 the leaders were the Khanty-Mansiisk Autonomous Region, the Yamalo-Neenets Autonomous Region, the Tyumen Region, Tatarstan and the Nenets Autonomous Region (Table 2). The overdue debt of the above regions was also much lower than the national average value, that is, 3.33% of the outstanding debt or the 74th place. As regards the number of loans per thousand persons, the leader among federal districts was the Urals Federal District (the overall 7th place). As regards the level of the overdue debt, the above federal district is rated second after the Far Eastern Federal District (the 44th place). The Central Federal District takes the overall 65th place and is rated the 85th as regards the level of the overdue debt, while Moscow is rated the 78th and 90th, respectively. The Republic of Altai which was the leader as of September 1, 2010 is now rated the 85th.

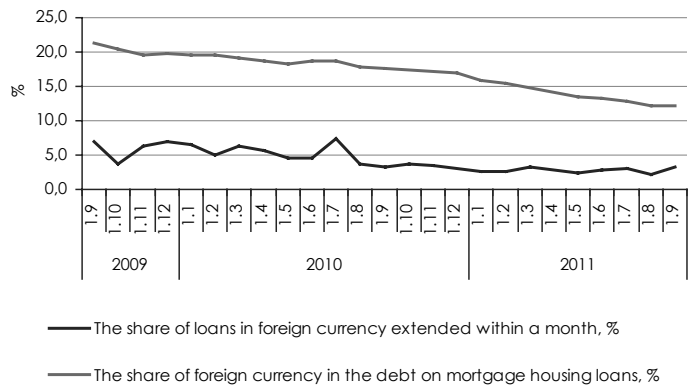
As of September 1, 2011, according to the data of the Central Bank of Russia a trend towards reduction of average weighted rates on mortgage housing loans extended from the beginning of the year both in rubles and foreign currency keeps prevailing (Fig. 2). The interest rate on loans in rubles amounted to 12.1%, while that on loans in foreign currency came to a stop at the level of 9.6%. In 2011, the average weighted term of lending as

regards mortgage housing loans in rubles extended from the beginning of the year has kept decreasing and as of September 1, amounted to 15.5 years, while that as regards loans in foreign currency keeps growing and amounts to 13.9 years (Fig. 2). In the past six months of 2011, the average value of mortgage housing loans in rubles extended from the beginning of the year changed insignificantly (Fig. 3) and as of September 1 amounted to Rb 1,347m. As of September 1, the respective value in foreign currency amounted to Rb 5,496m.

The ratio of the volume of mortgage loans in foreign currency to the total volume of mortgage lending within a month in 2011 varies from the minimum value of 2.40%

as of May 1 to the maximum one of 3.33% as of September 1 (Fig. 4). In 2011, the decrease in the share of loans in foreign currency in the total debt came to a stop at the level of 12.25% as of August 1 and amounted to 12.28% as of September 1 (Fig. 4).

As of September 1, 2011, among the regions Moscow has the highest value of the ruble/foreign currency ratio (Table 3) as regards the debt on mortgage housing lending (41.52%) and the overdue debt in foreign currency as a percentage of the overall overdue debt (76.37%).



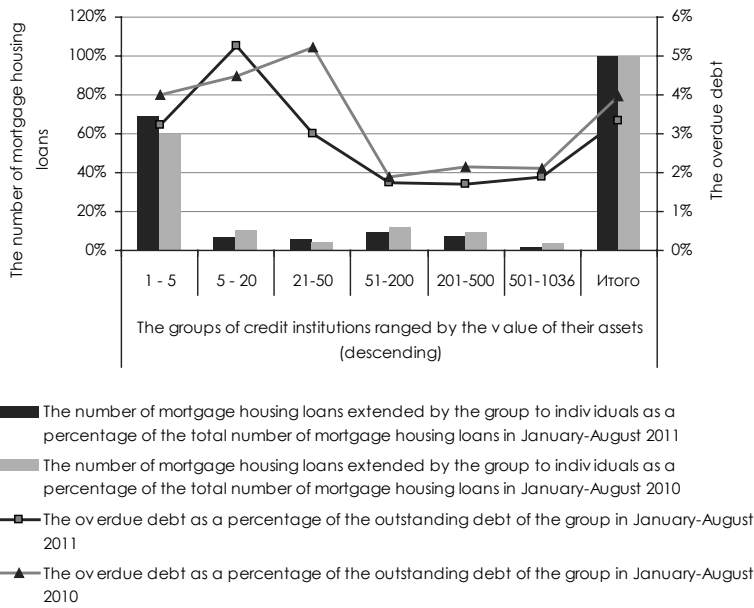
Source: on the basis of the data of the Central Bank of Russia.
Fig. 4. The dynamics of the ruble/foreign currency ratio in the mortgage housing lending

Table 3

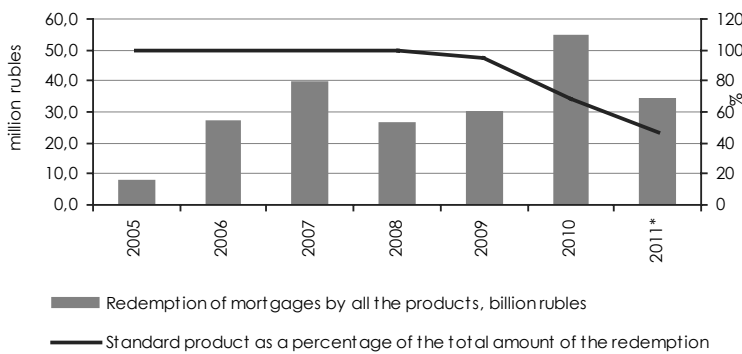
THE RUBLE/FOREIGN CURRENCY RATIO IN DISTRIBUTION OF THE DEBT AND OVERDUE DEBT ON MORTGAGE HOUSING LOANS BY THE REGION AS OF SEPTEMBER 1, 2011

	The total debt, million rubles	The share of the region in the debt, %	The debt in foreign currency as percentage of the total debt	The overdue debt, million rubles	The overdue debt in foreign currency as percentage of the total overdue debt
THE RUSSIAN FEDERATION	1 311 653	100.00	12.28	43 701	41.66
CENTRAL FEDERAL DISTRICT	400 864	30.56	28.51	21 320	69.75
Moscow Region	107 213	8.17	29.59	6 707	71.22
Moscow	181 499	13.84	41.52	12 375	76.37
NORTH WESTERN FEDERAL DISTRICT	147 106	11.22	14.51	3 657	39.76
St. Petersburg	76 636	5.84	21.16	2 197	46.61
SOUTHERN FEDERAL DISTRICT	76 426	5.83	4.75	2 370	7.64
NORTH CAUCASIAN FEDERAL DISTRICT	21 087	1.61	9.14	970	29.79
PRIVOLZHISKY FEDERAL DISTRICT	214 117	16.32	4.06	5 545	12.91
URALS FEDERAL DISTRICT	194 887	14.86	1.50	3 321	6.41
SIBERIAN FEDERAL DISTRICT	200 954	15.32	2.85	5 773	5.84
FAR EASTERN FEDERAL DISTRICT	56 212	4.29	4.51	745	19.46

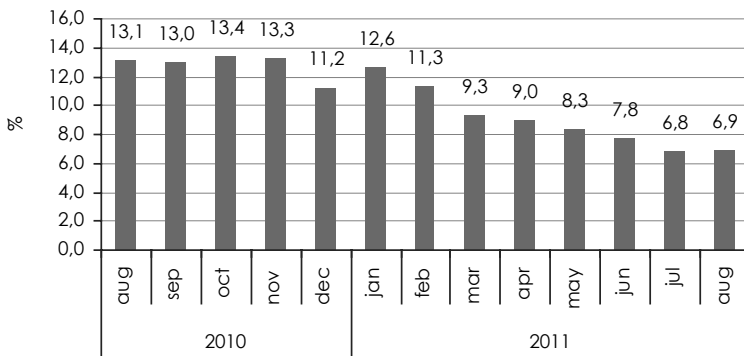
Source: on the basis of the data of the Central Bank of Russia.



Source: on the basis of the data of the Central Bank of Russia.
 Fig. 5. The dynamics of volumes of the extended mortgage housing loans and the overdue debt by the group of credit institutions ranged by the value of their assets



Source: on the basis of the data of OAO AMHL
 Fig. 6. The dynamics of redemption of mortgages of OAO AMHL



Source: on the basis of the data of OAO AMHL.
 Fig. 7. The share of mortgage loans refinanced by AMHL in the total number of the extended mortgage loans in the 2010–2011 period

As of September 1, 2011, the share of five largest banks (the first group of credit institutions ranged by the value of assets (descending)) in the total number of mortgage housing loans extended to individuals in January-August 2011 rose to 68.83% (Fig. 5) against 60.06% in the similar period of 2010. For comparison: as of September 1, 2009 the above share amounted to 67%. As compared to the respective period in 2010 the overdue debt as a percentage of the outstanding debt of the first group fell in January-August 2011 from 4.0% to 3.21%, which figure is below the national average value. The second group has mortgage housing loans of an inferior quality and their overdue debt as a percentage of the outstanding debt grew as compared to the respective period in 2010 from 4.47% to the maximum value of 5.27% (Fig. 5).

In January-August 2011, the volume of OAO AMHL’s refinanced mortgage loans (24096 mortgages for the total amount of Rb 30,098bn) (Fig. 6) exceeded by 8.3% in value terms the volume of the refinanced mortgage loans in the same period of 2010. In the same period of 2009, 15341 mortgages for the total amount of Rb 16,333bn were refinanced.

Starting from 2009, in the volume of redemption of OAO AMHL’s mortgages the share of standard mortgages (standard products) has been decreasing, while the share of the military mortgages, loans extended with the use of the maternal capital and mortgages in new buildings has been accordingly growing (Fig. 6). As of October 1, 2011, the share of standard mortgages refinanced by AMHL amounted to 46.7% of the total volume of redemption of mortgages in the amount of Rb 34,271bn.

In 2011, the share of the mortgage loans refinanced by AMHL in the total number of mortgage loans

refinanced by AMHL decreased from 12.6% in January to 6.8% in July. In August, the above share amounted to 8.9% (Fig. 7).

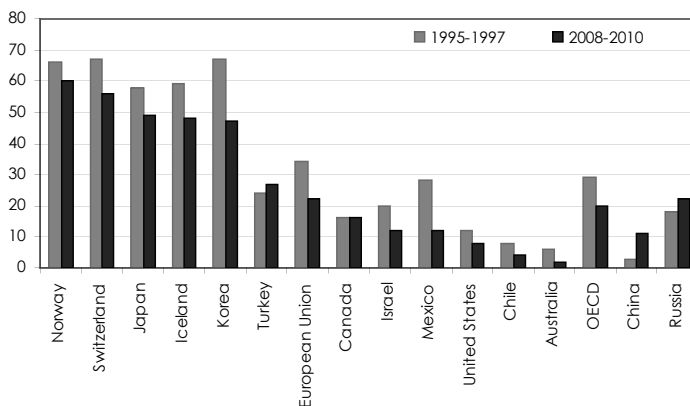
In October 2011, the President of Russia signed amendments to Article 809 and Article 810 of the Civil Code of the Russian Federation. Under the above amendments, the borrower has the right to repay the loan in advance without the bank's required approval by notifying the creditor at least 30 days in advance. The law has a retroactive force, that is, borrowers who had taken the loan before the above amendments came into effect may repay the loan in advance without any sanctions.

In a review of the judicial practice of the Supreme Arbitration Court (SAC), it is established that any disputes between the bank and an individual should be resolved only in courts of the place of registration of the borrower. Nor has the bank the right to demand from the borrower early repayment of the loan in case of worsening of the financial situation of the borrower and include such a clause in the agreement. Nor has the bank the right to include in the agreement a clause stipulating a penalty for the refusal to accept the loan. According to SAC, the bank has no right to change at its own discretion the tariffs by notifying the borrower to that effect via e-mail or by way of placing the relevant information on its Web-site. ●

LEVEL OF SUPPORT TO FARM PRODUCERS IN RUSSIA

R.Yanbykh

According to estimates of OECD in 2008–2010 the Producer Support Equivalent (PSE¹) in Russian agriculture averaged 22% thus exceeding the average indicator for OECD countries (20%). Taking into account the anticipated Russia's accession to both OECD and WTO one should seek to apply the least distorting support tools. The draft State Program for agricultural development in 2013–2020 envisages measures allowing to remedy the situation to some extent. It's important to use this program for re-targeting state support from price and input subsidizing to investments in long-term development able to improve sustainability, efficiency and competitiveness of agriculture as well as strengthen its institutional framework.



Source: OECD.

Fig. 1. Levels of farm producer support in OECD countries and emerging economies

OECD countries by 2% (22% PSE against 20%, see Fig.1)⁴. This is the outcome of tighter customs and tariff regulations in respect to key import items as well as of larger budget transfers to the sector.

2. In the three recent years the support to farm sector has been primarily targeted at import substitution. Special attention has been paid to investments in livestock sector and its protection from import. The surge of prices for food items in recent years made one think of excessive dependence on their import and consequently led to the decision to increase production and consumption of domestic products. At the same time the introduction of export ban on grain in 2010/2011 MY discouraged its producers and had a notable effect on the growth of world prices.

It's commonly assumed that as different from their European and North-American colleagues Russian commodity farm producers suffer from insufficiency of state support. Is it really so?

The review of agricultural policies in OECD countries and emerging economies in 2008-2010 prepared by the Organization for Economic Cooperation and Development (OECD) and published in September 2011 controverts this assumption².

The key assessments of Russian agricultural policies made by the OECD experts are as follows³:

1. From the mid-1990s the support to farm producers grew up to the level exceeding the current level of support in

1 PSE – Producer Support Equivalent – coefficient of producer support calculated as the ratio of overall state support (the sum of annual transfers from consumers and taxpayers to farm producers in producer prices) to the cost amount of gross agricultural output adjusted for multiple counting. This indicator is considered to be universal for comparative analysis of farm support levels in different countries.

2 It should be noted that the review is not an insinuation of Western specialists but the result of cooperative work of Russian experts with the OECD secretariat for agricultural policies, and all estimates therein are based on official data submitted by the RF Ministry of Agriculture.

3 Agricultural Policy Monitoring and Evaluation 2011: OECD Countries and Emerging Economies. Country chapter: Russia. http://www.oecd.org/document/30/0,3746,en_2649_37401_48714398_1_1_1_37401,00.html

4 Note: The level of support differs greatly by countries – members of OECD. It's the lowest in New Zealand (1%), Australia (3%), Chile (4%) and the US (9%). The level of support in the European Union has been cut noticeably (down to 22% of farm receipts) but still remains above the average (20%). The highest indicators are observed in South Korea (47%), Iceland (48%), Japan (49%), Switzerland (56%) and Norway (60%).

3. The set goals of agricultural policies were to a great extent achieved at the expense of consumers and owing to transfer of funds from crop to livestock production. The support was largely confined to subsidizing of farm products' prices and marketing as well as of input purchase – the most distorting forms of support.

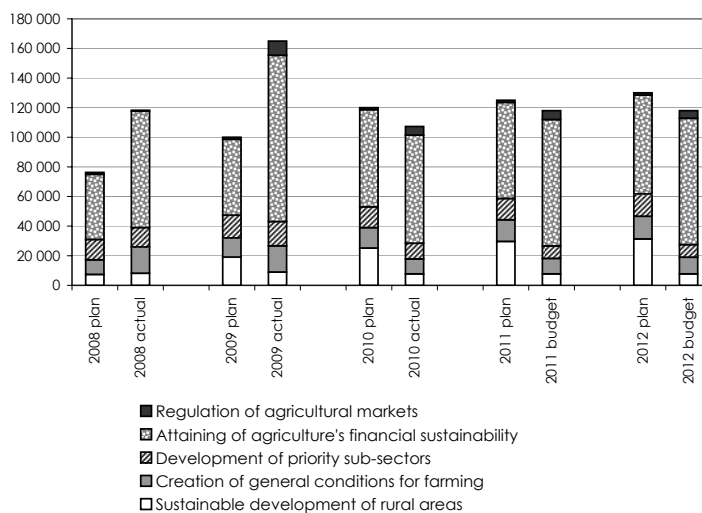
4. The growth of support to farm sector is directly related to the payment of large compensations for crop losses in 2009-2010. The global economic crisis of 2009 and droughts (especially in 2010) resulted in additional debt prolongations and restructurings.

5. Although forced by emergency situation, the ad hoc assistance aggravated the existing and generated new risks and problems. The restructuring of debts under agricultural credits not only enlarged their amounts but also induced “a spiral” of subsidies for reimbursing interest rate on credits. The growing share of respective subsidies in the State Program's budget (under the guideline “Attaining of financial sustainability”, see Fig.2) resulted in smaller allocations to soil improvement, sustainable rural development, rural infrastructure, consulting and other services to farm producers¹. But one will hardly manage to halt this trend within the framework of ending State Program for 2008-2012 due to both the increased budget commitments on subsidies and the fact that the budget for the 3 coming years has already been adopted.

The new 8-year State Program for agricultural development and regulation of agricultural markets till 2020 (the State Program), the draft of which is being actively discussed in the Ministry of Agriculture and the expert community, is intended to overcome these negative trends.

The new State Program sets the following tasks and objectives²:

- sustainable development of rural areas, creation of favorable and attractive social environment for rural residents including housing conditions, health care, education, road, transport and other kinds of infrastructure;
- ensuring commodity farm producers the rate of return sufficient for expanded reproduction of agricultural products and maintenance of their financial sustainability and competitiveness on domestic and foreign markets;
- modernization and switching to the innovational pattern of agrifood sector development, accelerated adoption of advanced research and technology enabling to improve productivity of labour and reduce per-unit input requirements;
- recultivation and more efficient use of land and other natural resources;
- development of smallholder farming and cooperation as an important factor of income growth for farm producers and facilitation of their access to agricultural and food markets;
- informational support to agrifood sector operators and providing them with state services in electronic form;
- increase of export resources of grain and other agricultural products with the view to expand Russia's share on the world food market.



Source: data of the RF Ministry of Agriculture.

Fig. 2. Planned and actual budget expenditures by guidelines set in the State Program for agricultural development in 2008-2012

1 In 2010-2011 the growth of carry-over budget commitments on subsidizing interest rate on credits extended to agriculture entailed more than 3-fold reduction of expenditures on measures under special federal program “Social development of rural areas till 2012”.

2 RF Minister of Agriculture E.B. Skrynnik. Report at the plenary meeting of State Duma on June 15, 2011, Moscow. www.mcx.ru

Indeed, according to the State Program's draft version of August 29, 2011¹ allocations to soil improvement and rural development are to increase 7.5 fold while allocations to subsidizing of interest rate on credits – less than 2 fold as compared with the previous State Program. The range of to-be-applied measures causing minimal market distortions is widening, e.g. some subsidies will be distributed on a per-hectare and per-head basis and won't be tied to units of produced farm products. Still, 41% of the planned Rb 2,113bn of state support will be used for compensating input costs and supporting market prices.

Russian agricultural policy is at the crossroads. After Russia joins the WTO, some commitments on reduction of the most distorting support measures will come into force. Since the term of the effective State Program for agricultural development and regulation of agricultural and food markets ends in 2012 and a new program is being worked out, this is the best moment for re-targeting state support from subsidizing of prices and input purchase to investments in long-term development able to improve sustainability, efficiency and competitiveness of agriculture as well as strengthen its institutional framework. ●

1 <http://www.mcx.ru/documents/document/show/16834.342.htm>

RUSSIA'S RANKING ON GLOBAL MARKETS: BEFORE AND AFTER THE CRISIS

A.Pakhomov

The nowadays realities dictate the need for a modern, competitive model of the national economy resting on innovations and new growth factors, including those in the foreign trade area. But prior to developing a new model, it is appropriate to identify Russia's real place in the post-crisis global economic system.

In the conditions of globalization of economic ties and intensification of the international division of labor, an ensuring of the economy's competitiveness emerges as a prime objective. Given the current economic interdependence between Russia and other economies, increase in the domestic economy's competitiveness de facto forms a key element of its post-crisis foreign trade strategy. Attainment of this objective to a significant degree will depend on Russian corporations' competitiveness, ie. their ability to efficiently operate on a global scale.

According to estimates by the most credible in Russia WEF international rating, which is based upon comparisons of global competitiveness indexes, in 2011 RF was ranked just 66th out of 142 nations, thus having slid by three points since 2005¹. Meanwhile, by the Global Enabling Trading Index 2010, which reflects nations' basic ranking in terms of the global division of labor, Russia came in 114th out of 125 nations².

With an insufficiently high level of its overall competitiveness (ie. a set of factors of production, institutions and public policy measures which determine the overall volume of an economy's productivity), Russia displays yet a lower degree (according to the ratings, 1.5 times as a minimum) of the national business's competitiveness.

In this context, comparison of the WEF global competitiveness ratings with regard to BRICS countries prior to the crisis and upon its peak appears quite illustrative. More specifically, in 2007 Russia was ranked 58th (out of 131 nations), trailing behind SAR (44th), India (48th) and China (34th) and outpacing just Brazil (72th). So, while having better macroeconomic stability indicators, pre-crisis, Russia has been falling far behind even the leading emerging economies by the institutional development, efficiency of business and introduction of innovations indicators.

In 2011, SAR and India were 50th and 56th in the rating, while China and Brazil advanced to 26th and 53rd positions, respectively. So, all these countries were ahead of Russia, and the gap was widening. Ultimately, the post-crisis period saw a number of Russia's indicators and the nation's aggregate rating decline against the background of growing competitiveness rate of other BRICS countries, which are gradually but steadily catching up with the developed nations.

But Russia is unlikely to climb up the rating without making progress in the institutional sphere, and its absence, according to the WEF experts, poses one of major hurdles to the nation's success. A new quality of the economy could be secured by cementing the supremacy of law, beefing up protection of property rights, bolstering the judiciary's performance, improvement of the level of personal security, and creating an adequate competition environment³.

As to some other ratings that are critically perceived of in the country, Russia holds yet lower positions therein⁴. In all fairness, it should be noted that credible international rankings display a similar situation, too. More specifically, the World Bank's Doing Business ranking, which even Russian public agencies tend to cite extensively, in 2012 puts Russia only on the 120th position out of 183 nations by conditions of doing business, thus having it advance just by 4 positions. According

1 The Global Competitiveness Report 2011–2012 // World Economic Forum, Geneva, September 2011. The World Economic Forum web-site: <http://reports.weforum.org/global-competitiveness-2011-2012/>

2 http://www3.weforum.org/docs/WEF_GlobalEnablingTrade_Report_2010.pdf

3 The Global Competitiveness Report 2011–2012 // World Economic Forum, Geneva, September 2011, P. 19.

4 Thus, in the 2011 Heritage Foundation's IEF rating, Russia sank to the 143th position among 183 surveyed nations, while according to the TI's CPI rating it came in 154th out of 178 surveyed countries.

to the Swiss IMD's global economic competitiveness rating, Russia advanced from the 51st position to the 49th one out of 59 surveyed nations, etc.

In connection with the above it should be emphasized there is a significant correlation between Russia's scores across numerous ratings (rankings), which differ from each other by methodology of their building, data used and objectives pursued. Published by international organizations and structures, overall, the indices provide a consistent and fairly objective assessment of the quality of fundamental institutions and the dynamic of quantitative indicators of Russia's current economic status.

That said, it should be noted that even with account of all the current complexities and institutional and structural constraints, Russia's economy deserves higher scores in the noted ratings, nonetheless. But positive changes do not come automatically, as they require a thorough professional work, including contribution to crafting the international system of scores and indicators, including those relating to competitiveness.

To evaluate the problem in question and identify an initial level of Russia's positioning in the post-crisis period it appears appropriate to compare the level of its competitiveness in dynamic and across macroeconomic indicators characterizing the foreign trade area (as a critical sphere of the national economy) (Table 1).

Table 1

DYNAMIC OF RUSSIA'S POSITION AND SPECIFIC WEIGHT IN THE INTERNATIONAL EXCHANGE OF GOODS, SERVICES, AND FDI* MOVEMENT IN 2000–2010

Indicator	2000	2005	2007	2008	2009	2010
Volume of GDP	17 / 0,8	12 / 2,1	10 / 1,3	8 / 2,7	12 / 2,1	11 / 2,4
Export of goods	17 / 1,7	13 / 2,4	12 / 2,5	9 / 2,9	13 / 2,4	12 / 2,6
Import of goods	29 / 0,7	19 / 1,2	16 / 1,6	16 / 1,8	17 / 1,5	18 / 1,6
Export of services	31 / 0,7	26 / 1,1	25 / 1,2	22 / 1,3	22 / 1,3	23 / 1,2
Import of services	22 / 1,2	17 / 1,6	16 / 1,9	16 / 2,2	16 / 1,9	16 / 2,0
Export of FDI	27 / 0,3	17 / 1,4	14 / 2,0	12 / 2,8	7 / 4,2	8 / 3,8
FDI accumulated overseas	28 / 0,3	15 / 1,1	13 / 1,9	15 / 1,3	15 / 1,3	13 / 2,1
Import of FDI	37 / 0,2	15 / 1,2	10 / 1,8	5 / 4,1	6 / 3,8	8 / 3,3
FDI accumulated domestically	27 / 0,4	17 / 1,6	10 / 2,7	18 / 1,4	18 / 1,4	15 / 2,2

* The first digit means position in an international rating, while the other one – proportion in the world (as%) by a specific indicator

Source: Calculated by the author on the basis of IMF, WTO and UNCTAD over the respective period.

More specifically, according to the IMF data, in 2010, Russia came in 11th in terms of nominal volume of GDP, while its specific weight in the global GDP accounted for 2.35% vis-à-vis its 8th position and the 2.75% proportion in 2008. That became an ocular evidence of the negative impact of the global crisis on Russia's economy¹. With account of the universal nature of the GDP indicator, Russia's place in the global GDP volume-wise (in \$ equivalent) and in terms of share of GDP it can be construed as the original level for the sake of comparing key indicators of its foreign trade sector (and, accordingly, competitiveness level) on a global scale (see Table 1)².

To begin with, for reference, it is necessary to examine Russia's position in the sphere of international trade with goods, which is traditionally conceived of as the nation's competitive edge,

1 International Monetary Fund // World Economic Outlook Database, September 2011 // Nominal GDP list of countries. Data for the year of 2010.

2 Lately, the RF Ministry of Economic Development has employed the IMF's PPP-based GDP index. According to this methodology, back in 2006, Russia hit 6th position worldwide with its proportion in the global GDP accounting for 3.3%. In 2009, the nation slid to the 7th position (3.0%) and climbed back by one line in 2010 (3.0%). It looks like the indicator recalculated by PPP biases the comparison with the below indicators in absolute terms. See. International Monetary Fund / World Economic Outlook Database // October 2011: Nominal GDP list of countries. Data for the year of 2010.

at least, as far as quantitative metrics are concerned. In 2010 (according to WTO) Russia tumbled by 3 lines in the global rating vs. 2008 and came in 12th in terms of the volume of trade with goods (\$ 400bn). The country's specific weight in the global export made up 2.6% (2.9% in 2008), while in terms of import (\$ 248bn) Russia plunged from the 16th position to the 18th one, with its share in the global import down to 1.6% (1.8% in 2008).

In the 2010 rating of countries – suppliers of commercial services, Russia was 23rd (\$ 44bn) with the share of 1.2% (22nd position and 1.3% in 2008). As to import of commercial services (\$ 70bn) the nation retained 16th position worldwide, but its specific weight shrank to 2.0% vs. 2.2% in 2008¹.

The country's positions in the trans-border capital moving stirs a particular interest. Thus, according to UNCTAD's estimates, in 2010, Russia was ranked 8th in the world in terms of the size of annual export of direct investment (\$ 51.7bn), and its share expanded by 3.8% vs. the 2008 figures (12th position and 2.8%, respectively). Direct investment the domestic business accumulated overseas in 2010 accounted for \$ 433.7bn, and the country is ranked 13th by this parameter, while its specific weight hit 2.1% (15th position and the 1.3% share back in 2008)².

As to direct foreign investment inflow in 2010, despite a fairly known set of challenges associated with attraction of foreign capital, Russia came in 8th nonetheless (5th in 2008). Overall, the country's share in the global volume of FDI inflow accounted for 3.3% (4.1% in 2008), or \$ 41.2bn. That said, accumulated foreign investments into Russia made up \$ 432.2bn in 2010. The country's specific weight in the global volume of accumulated FDI soared to 2.2%, and it became 15th in the world in this regard (1.4% and the 18th position in 2008)³.

So, the above comparisons allow ascertaining that, first, there is a strong correlation between the dynamic of indicators of the national GDP and export of goods in Russia, which mirrors the traditional mineral export-oriented model of its economy. Second, gauged on a global scale, the country's scores with regard to export and import of FDI (the so called FDI dynamic index) is greater than its respective indexes of GDP and export of goods and services. Meanwhile, the volume of FDI accumulated domestically and the volume of domestic investment overseas are not that huge as yet, which evidences the initial stage of Russian corporations' vigorous trans-border operations⁴.

The above comparisons exposed a relatively new phenomenon in Russia's economy – that is, a large-scale export of direct investments on a global scale. Notably, that appeared to be the sole index out of the evaluated nine ones which has demonstrated a steadily positive dynamic over the past decade. As a result, in the crisis year of 2009 Russia for the first time ever became a net exporter of FDI, and kept this status ever since.

That domestic corporations export productive capital can be ascribed to their acquiring overseas material assets in the form of M&A deals and, partially, by implementing greenfield projects. So, by doing business overseas, Russian corporations secure a direct access in recipient countries both to strategic resources and new sales markets, as well as advanced technologies and modern management practices, thus beefing up their competitiveness.

The domestic businesses' overseas investment operations may have direct or indirect positive systemic effects on Russia's economy on the whole. However, as evidenced by the record of certain countries with a comparable development level, an anticipated payoff can be secured by observing with certain conditions, such as: market environment, a circumspect public policy, and respective sectors' ability to build on the aforementioned preferences generated by Russian corporations' overseas operations.

That said, it should be taken into account that future possibilities for boosting other forms of export from Russia are limited, by an insufficient degree of diversification of the national economy in the first place. Growth in exportation of both traditional energy sources and fabricated goods has its own limits⁵. Materialization of the nation's export capacity requires shaping a holistic system of state support of non-mineral exports, which is presently inefficient.

1 WTO Secretariat, Press release // PRESS/628, Geneva, April 7, 2011, P.21–23.

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

3 Calculated by the author by: World Investment Report 2011 /Non-Equity Modes of International Production and Development // UNCTAD, Geneva, 2011, P. 187–193.

4 Ibidem.

5 UNCTAD // Country fact sheet: Russian Federation, 2011 – www.unctad.org/fdistatistics

That export of services still is an underactor in the nation's foreign trade activity can be attributed to a very nascent stage of development of this particular sector¹. A poor diversification of the traditional kinds of services (largely transportation and travel services) should be factored into, too. That is why there are no opportunities for a breakthrough in this segment of export, at least, in the medium term.

Technology transfer in Russia is currently limited, with a chronic imbalance between export and import being in place since the early '2000s. The imbalance in question exhibits the nation's growing technological reliance on its supplier countries. Expansion of a significant export of technologies across certain areas may arise only provided success of the innovation based type of the economy's advancement across priority direction. That said, an efficient protection of intellectual property rights is paramount in this respect.

At the same time, given the magnitude of the ongoing processes, resources and the record of performance in place, and positions staked out on the global market, export of direct investment can be regarded as Russia's comparative advantage (competitiveness pillar). This process requires a thorough analysis from the perspective of potential risks and new opportunities facing the national economy.

With regard to export of direct foreign investment Russia is an undisputable leader across CIS and among other transitional economies, with its proportion of outgoing and accumulated overseas FDI accounting for more than 90% of the overall amount reported by the said nations². Plus, as far as all macroindicators associated with export of FDI are concerned, Russia is notably far ahead of the other BRICS nations and finds itself in a position closer to that of developed nations³. But behind such a situation is the absence of juicy opportunities for investing domestically, because of an unfavorable business climate and institutional challenges.

From our perspective, bolstering the domestic business' positions on the international level will be driven both by their growing influence on global markets and diversification of operations beyond the traditional mineral spheres, a second echelon of Russian TNCs entering the global market, and by a greater efficiency of corporate management of overseas assets and the government's selective support of export of production capital from Russia with account of national development priorities.

In light of the above, focused export activities – and not only in the sphere of commodity export, but in non-commodity ones (export of services, results of intellectual activity and, particularly, direct investment) may emerge as one of locomotives of the country's post-crisis development, which should be factored into respective target programs under development.

At this juncture, the Russian corporations' FDI export, including that in the form of M&A and launch of greenfield projects overseas, forms an objective process mirroring the nation's increasing contribution to the international labor division system and globalization of international economic ties. At the end of the day, it is Russian corporations' actual contribution to development of concrete sectors and implementation of the national economy's post-crisis priorities, rather than boosting individual corporations' performance, which forms a major criterion of the national businesses' expansion overseas. ●

1 This trend is determined by vague prospects facing the global market for energy sources, which are driven by a string of global factors of political and economic nature. As to Russia's other key traditional mineral exports – that is, metals, fertilizers, chemicals and wood-working produce, they exhibit signs stabilization of export or its transition to more moderate trends.

2 By the UNCTAD methodology, in 2010 the group of transitional economies comprised 18 countries, including the CIS and the former Yugoslavia (except for Slovenia as an EU member state), and Albania.

3 For instance, the index characterizing the volume of accumulated overseas FDI to GDP ratio was: in China – 5.1%, India – 5.8%, Brazil – 8.8%, SAR – 22.5%, while in Russia it hit a record-breaking 29.4% (vis-à-vis 12.3% in 2008).

RUSSIAN MILITARY EXPENDITURE: ANTI-EFFICIENCY PRIORITY

V.Zatsepin

The continuous exacerbation of the permanent crisis of Russia's military-technical policy this time manifested itself in ship-builders utter refuse to disclose their producer prices to the governmental customer. This year's state of affairs with regard to the planning of the state defense order do not leave hopes for a greater efficiency of the federal budget military expenditure in the short run.

The beginning of the autumn colored pages of normal, not yellow, printed and electronic media with quite illustrative headlines¹, which earlier seemed to have ultimately sunk into oblivion². It came out of the blue that the RF Defense Ministry failed to come to terms with the Joint Ship-Building Corporation regarding contracts on building two missile carrier submarines of Boreus class and one multipurpose nuclear submarine of Ashtree class. According to Mr. Serdyukov, the Defense Minister, the talks concerned the last Rb. 20bn. tranche out of the 2011 Rb 581bn-worth state defense order.

Regretfully, the situation had not changed by the early November, and despite the customer's demands, JSBC continued refusing to disclose the price structure of their products. While the scandalous situation did not have an immediate effect on the Russian Navy's military capacity (for missiles for the new submarines are simply missing), it stirs much concern, as public officials have been promising to sort things out in the second half of the summer. It is becoming evident now that the President and Prime Minister's attempts to personally intervene in the situation were of no avail. Despite that, they both made quite important statements concerning both military spending and the nation's military-technical policy.

More specifically, while addressing participants in the strategic military exercise Center-2011³ in Chelyabinsk oblast on 27 September, Pres. D. Medvedev asserted that, "spending on defense, new arms, monetary allowance for the military, on their normal living conditions, on their housing shall form a high priority for the state. It should not be otherwise." Making this thesis a general moral commandment ("...this is the imperative"), he built it on the premise that, "we, no matter how frustrating it sounds for the budget, will always see very high spending on defense and security; this is our mission as far as both our citizens and our neighbors are concerned" and associated that with such factors as the size of Russia's territory, its seat on the UN Security Council, and its nuclear arsenal.

Sadly, not only do the fruits of the President's intellectual voltage force one to question his logic (at least, as far as our mission with respect to our neighbors is concerned) and the accuracy of his factoring into the effect of relevance and signs of factors, but they proved being in a direct conflict with art. 23 and 112 of the National Security Strategy until 2020⁴, which he personally approved. The Strategy does not at all refer to military expenditures as one of major national security priorities or major characteristics of the state of the national security. Meanwhile, unlike "strategic national priority", the concept of "high priority" has not been codified in the document at all.

Pres. Medvedev's simple-hearted reference to "high priority" is not saved even by the morale pillar of the imperative and reference to Russia's "special mission". His failure to understand

1 *Kalinin I.* State Defense Refusal // *Moskovsky Komsomolets*. 2011. 8 September; *Veselov A., Dyatlikovich V.* State Defense Scandal // *Russky Reporter*. 2011. 22 September (№ 37); *Gruzinova I.* Defense Denial // *Moskovskiyie Novosti*. 2011. 11 October; *Staalesen A.* Russian Defense Industry's Riot // *BarentsObserver.com*. 2011. 20 October.

2 *Poroskov N.* State Defense Refusal // *Vremya Novostey*. 2004. 28 October.

3 <http://news.kremlin.ru/transcripts/12836>.

4 The National Security Strategy of the Russian Federation until 2020. Approved by Decree of the RF President of 12 May 2009 № 537.

the concept of optimal balance manifested in NSS-2020 or his ignorance of it simply mean the traditional preference to the great-power status over an increase in the citizenry's well-being, the necrosis of investment resources and decline in economic growth rates in the long run.

In his opening address to a meeting on military-industrial complex on 7 October¹, PM V. Putin argued that, “we face a huge, large-scale challenge – that is, to practically completely rearm our Armed Forces and Navy within the next decade”. While Pres. D. Medvedev earlier cited the objective of the state arms program for the period 2011–2020 being a 70% rearmament (and a 30% one by 2016), rather than the 100% one, such distinctions should be ascribed to the bureaucratic megalomania exacerbated by the impact of the political cycle.

The fact of the matter is, the focus of NSS-2020 on a complete rearmament within the next decade exhibits a sheer ignorance of foreign and domestic experiences and incomprehension of the principle of balance, and its authors' inability to look beyond the 10-year planning horizon.

The coherence of NSS-2020 and, accordingly, the plausibility of its implementation can be questioned, particularly with account of the last year's accusations of an absence of rationale voiced by Mr. V. Putilin, the then First Deputy Chairman of the Military-Industrial Commission under the RF Government with regard to the Defense Ministry's policies. Likewise, Mr. V. Popovkin, ex-Deputy Minister of Defense, held in his two interviews² back in March that in Russia, “strategic nuclear forces-wise, the share of modern means in the arms and military equipment roughly accounts for 20%, and for 10% – in conventional forces. For reference: the respective proportion in armed forces of leading foreign states makes up between 30 and 50%”.

If Mr. Popovkin's data on the latter situation are accurate, it means that Russia will have caught up with the leading nations' level already by 2016 and substantially outrun it by 2020. By all accounts, none of authors of the national armament program for 2011–2020 and public officials who have lobbied and advocated it ever wondered why the proportion of new arms and military equipment in the leading countries does not exceed 50%. As well, they seem not to have ever entertained themselves with other simple questions, such as whether Russia would ultimately be overstretched by this crazy pursuit of the bizarre 70% level by 2020 and what is going to happen to the defense industrial enterprises post-2020, when the Army and the Navy have proved fully rearmed: that is to say, whether the corporations in question would face the challenge of the need to focus on overseas markets for long, as arms and military equipment are supposed to remain in service for 25 to 30 years.

The federal target program “Development of the defense-industrial complex of Russian Federation for the period up to 2020” to which Mr. V. Putin referenced, appears equally dubious. For one, it has not been adopted as yet, albeit it is already funded out of this year's federal budget, which violates respective procedures. In this context, the call to expedite its adoption is fairly illustrative per se.

Interestingly, the duumvirate proved divided on the peculiarity of the current situation: while Mr. Medvedev argued on 27 September that Russia has “a special destiny” (thus being doomed to extremely high military spending), ten days later, while speaking about his hope for an indirect boost and modernization of the economy by injecting Rb 3bn in investments in the defense sector, Mr. Putin emphasized that the country “does not differ” from other nations. It seems that he is fully ignorant of the sad Soviet experience. Mr. Putin would unlikely be able to explain what is behind his hopes, and the tone of his address appears reminiscent of his numerous statements back in 1999–2002. Quite notably, even the number of DI corporations (1,700) has remained the same since then, despite a whole series of federal target programs on reforming and restructuring of the sector. Apropos, the groundbreaking federal target program from that list would aim at reducing the number of such corporations to 600, and this figure still is quite adequate, given that the Defense Ministry invited the very number of MIC corporations to contribute to fulfillment of its 2012 State Defense Order³.

1 <http://premier.gov.ru/events/news/16656/>.

2 We cannot afford to procure lousy arms // Military-industrial courier. 2011. 2–8 March (№ 8); *Litovkin D.* “Triumph” and “Zircon” are set to go to the army // *Izvestia*. 2011. 11 March.

3 The Defense Ministry is ready to conclude 200 contracts in the frame of the 2012 defense order // RIA “Novosti”. 2011. 11 October.

Unlocking the current red-tape, rather than economic, dead end is possible only if the military-technical policy is back to the course Mr. Putin charted back in 2004 in his Address to the Federal Assembly. At the time, he put forward a thesis of “transparent military economy” as an indispensable condition of reforms. This would undoubtedly demand abandonment of the recent practice of an unreflecting pumping of budget resources into the defense-industrial sector, strengthening discipline across all the public administration links and addressing the problem of political irresponsibility in the government on the whole. The 12-year long record has evidenced that under the current bureaucratic model of the vertical of power, the directive and financial methods of administration of the sector proved inefficient both from the short- and long-term perspectives.

As one would succeed in capitalizing on indirect administration methods in the form of a high-quality public statistics, a genuinely transparent federal budget, a glasnost-style policy in the military sphere and a real combat against corruption, so it would become possible to bolster efficacy of military spending, among other things. Efficiency comes hand-in-hand with transparency, and Table 1 shows what a long and winding road Russia will have to travel in this particular direction.

Table 1

PROPORTION OF CLASSIFIED APPROPRIATIONS IN THE 2004-2012 FEDERAL BUDGETS, AS %

Code and name of the section (subsection) containing classified expenditures	2004	2005	2006	2007	2008	2009	2010	2011	2012
The federal budget expenditures, total	9.83	11.33	11.80	10.33	11.92	10.01	10.46	12.25	12.15
0100 GENERAL PUBLIC ADMINISTRATION ISSUES	n/a 1	3.67	6.28	5.52	8.66	5.05	4.75	8.66	10.17
0108 International relations and international cooperation	18.04	–	0.01	< 0.01	3.66	–	–	–	–
0109 The state material reserve	93.33	82.86	89.23	92.18	90.17	85.01	85.08	88.15	85.71
0110 Fundamental research	–	2.13	1.22	1.12	0.97	0.78	0.32	0.66	2.89
0114 Other general public administration issues	n/a	0.05	0.72	0.28	4.42	1.56	1.05	0.95	1.11
0200 NATIONAL DEFENSE	38.40	42.06	42.77	45.33	46.14	48.09	46.42	47.73	48.60
0201 The Armed Forces of RF	36.11	33.07	35.59	37.11	39.04	40.21	39.03	41.50	42.97
0204 Mobilization preparation of the economy	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
0205 Preparation for and participation in provision of the collective security and peacekeeping activities	–	100.0	100.0	100.0	–	–	–	–	–
0206 Nuclear arms complex	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
0207 Implementation of international obligations in the sphere of military-technical cooperation	41.05	45.22	46.90	50.65	100.0	100.0	100.0	100.0	100.0
0208 Applied research in the area of national defense	n/a	98.37	93.94	93.69	93.20	92.85	91.32	92.94	94.64
0209 Other issues in the national defense area	n/a	2.49	8.79	24.38	29.21	34.64	42.03	36.41	44.03
0300 NATIONAL SECURITY AND LAW ENFORCEMENT	20.79	28.52	31.64	31.07	31.84	30.82	32.12	32.54	24.86
0302 Interior Ministry bodies	3.01	4.76	6.31	5.16	4.97	3.70	4.30	6.56	3.42
0303 Interior Ministry troops	11.10	11.76	10.31	9.80	10.25	8.19	8.28	7.89	4.77
0306 Security bodies	98.91	97.80	95.49	97.31	99.05	99.61	97.05	99.87	99.56
0307 Border Guard bodies	22.88	100.00	98.97	97.62	100.00	99.47	98.61	99.11	99.09
0309 Population and territory protection from emergency situations of natural and technogenetics situation, civil defense	41.74	59.02	62.39	50.65	51.39	51.00	51.28	47.35	42.81

Table 1, cont'd

Code and name of the section (subsection) containing classified expenditures	2004	2005	2006	2007	2008	2009	2010	2011	2012
0313 Applied research in the area of national security and law enforcement activity	n/a	73.95	66.41	64.43	75.49	79.35	92.09	87.07	84.50
0314 Other matters in the area of national security and law enforcement activity	n/a	8.26	50.71	39.95	56.32	68.37	67.94	78.29	30.41
0400 NATIONAL ECONOMY	n/a	0.05	0.02	0.44	0.64	0.55	1.56	1.94	2.70
0411 Applied economic research	n/a	–	–	5.23	5.84	4.49	5.61	12.07	15.24
0412 Other matters in the national economy area	n/a	0.12	0.06	< 0.01	0.31	0.72	4.47	2.22	2.69
0500 HOUSING AND UTILITIES SECTOR	n/a	–	3.42	0.85	6.96	10.09	19.26	19.75	11.22
0501 Housing	n/a	–	4.22	5.69	15.97	12.91	20.79	25.04	15.02
0700 EDUCATION	–	2.76	2.69	2.39	2.55	3.06	3.59	4.30	3.21
0701 Preschool education	–	2.03	2.17	2.44	2.48	2.45	3.91	5.00	3.58
0702 General education	–	1.51	1.91	2.14	2.00	2.75	3.45	0.59	0.20
0704 Secondary vocational training	–	1.06	1.03	1.02	0.86	0.99	–	–	–
0705 Professional training and retraining	–	16.85	15.78	17.22	1.80	2.54	9.40	18.50	8.27
0706 University and post-graduate professional education	–	3.15	2.93	2.53	3.08	3.64	4.08	5.32	4.18
0709 Other matters in the sphere of education	–	0.30	0.33	0.28	0.29	0.48	0.61	0.26	0.26
0800 CULTURE, MOTION PICTURE INDUSTRY, MASS MEDIA	–	0.17	0.17	0.21	0.17	0.18	0.17	–	–
<i>0800 CULTURE and MOTION PICTURE INDUSTRY</i>	–	–	–	–	–	–	–	<i>0.12</i>	<i>0.12</i>
0801 Culture	–	0.14	0.10	0.16	0.10	0.14	0.09	0.14	0.14
<i>0804 Periodical media and publishing</i>	–	<i>13.46</i>	<i>7.45</i>	<i>2.57</i>	<i>2.62</i>	<i>3.14</i>	<i>3.59</i>	–	–
<i>0806 Other matters in the sphere of culture, motion picture industry and mass media</i>	–	<i>0.02</i>	<i>0.15</i>	–	–	–	–	–	–
<i>0900 HEALTHCARE, PHYSICAL CULTURE AND SPORT</i>	–	<i>4.30</i>	<i>3.99</i>	<i>2.57</i>	<i>4.14</i>	<i>3.54</i>	<i>3.01</i>	–	–
0900 HEALTH CARE	–	–	–	–	–	–	–	2.60	2.39
0901 Stationary medical assistance	–	5.61	4.66	2.94	3.24	2.77	2.41	2.32	2.01
0902 Outpatient medical assistance	n/a	n/a	n/a	n/a	13.94	4.34	3.75	2.70	2.90
0905 Rehabilitation	n/a	n/a	n/a	n/a	14.07	15.88	10.73	11.67	10.99
0907 Sanatorium-epidemiological well-being	n/a	n/a	n/a	n/a	2.09	0.63	0.64	0.70	1.04
0908 Physical culture and sports	–	0.28	0.26	0.24	0.42	0.32	0.62	–	–
0910 Other matters in the sphere of health care, physical culture and sports	–	–	–	–	1.74	1.07	1.01	–	–
0910 Other matters in the sphere of health care	–	–	–	–	–	–	–	0.43	0.30
1000 SOCIAL POLICY	–	–	–	–	0.01	0.01	–	–	0.06
1003 Social security of the population	–	–	–	–	0.02	0.02	–	–	0.24
1100 PHYSICAL CULTURE AND SPORTS	–	–	–	–	–	–	–	0.26	0.29
1101 Physical culture	–	–	–	–	–	–	–	53.51	41.53
1200 MASS MEDIA	–	–	–	–	–	–	–	0.27	0.27
1202 Periodical printed media and publishing houses	–	–	–	–	–	–	–	3.38	3.15

Table 1, cont'd

Code and name of the section (subsection) containing classified expenditures	2004	2005	2006	2007	2008	2009	2010	2011	2012
1400 INTERBUDGETARY TRANSFERS OF GENERAL NATURE TO BUDGETS OF THE RF SUBJECTS AND MUNICIPAL ENTITIES	–	–	–	0.16	–	–	–	–	–
1401 Budget sufficiency equalization grants to RF Subjects and municipal entities	–	–	–	0.50	–	–	–	–	–

Source: 2004–2011 federal budgets. For the year of 2012 – the draft budget of 30.09.2011. The data on 2004–2010 are adjusted to respective sections and sub-sections of the budget classification that came in effect since 2011. The data used in the previous budget classification are given in italics.

RESEARCH INFRASTRUCTURE: FROM COLLECTIVE USE CENTERS TOWARDS SUPERSIZED APPS

I.Dezhina

Securing cutting-edge infrastructure for science has become a critical aspect of the public policy in the research area, with emphasis being put on support of supersized and unique apps and complexes. Centers for collective use of equipment can form the basis for research infrastructure, provided the system of their support and monitoring is modified. However, new large-scale projects have so far been initiated without assessing existing reserves.

The public policy in the scientific area has recently seen an intense rise of the «infrastructure» direction – that is, approaches to providing research organizations with apps and equipment, including, in particular, complex and huge installations (which fall under the more and more popular term megascience). The Government's intention to bolster international cooperation, which suggests unique apps and equipment at hand, has become an important incentive to the process.

Centers for collective use of equipment (CCUEs) have long been a common form of support of the research infrastructure. Originally, they were established to ensure research process in a situation when each research institution could not afford much-needed equipment and apps. Plus, CCUEs were home to very costly equipment, which could not be purchased in huge quantities, while such centers would make it available to a broad array of users. Nowadays, CCUEs emerged as yet another small, albeit important, source of extrabudgetary funds for research institutions. Numerous initiatives funded by the RF Ministry of Education and Science suggest extrabudgetary financing. It is common knowledge extrabudgetary funds available for that scientific organizations and universities are scarce, while the industrial sector is reluctant to finance research beyond the immediate corporate sector's frame. That is why revenues generated by services rendered with the use of CCUEs' equipment are one of a very few genuine sources of extrabudgetary financing. The RF Ministry of Education and Science estimates that works performed with the use of CCUEs' equipment at 77% are research projects, while the proportion of services averages 23%.

Should the approaches to their funding and monitoring be modified, CCUEs can emerge as pivots to further development of the research infrastructure. But so far the support of CCUEs has evolved only from the perspective of growth in volume of financing of equipment purchases. That said, after more than a decade in existence, there has been no holistic evaluation of CCUEs' operational record to date, nor their efficacy has ever been gauged.

Indeed, while the RF Ministry of Education and Science annually collects a string of formalized metrics with regard to CCUEs' performance¹, there were no public assessments of their operational efficiency, including, inter alia, an assessment of unique apps installed therein². What's worse, the precise number of up and running CCUEs remained unknown, for there is no clarity as to which organizations qualify for this status. Even the website of the RF Ministry of Education and Science displays controversies in this regard. More specifically, judging the list of CCUEs, which comprises resource centers, technoparks, among other centers, their ultimate headcount is 418 units. Meanwhile, an interactive map of the country posted on the very same web-site displays less than

1 The Ministry requests the following kinds of CCUEs' performance indicators: the number of staff, including those holding a degree, equipment loading rate; costs of works; list of methodologies; the list and costs of works; the list of R&D projects, volumes of their financing and conformity with priority avenues; the list of corporate users; the list of publications, research theses and patents produced with the use of the CCUEs' equipment. Source: http://ckp-rf.ru/news/science/Ezhegodnyj_monitoring_effektivnosti/

2 In his paper «Methodological approaches to assessment of centers of collective use of research equipment» (published in almanac «Science. Innovation. Education», issue 9, 2010 PP. 189-202) A.B. Gusev puts forward a methodology of assessment of CCUEs, including their operational effectiveness; however, the paper fails to cite results of such an assessment, even a selective one. Official presentations by the RF Ministry of Education and Science offer a general perspective on capacity of the supported by the Ministry CCUEs, but not on their efficiency.

a hundred of them, including unique apps. Some experts hold there currently are between 43¹ and 63 CCUEs in the country (apparently, those ones that received target funding from the Ministry), with 11 centers in possession 30% of all the research equipment placed with CCUEs². Lately, when the RF Government has begun allocating substantial funding for purchasing research equipment, numerous structures rushed to declare themselves centers for collective use and the competition for funds on support of the infrastructure has grown very intense. That in turn potentially lowered chances for continuation of receipt of funding out of federal sources for the CCUEs in operation for already several years (though such funding has not ever been guaranteed for more than 1-2 years).

The question of the CCUEs' operational efficiency appears yet a more complex one. That certain capacity enabling one to efficiently conduct research on the basis of CCUEs is there raises no question: according to the RF Ministry of Education and Science³, the average age of CCUE equipment is 8 years, or twice as low as nationwide, while the technical capacity rate of researchers in such centers is nearly 8-fold greater. So, CCUEs form one of the most progressive kinds of research infrastructure in Russia. Meanwhile, expert estimates suggest that there is just a handful of efficient CCUEs in Russia, even without regard to differences in interpretation of their efficiency per se. According to a number of CCUE directors, such centers prove efficient only when their equipment loading rate reaches its absolute peak⁴, which is not typical of all the centers. Another interpretation suggests that CCUEs are efficient at organizations that have built sound financial and operational models⁵. That said, many centers fell short of formalizing procedures of granting users access to their equipment, nor there are normative and legal documents determining forms of organization of such centers and interaction with them⁶. As a result, CCUEs' equipment is not used in an optimal manner. Finally, their operational efficiency depends on organizational peculiarities of their operations. So far CCUEs have been centers of provision of individual gauging services or the basis of implementation of individual fragments of research projects, rather than project research centers (the way they largely operate overseas)⁷. Plus, practically all the CCUEs face such systemic challenges, such as lack of funds to compensate equipment operators' labor costs and to procure spare parts and maintain equipment.

In the US, from where the concept of CCUEs was partially borrowed, the fundamentals of their financing, operations and assessment of operational efficiency offer dramatic contrast to the Russian practices. One of key agencies supporting the university based research infrastructure, the National Science Foundation, sponsors establishment of a variety of centers for collective use which emerge as the basis for interdisciplinary research. Today, the US federal budget allocates support to seven kinds of such centers: Centers for Analysis and Synthesis, Centers for Chemical Innovation, Engineering Research Centers, Material Science Centers, Nanotechnology Research Centers, Technology Research Centers, and Education Research Centers. Within each category, the number of centers varies strongly: from 29 Material Science Centers to 2 Centers for Chemical Innovation. Any rate, they are not counted in hundreds, like in today's Russia. The number of government supported CCUEs in US has recently diminished slightly, as the US Government is keen to secure robust funding for the strongest centers with the most promising research projects.

The NSF awards grants to each Center in the region between US2m and 5m a year, and such a support is provided over a long period of time (usually, in a span of two 5-year long cycles). The NSF encourages cooperation between different participants, Centers' delivery of business services, and creates incentives for their sustainable operations in future, which should be secured through diversification of sources of financing.

1 Centers of collective use of research equipment in the sector of modern research and development. <http://www.fcpir.ru/doc.aspx?DocId=970>

2 On the basis of oasis. CCUEs quench the thirst for knowledge// Poisk, №10, 5 March 2010, p.7.

3 Данные за 2007-2010 гг. <http://www.fcpir.ru/doc.aspx?DocId=970>

4 Bykova N. The sunshower for CCUEs. http://ckp-rf.ru/news/science/Ezhegodnyj_monitoring_effektivnosti/20.09.2011

5 Axenova L. Just a handful of efficient CCUEs. http://strf.ru/material.aspx?CatalogId=221&d_no=42105 05.09.2011

6 Golichenko O.G., Kleiner G.B., Samovoleva S.A. An analysis of implementation of main avenues of the public innovation policy in Russia (2002-2010). M.: TSEMI RAN, 2011. P.49.

7 Gorbatova A. A non-for-profit effect. http://strf.ru/material.aspx?CatalogId=37188&d_no=42310 16.09.2011

The structure of spending of a grant funding of the Centers' operations is worth a particular notice. While in Russia the bulk of funding is spent on equipment purchases, the US Centers spent on that an average 12% of the NSF grant, with the bulk of financing, some 60-65% of the grant, being spent on labor compensations to students, postgraduates, and postdocs working at a Center and, partly, on university professors' salaries¹. That equipment purchase costs appear relative humble can be ascribed to Centers being, as a rule, established on the basis of universities that already are in possession of a modern material base. Established at different times and with an emphasis on different areas, the Centers are currently linked to each other and even integrated into a single nationwide shared facilities network.

Equally important factor is that the NSF periodically monitors the Centers' performance, with contribution to advance discovery and broader impacts as major criteria. There are just a few quantitative indicators, while the major assessment is an expert, informal one, with the quantitative indicators being interpreted in the context of the Center's specialization and other operational peculiarities. That is why support is extended to very versatile centers, be those monospecialized or diversified, large or small ones. This ensures the much-needed degree of flexibility of the system of material support of research.

Russia now shifts the focus of attention towards building megascience-style apps. Indeed, significance of such centers for the country is hard to overestimate, for they enable one both to obtain fundamentally new research products and technologies, and breakthrough discoveries across a broad array of subjects. By bolstering international cooperation, arresting the brain-drain, and, potentially, forming the basis for the rise of innovation clusters, such centers engender an inflow of qualified cadres.

The Russian Government appears divided on the issue of the development path with respect to megascience apps. While some members of the Cabinet believe it is imperative to build supercenters similar to CERN and the likes, others propone the need to strengthen a number of existing infrastructure facilities so that they would be able to cope with the tasks complementing experiments run at the largest international centers. In all likelihood funds will be allocated to beef up the existing capacities to tackle individual problems for the sake of furthering studies into subjects performed using the largest overseas apps. The Government has already approved establishment of at least six facilities to complement international megascience ones, of which two facilities will be located at institutions under the auspices of the RRC Kurchatov Institute².

It is important to make sure the funding of new apps is concomitant with solutions to the problem of approaches to, and mechanisms of their operation. Continuation of the policy of allocation of budget funds exclusively for the purpose of equipment purchases along with cutting costs of its further use and scaling back the maintenance staff and operators payroll will substantially lower the potential of use of new research infrastructure facilities. ●

1 The National Science Foundation's Material Research Science and Engineering Centers Program: Looking Back, Moving Forward. National Research Council of the National Academies. The National Academies Press, 2007.

2 Стерлигов И. Меганаука обойдется стране в 133 млрд. рублей http://strf.ru/material.aspx?CatalogId=221&d_no=40914 06.07.2011 г. Стерлигов И. В Минобрнауки России отобрали шесть megascience-финалистов http://strf.ru/material.aspx?CatalogId=37188&d_no=40541 24.06.2011 г.

BANKRUPTCIES IN 2009–2011: THE DYNAMIC AND TRENDS

E.Apevalova

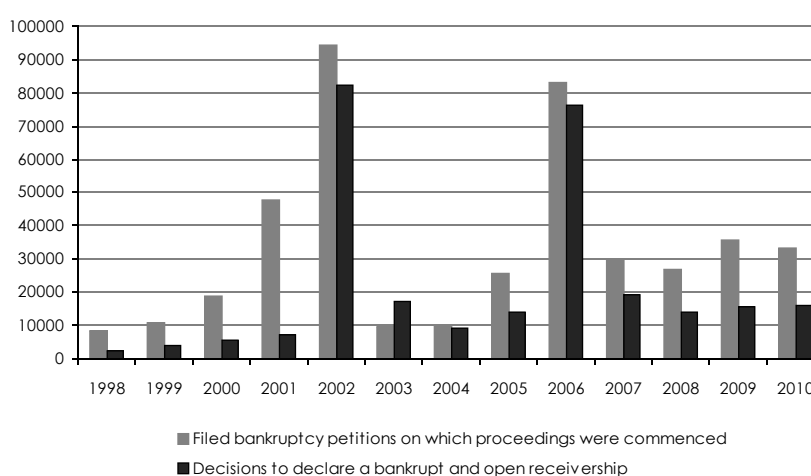
The first half of 2011 saw a considerable, nearly a 20%, decline in bankruptcy petitions to the court of law and a 13.5% drop in the latter's adjudication orders vs. the same period of 2010. In 2010-11, there emerged the trend to increase in the number of amicable agreements, conduct of financial restructuring of corporations and introduction of bankruptcy administration.

The landscape of the bankruptcy sphere in the period in question is characterized by four key trends:

1. The beginning of decline in the number of bankruptcies and filing respective petitions to the court of law in H1 2011 after increase in the above figures in 2009-10. More specifically, in the latter period, the number of adjudication orders and opening of the receivership soared by more than 15% (2008 – 13,900; 2009 – 15,500, 2010 – 16,000 rulings¹). The first half of 2011 saw a considerable, nearly a 20%, decline in the number of filed bankruptcy petitions (H1 2010 – 21,037, H1 2011 – 16,853) and a 13.5% drop in adjudication orders vs. the respective period of the prior year (H1 2010 – 8,047, H2 2011 – 6,955)². The dynamic of adjudication orders between 1998 and 2010 is displayed in Fig. 1.

The drastic spikes of bankruptcies in 2002 and 2006 and their increase in 1998-2010 were driven by the state's keenness to "stub the field" by dumping de-facto abandoned enterprises by getting missing debtors bankrupt and allocating respective budget funds for that purpose.³

The period between 2009 and 2010 saw continuation of the started back in 2008 increase in the overall number of filed bankruptcy petitions (2008 – 34,400; 2009 – 39,600; 2010 – 40,200) as well as petitions submitted with regard to so called meaningful debtors⁴ (2008 – 26,400; 2009 – 35,200; 2010 – 36,600). Specifically, between 2008 and 2009 the number of petitions filed with regard to meaningful debtors surged by 38.6%, while the overall increase in the number of petitions roughly accounted for 17.1%. The peak of the increase fell on 2009. While the 2011 data on meaningful debtors' bankruptcies has not become available as yet, there is every reason to assume that following the general trend to fall in the number of bankruptcy procedures, their figure will be in decline. The dynamic of indicators of the



Sources: Reference documents of the Supreme Arbitration Court of Russian Federation on consideration by arbitration courts of Subjects the Russian Federation of bankruptcy (insolvency) cases in 1998-2010.

Fig. 1. Dynamic of Adjudication Orders in 1998–2010

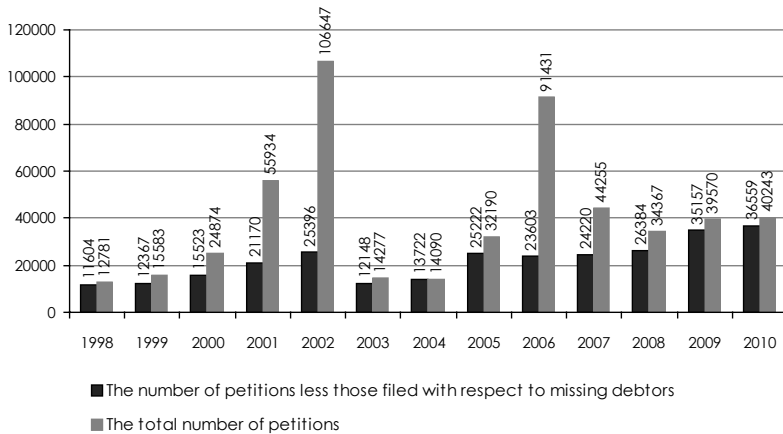
1 Of 16,009 adjudication orders and initiation of receivership in 2010:

- 3.2%, or 508 cases concerned public and municipal unitary enterprises; - 13.1%, or 4,882 cases – self-employed individuals; - 5%, or 800 cases – agrarian producers; - 1.4%, or 224 cases – financial organizations.

2 Reference document on consideration by arbitration courts of the Russian Federation of bankruptcy (insolvency) cases in 2008–2010, in H1 2011 – www.arbitr.ru

3 Economy of Transitional Period. Essays on Economic Policies of Post-Communist Russia 1998-2002., M.: IET, 2003, P.505; Economy of Transitional Period. Essays on Economic Policies of Post-Communist Russia 2000-2007., M.: IET, 2008, P.473.

4 The term "meaningful debtor" embraces all debtors less missing ones.



Sources: Reference documents on consideration by arbitration courts of Subjects the Russian Federation of bankruptcy (insolvency) cases in the respective periods; analytical memoranda by the Supreme Arbitration Court of Russian Federation on statistical reports on performance of arbitration courts of Russian Federation.

Fig. 2. The Number of Petitions on Adjudication Orders in 1998-2010

Against the background of the overall increase in bankruptcy procedures and their enforcement in individual segments of the economy, the dynamic of agrarian producers' bankruptcies exhibits an opposite tendency: between 2006 and 2010 the number of bankruptcies in the agrarian sector was down more than 5-fold (2006 – 4,000; 2007 – 2,465; 2008 – 1,614; 2009 – 1,036; 2010 – 800). Behind this result lay government measures to support the agrarian sector: expansion of lending, tax arrears restructuring, subsidized purchases of fuel and lubricants, among others. That said, in the segment of self-employed individuals, the bankruptcy indexes more than doubled between 2007-2009 vs. the prior years: 2004–2006 – 200–700 bankruptcies a year; 2007 – 2,478; 2008 – 4,751; 2009 – 5,423). The year of 2010 saw some signs of their decline (down to 4,882 cases, or by 10% relative to the 2009 level).

3. Revitalization of creditors in protecting their interests in the process of bankruptcy procedures since 2009 and in initiating bankruptcies- since 2010.

Thus, the number of claims, petitions, discrepancies and solicitations under bankruptcy cases doubled between 2009 and 2010: from 111,521 cases in 2008 to 232,845 in 2010, while the increase in submitted and considered bankruptcy cases was far less dramatic. The main reason behind such a drastic surge became a considerable increase in the number of lawsuits associated with failure to honor/breaching contractual obligations, the general economic situation, and modifications to the bankruptcy law with regard to granting new rights to parties to the bankruptcy process. With respect to the latter, suffice it to reference to such novelties as challenging the debtor's transactions, having entities in control of the debtor vicariously liable, the right to submit a claim on the intention to meet the calls for mandatory payments, among others². H1 2011 saw some correction in this

1 On the impact of public agencies' operations in the area of liquidation of legal entities on the general dynamic in the bankruptcy area see: Apevalova E.A., Radygin A.D. Bankruptcies in the '2000s: from the Raiders' Lever to the Double-Standard Policy. – "Economic Policy", Aug. 2009.

2 Out of 232,800 claims, petitions and solicitations, 165,00 ones, or 70.1%, fall on requests to establish the size of creditors' claims. This index posted a sizeable (2.4 times) increase vs. the 2008 figure (67,600), while the level of claims to remove a bankruptcy commissioner discontinued its decline and posted a slight increase in 2010 – up to 13,416 cases (or 5.8% of the aggregate number of claims, petitions and solicitations). The statistics show that the number of creditors' claims on abuse of their rights and legal interest in 2010 was 73.5% up on a year-on-year basis, with considered petitions to establish the creditors' claims up by 33.2% and the number of submitted claims to extend the term of the bankruptcy procedure up by 27.5%. The bulk (62.4% of the aggregate number) of claims, petitions and solicitations were considered by courts of law at the receivership stage, while 33.4% of claims were considered at the stage of supervision. The number of considered by courts of law claims submitted in the course of exercise of the bankruptcy administration procedure nearly tripled – from 2,158 to 5,749.

number of bankruptcy petitions filed with regard to meaningful debtors over the period between 1998 and 2010 vis-à-vis the overall number of petitions is displayed in Fig. 2. The number of petitions less those filed with respect to missing debtors.

The total number of petitions

2. Fall of the effect of public policy measures on the bankruptcy dynamic, which includes, inter alia, regulation of tax authorities' operations in the adjudication area¹. More specifically, while in 2008 over 67% of bankruptcy petitions were filed by competent agencies, largely tax ones, in 2010, the specific weight of this particular group's indexes was down to 39.2%.

respect – that is, a 10.9% decline against the aforementioned 2010 index.

Plus, the year of 2010 saw a 31.7% increase, on a year-on-year basis, in the number of claims submitted by bankruptcy creditors: such claims in 2010 accounted for 39.1% of the aggregate number of claims. Meanwhile, the proportion of debtors' claims tumbled from 23.1% in 2009 (9,145 claims) to 21.7% in 2010 (8,727 claims)¹.

4. The rise of the tendency to increase in the number of amicable agreements, restructuring and bankruptcy administration cases in 2010-2011.

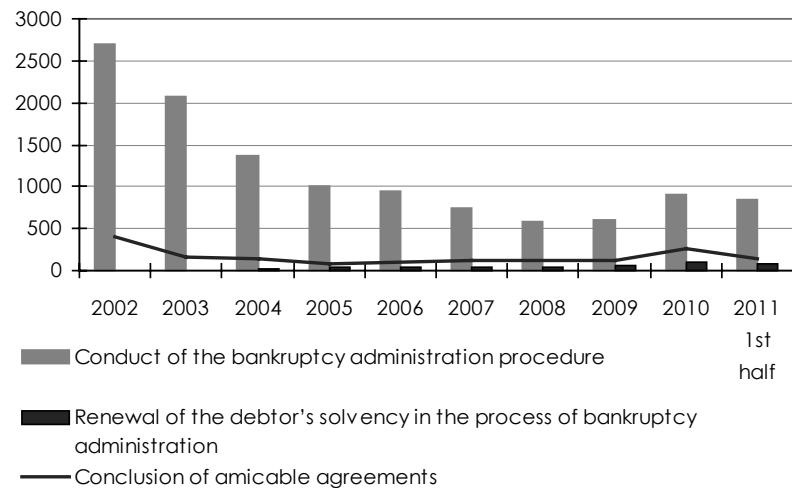
Thus, with the corporate solvency renewal level remaining traditionally low in the process of

bankruptcy administration, the number of procedures of institution of bankruptcy administration in H1 2011 was 30.9% up vs. the respective indexes of 2010 (839 – H1 2011 against 641 – H1 2010). The period of 2002-2008 saw the five-fold decline in the number of introduced procedures in question.

The dynamic of employment of procedures of bankruptcy administration, financial restructuring, and conclusion of amicable agreements between 2002 and H1 2011 is displayed in Fig. 3.

It is anticipated that in 2011 the number of concluded amicable agreements should hit its highs (some 300 ones) over the period between 2002 and H1 2011. The number of applications of the restructuring procedure is most likely to make up a peak one too: already in H1 2011 there were 76 such cases, or up by 13.4% vis-à-vis the previous record-breaking figure of 67 cases reported in H1 2010.

That the rise in the number of amicable agreements, application of restructuring procedures and bankruptcy administration ones has continued for the second straight year became possible, should be ascribed in no small part to the tax novelties of 2010. They expanded opportunities for applying deferments and extensions with regard to mandatory payments and writing-off irrecoverable receivables. Besides, the process was further fueled by novelties aiming at prevention of financial (including insurance) organizations' bankruptcies and regulation of the bankruptcy procedure applicable to non-state pension funds, professional operators on the securities market, investment and mutual funds' management companies. ●



Source: Reference memorandum on consideration by arbitration courts of Subjects of Russian Federation of cases on insolvency (bankruptcy) in 2006 – 2010, H1 2011.

Fig. 3. Dynamic of Application of Bankruptcy Administration, Restructuring and Amicable Agreement Procedures in 2002–H1 2011

¹ Hereinafter: Analytical memorandum to statistical report on performance of arbitration courts of Russian Federation in 2010, p.16-19.

REVIEW OF MEETINGS OF THE GOVERNMENT OF THE RUSSIAN FEDERATION IN OCTOBER 2011

M. Goldin

In October 2011, at the meetings of the Presidium of the Government of the Russian Federation the following issues were considered: a draft law which toughens residents' responsibility for a failure to notify tax authorities of opening of accounts (deposits) or changing of banking details of accounts (deposits) with banks situated outside the Russian Federation; the draft law which specifies the Law of the Russian Federation on Organization of Insurance Business in the Russian Federation and provides among other things insurance coverage against financial risks of individuals who in case of insurance event may incur additional expenses and costs in order to make up for the loss of income.

On October 13, 2011, considered at the meeting of the Presidium of the Government of the Russian Federation was the draft of the Federal Law on Amendment of Article 15.25 of the RF Code of Administrative Violations (CAV) which draft law was introduced by the Ministry of Finance of the Russian Federation.

As of today, compliance with the requirements of Federal Law No. 173-FZ of December 10, 2003 on Foreign Exchange Regulation and Foreign Exchange Control is enforced by Article 15.25 of the CAV of the Russian Federation which article lists both grounds on which residents may be brought to administrative responsibility and types of punitive measures provided for violation of the foreign exchange law.

Article 15.25 (2) of CAV provides for such administrative responsibility for violation of the established procedure for opening of accounts (deposits) with banks situated outside the Russian Federation as implies imposition of fines on individuals (in the amount of from Rb 1,000 to Rb 1,500), officials (from Rb 5,000 to Rb 10,000) and legal entities (from Rb 50,000 to Rb 100,000).

At the same time, from June 2004 the Federal Law on Foreign Exchange Regulation and Foreign Exchange Control includes a norm which holds residents liable to notify tax authorities of the place of their registration of opening (closing) of accounts (deposits) and changing of banking details of accounts (deposits) within a month from the day of opening (closing) or changing of banking details of such accounts (deposits) with banks situated outside the Russian Federation in accordance with the form approved by the federal executive authority authorized to carry out control and supervision in the field of taxes and duties.

According to the Ministry of Finance of the Russian Federation, the size of fines set by CAV for a failure by the resident to notify of the opening of accounts (deposits) with banks situated outside the Russian Federation and a lack of responsibility for carrying out foreign exchange transactions on such accounts (deposits) does not exclude a possibility for such financial transactions to be effected for the purpose of gaining the unjustified tax profit.

Due to the above, it is proposed to set forth Article 15.25 (2) of CAV in a revised version. Simultaneously, the draft law provided for a new section to be added to Article 15.25 of CAV which section would set administrative responsibility for residents for a failure to notify tax authorities of opening accounts (deposits) with banks or changing banking details of accounts (deposits) with banks situated outside the Russian Federation.

Thus, according to the draft law approved by the Government of the Russian Federation a failure by the resident to notify the tax authorities of opening (closing) of accounts (deposits) or changing of banking details of accounts (deposits) with banks which are situated outside the Russian Federation implies administrative fines to be imposed on:

- individuals (in the amount of from Rb 4,000 to Rb 5,000);
- officials (from Rb 40,000 to Rb 50,000);
- legal entities (from Rb 800,000 to Rb 1,000,000).

As the draft law sets administrative responsibility for the above violations it also provides for the fact that the law becomes effective 90 days after the day of its official publication. It is required to do so because individuals, officials, legal entities, officers of the foreign exchange control authorities, officers of the foreign exchange control agents which are authorized to make up reports on administrative violations, as well as judges could get acquainted with it.

The draft law was introduced to the State Duma of the Russian Federation by Order No.1812-r of October 17, 2011 of the Government of the Russian Federation.

On October 27, 2011, considered at the meeting of the Presidium of the Government of the Russian Federation was the draft Federal Law on Amendment of the Law of the Russian Federation on Organization of the Insurance Business in the Russian Federation.

The draft law is expected to specify insurance objects and the specifics of individual types of insurance, set minimum (standard) requirements to insurance terms and raise responsibility of insurance intermediaries.

In particular, the draft law provides for extension of insurance coverage against financial risks not only to businessmen, but also to individuals who may incur additional expenses and costs in case of occurrence of the insurance event and need to make up for the loss of income. It concerns primarily persons who go abroad as entering into an insurance agreement constitutes grounds for obtaining exit visas and insurance against loss of earnings (income) as result of the loss of a job and bankruptcy of the employer or other entity in which the individual's funds were deposited on the basis of the relevant agreements.

The draft law includes requirements to maintenance by the insurance supervision authority of the register of the insurance business entities and obligates insurers to inform consumers of insurance services of the activities of the insurer and the offered insurance terms.

According to the draft law, the insurance supervision authority is obligated to maintain the unified state register of insurance business entities, while the insurers are obligated to inform their customers of their activities and the offered terms of insurance. ●

AN OVERVIEW OF THE NORMATIVE DOCUMENTS ADDRESSING ISSUES OF TAXATION INTRODUCED IN SEPTEMBER–OCTOBER 2011

L. Anisimova

In late September and October 2011, long before the next elections, Russian society was informed of the intended alterations that were to take place, in the next few years, within the higher echelons of state authority. The result of concentrating power in the sphere of politics was a similar trend in the economy that has been a reflection of a step-by-step aggregation of Russia's financial resources management over the period prior to and after the 2011–2012 elections, predominantly at the Federation's level, the removal of procedural barriers to the management of financial flows in the field of taxation and the budget sphere. While in the 1990s the attempts to concentrate authority at the federal level were counterbalanced by a strong regional bloc represented by elected governors, nowadays the Council of the Federation has revealed its poor ability to protect the real economic interests of its constituencies in their interactions with the federal center, which significantly weakens the role of the regions in managing the country's financial flows. As a consequence, the finances are becoming increasingly concentrated in the center before being distributed between the regions, while the methods applied in managing the finances are increasingly resembling mechanisms based on mobilization orders.

1. The aforesaid trends can be traced not only in the actual ways of making decisions in the sphere of finances, but also in the specific kind of decisions that are being made there. The evident weakness of the economic position of regional representatives in the Federal Assembly (caused by the fact that the governors are no longer elected to their posts) determines also the predictability of the results of voting on budget issues and the structure of distribution of resources. There was a time when, in order to protect the interests of the regions, special norms were legislatively consolidated that established a proportional distribution of the regulating taxes between the federal and regional budgets. By Federal Law of 6 October 2011, No 270-FZ some of the legislative norms regulating the formation of the federal budget and regional budgets, including the distribution of budget revenues across the tiers of the budgetary system, were suspended. In particular, the provisions of the RF Budget Code concerning the transfers (including distribution) of tax revenues from excises on alcohol products and beer into the budgets of RF subjects are suspended until 1 January 2013. The implementation of the distribution scheme as envisaged by legislation in regard to the resources held in the RF Reserve Fund and the RF National Welfare Fund is suspended to 2015, and for the same period the norms regulating the marginal value of the budget deficit are suspended (less oil and gas revenues).

The situation in the sphere of tax norms is even more explicit. One of the most important achievements of the tax and budget reform implemented in the early 2000s was the legislative consolidation of a rule whereby all tax-related alterations became incorporated in the procedure for developing a budget for every next year. Once the law on a next year's budget was adopted, it was forbidden to impose any additional tax loads that were not incorporated in the revenue of each budget. However, that principle has been abolished for the period of the 2011 election campaign. By the same Federal Law No 270-FZ the provisions of the RF Budget Code whereby it is determined that the federal laws, the laws of RF subjects and municipal legal acts introducing alterations in federal, regional and local legislation on taxes and levies or budgetary legal relations resulting in altered budget revenues and entering in force in a forthcoming financial year and a planning period, must be adopted no later than one month prior the day on which the draft law (or municipal act) on budget for the next financial year and planning period is submitted to the State Duma or a relevant legislative (or representative) body, are suspended until 1 January 2012.

In other words, this means that, theoretically speaking, in any moment prior to 1 January 2012 a law or the RF President's edict can be adopted whereby any changes may be made to the tax system. Thus, an extraordinary tax can be imposed (which is not envisaged to be part

of the approved budget revenue and thus is automatically excluded from the overall scheme of government revenue distribution), or the rates of and/or the procedure for the payment of certain taxes can be altered on an entirely arbitrary basis. This institutional adventurism in the federal budget's formation may be a manifestation of Russia once again entering a "tax turbulence zone". It can be recollected in this connection that in late 2010, quite unexpectedly, the effective rate of insurance contributions to state off-budget welfare funds was raised 2.4 times and that the end of this year is marked by uncertainty in regard of the size of the expected tax load for 2012 that has lasted for 4 months. This uncertainty definitely has a disruptive effect on the existing mechanisms of contracting applied by producers of commodities.

While no extraordinary tax measures have been implemented so far, the conditions for adopting the measures have already been created.

2. As a protective measure for the interests of businesses – among other things, against dramatic fluctuations of their tax load – a special procedure has been elaborated in the Russian Federation, whose purpose is to identify those draft document which, when actually adopted, can create obstacles to a smooth running of businesses. By Decree of the RF Government of 15 May 2010, No 336 a new component was incorporated in the procedure for drafting legislative acts of the Russian Federation – the regulatory impact assessment (RIA). Under that procedure the drafts of federal laws, presidential edicts and government decrees are to be analyzed in order to identify those provisions that may: a) impose excessive administrative restrictions on subjects of entrepreneurial activity; b) cause unnecessary expenses for entrepreneurs or for the budgets of all levels within the RF budgetary system. One most important component of the regulatory impact assessment procedure are public consultations with representatives of biggest organizations expressing the business community's interests. However, most regretfully, the RIA mechanism has turned out to be too cumbersome for state-owned business structures, and so they only rarely apply it in actual practice. Besides, no sanctions are envisaged for failures to comply with that Decree of the RF Government.

By way of example, we are going to describe here the situation that arose in connection with the introduction of special tariffs for compulsory insurance of civil responsibility of owners of dangerous objects. This type of insurance was introduced by Federal Law of 27 July 2010, No 225-FZ. The Law established the size of an insurance sum (in some cases – up to Rb 6.5bn) and the prerogative of the RF Government to establish the insurance tariffs. By Decree of the RF Government of 1 October 2011, No 808 the tariff rates were established in the range from 0.3 to 4.9%. Thus, the tariff rate for a coal mine (or a shale mine, a hydraulic mine) amounts to 4.94% of the sum of insurance; the tariff rate for a coal section (or a slate section or a rock dump or a bricketting area) – 0.85%; the tariff rate for a mud sump – 3.1%, the tariff rate for quarry (non-ferrous metal concentrator) – 0.84%; the tariff rate for mining pits (mining capital construction areas, crushing and sorting areas) – 0.94%, etc. The industrialist community expressed their disapproval of the fact that the tariff rates were introduced without resorting to the RIA procedure, and so, according to representatives of the Russian Union of Industrialists and Entrepreneurs, Business Russia, the All-Russian Non-Governmental Organization of Small and Medium-Sized Business (OPORA RUSSIA), and the RF Chamber of Commerce and Industry, turned out to be unreasonably high. The RF Ministry of Economic Development (after the RF Government's Decree of 15 May 2010, No 336 had already been signed) was forced to issue a special letter with the request that the tariffs should be altered. The insurers, naturally, were opposed to this. The president of the National Union of Responsibility Insurers (NURI) spoke in support of those state structures that had submitted the decree's draft to the RF Government. He noted that the coordinating meeting that had been held in August at the RF Ministry of Finance made a comprehensive revision of the tariffs, including the RIA issue¹. The insurers' struggle for the tariff rates, given the actual size of the insurance sum established by the law (i.e., monopoly income) looks especially dramatic in view of the general insufficient capitalization of insurance companies (in the amount of Rb 32bn), the planned reduction in the

¹ The issue was debated on the website of The Kommersant newspaper on 24 and 26 October 2011 (see T. Grishina, Pronyshlennost' ne sdaetsia strakhovke [Industry does not give in to insurance], Kapital'nyi Ukhod [Capital evasion]).

overall number of insurance companies in 2012 from 588 to 488 (on condition that the minimum capital of a universal insurer is increased to Rb 120m coupled with lack of transparency in capital placement ('inflated capital', as Head of the Federal Financial Markets Service D. Pankin has aptly described it).

We believe that it will be feasible to organize insurance for big objects in accordance with the scheme practiced by Lloyds, when many small insurance brokers create optional insurance pools. On the one hand, that scheme can introduce an element of market competition when insuring some especially big and dangerous objects, prevent monopoly pricing of insurance services, and minimize insurers' individual risks associated with the simultaneous participation in an insurance scheme of several big objects, while on the other hand, it can become a convenient form of financial investment for those small-sized insurers and individuals who might be willing to assume certain risks in regard to insurance of dangerous objects.

This example can serve as a graphical illustration of the fact that interference of the State with the pricing process results in an economically unjustified involvement of sectoral markets in the sphere of monopoly regulation. Monopoly price, in our opinion, is a form of 'pseudo-tax' regulation, because it enforces an artificial redistribution of revenues between market participants. In fact, monopoly pricing can be applied only in those cases when access to some specific resources is restricted, but in Russia the switchover of a competitive market into the sphere of monopoly regulation is neither considered to be a violation of the interests of businesses nor is qualified as a forceful confiscation of incomes – on condition that the RF Government is allowed to introduce, by a special 'sectoral' law, a certain kind of payment and to establish its parameters. When the State begins to set prices for some typical market services, the only winners will be those businesses that have managed in due time to influence the size of monopoly price ahead of their competitors. Thus, monopoly pricing not only has a destructive effect on a competitive market – it disrupts the very foundation of state authority by transforming market competition into competing for the ability to influence the decisions of state agencies.

That is, with regard to this particular case we only want to say that there was absolutely no need for the introduction of a monopoly pricing regime, and so this (overestimated) price currently serves the purpose of providing insurers with financial support because of their insufficient capitalization on the market.

3. Another vivid example of applying an administrative mechanism to a market is the set of special powers granted to the Government Commission for Economic Development and Integration. By the RF Government's Decree of 6 October 2011, No 819 it is established, in particular, that the Commission is also empowered to make decisions on the issue of granting exclusive tariffs for railway transport services to consigners from the member countries of the Customs Union (CU) in instances, when they cannot be supported in any other form. Also, the Decree extends the competence of the Commission to legal regulation in the sphere of natural monopolies, including the placement of commodity markets in the sphere of natural monopolies; and gives it the right to effectuate withdrawals from the national regime granted to actual and potential suppliers of goods (or work or services) in the sphere of government purchases in the territories of the member countries of the Customs Union, etc.

Thus, as has been seen, the market principles initially applied in the creation of the Customs Union are gradually being supplemented by some "administrative command" levers. The Commission is allowed to withdraw commodity markets from the sphere of state monopolies, to establish government-regulated prices for the services rendered by some sectors and thus, in effect, to ignore some aspects of existing legislation (the Decree applied the term "national regime", but it is not a legal term). When applied to taxation issues, this means that the procedure for recognizing the prices established by the Commission to be legitimate for the purposes of taxation needs to be further specified. Thus, it is not clear if such prices are going to be established by orders, ordinances or by some other documents issued by the Commission itself, or if the Commission is going to work in conjunction with the Federal Tax Service.

4. Among the decisions made during that period (late September – October 2011) that had evidently been influenced by some administrative and/or political motives we may also point out

the establishment, by the Russian Federation for the Republic of Belarus, of a privileged export duty for crude oil and petroleum products, when the Republic of Belarus is granted the right to introduce its own surcharge on the tariff (Agreement of 9 December 2010 on the procedure for the payment and transfer of export duties is ratified by Federal Law of 19 October 2011, No 281-FZ).

All the examples referred to here show that the foundation of the economic policy of any state is its attitude to market competition. To be more precise, it is the question of whether one or other state considers it possible to interfere with the market's natural development or not. Taxes enable the State to gather financial resources in the territory under its jurisdiction and then – at the expense (and within the limits) of those pooled resources – to reshape effective demand or to provide competitive businesses with some additional means. If the money is invested efficiently, the market's rate of development will be ahead of that of the world market, if not – resources will be spent or hoarded, but the base market will not deviate from the general development trends on the world market. If, however, instead of budget or credit-funded investments we observe pseudo-monopoly prices or tax exemptions, the consequences for businesses are different in principle. If demand is reshaped, a new sales market emerges, or expansion of competitive commodities on other markets is promoted, but in the presence of pseudo-monopoly prices or tax exemptions noncompetitive industries are “conserved” and artificially sustained on the market. So we consider the technical issues of removing distortions in the distribution of tax load on market participants to be a priority in the sphere of taxation. If deformations of tax loads are ignored by relevant bodies of executive authority, or if lawmakers torpedo measures aimed at correcting these deformations, such issues must become the focus of broad public discussions.

5. It seems that at present the RF Ministry of Finance and the Federal Tax Service are often faced with a rather complicated situation. The measures designed to even out the tax load that these two government agencies are putting forth are by no means always supported at the level of legislative authorities. As a result, for technical reasons, a distorted tax load becomes consolidated in legislation for a long time. There is no mechanism for obligating the lawmakers to quickly bring tax legislation in conformity with the principles consolidated in it.

In actual practice this may result in substantial losses for the state budget. In our February overview we already pointed out that the situation in regard to VAT had become uncertain due to the introduction of legislation on clearing and its extension to transactions with commodities. Since then one more innovation has been introduced: adjustment invoices. We view the problems that may arise as a result of this decision as follows.

Adjustment invoices were introduced by Federal Law of 19 July 2011, No 245-FZ. In Letter of 28 September 2011, No ED-4-3/15927@ issued by the RF Ministry of Finance and the Federal Tax Service the mechanism for applying these invoices is explained. Strictly speaking, this was not an entirely new phenomenon, because previously the RF Tax Code had contained certain norms regulating to some or other degree the settlement of VAT payments in instances when goods were returned by buyers to sellers. However, the new scheme, being based on adjustment invoices, makes it possible to nearly freely change the prices of products delivered. From 1 January 2012 onwards adjustment invoices will be applied alongside the norms stipulated in legislation on clearing. Clearing setoffs against operations with commodities coupled with the convenient and easy-to-use adjustment invoices may result, in actual practice, in shrinkage of the VAT base because this will mean a return to the classical barter-based scheme of ‘ring settlements’ between several producers, which will now be protected by a specially designed system of legislative norms regulating in detail the mechanism of mutual settlements (that can be otherwise characterized as collapsing the VAT base). Thus, now clearing is allowed, that is, mutual settlements under several contracts; the results of such mutual settlements may be formalized by some additional agreements and adjustment invoices issued under such agreements.

However, so far no mechanism of reinstating the sums in incoming VAT in instances when goods are sold at lowered prices has been created. The situation can be explained as follows. When an ordinary consumer buys some commodity, he pays VAT as part of its price, and if the commodity is not subsequently utilized in production, the sum of VAT is neither reinstated nor refunded, so VAT is transferred to the budget. But if a producer has manufactured a commodity at a loss,

the incoming VAT is not reinstated as part of production costs with regard to the commodity sold at a loss in the part relating to the sum of loss, so the State in effect refunds the sum of the incoming VAT in full, although production of commodities at a loss represents a clear waste of assets – a situation when, in an ordinary setting, the producer is entitled to no VAT refund. In accordance with the RF Tax Code's principles (justice and neutrality), one may reasonably expect the lawmakers to ensure an even distribution of the tax load between taxpayer incomes in similar situations irrespective of their form of ownership or sphere of activity. Thus, in this particular case it would be only fair to reinstate the incoming VAT that has been set off or refunded to the producer if the commodity in question for some or other reason cannot be sold, or to reinstate the incoming VAT in the part that corresponds to the losses incurred as a result of the commodity's realization. This does not happen in actual practice, however.

The RF Ministry of Finance has repeatedly pointed out that in situations when commodities cannot be sold the deducted sum of VAT must be reinstated. In the Ministry's opinion, this follows from the norms stipulated in Articles 39 and 146 of the RF Tax Code, whereby withdrawal of goods for reasons unrelated to their sale or gratis transfer (for example, due to the expiry of their shelf life, or stock shortage revealed during an inventory) is not subject to levying VAT (see Letter of the RF Ministry of Finance of 4 July 2011, No 03-03-06/1/387). This standpoint of the RF Ministry of Finance, however, is supported neither by the judicial nor the legislative system. In the RF Supreme Arbitration Court's Resolution of 19 May 2011, No 3943/11 it is stated, in particular, that the responsibility of a taxpayer to reinstate the sum of VAT that has previously been earmarked for a setoff should be directly stipulated in the law. The instances when the sums of VAT accepted for deduction in regard of goods (or work, or services), including fixed assets and intangible assets, property rights, must be reinstated are enumerated in Item 3 of Article 170 of the RF Tax Code. Since no writing-off of goods with expired shelf life (or period of realization) is mentioned among those instances, the RF Supreme Arbitration Court declined the request that the sums of VAT previously accepted for a setoff should be reinstated. The attempts of the RF Ministry of Finance to introduce some alterations in the RF Tax Code's text designed to fill that gap have not been supported by the lawmakers¹.

The same difficulties will probably be encountered in connection with the issue of reinstating an incoming sum of VAT set off against goods that have been subject to a clearing deal confirmed by supplementary agreements concerning the changing (lowering) of the contractual prices and by adjustment invoices. The glitch here is that the scope of such clearing deals involving goods may turn out to be quite substantial.

6. A number of other documents adopted during the same period are, on the contrary, designed to eliminate individual approaches when allocating budget revenue and thus can be regarded as a manifestation of the gradual implementation in the practical management of RF finances of methods compatible with a market economy. These are, in particular, the mechanism of allocating dotations between budgets of RF subject, which takes into account the efficiency of the use, by a given region, of its own resources coupled with the previously received budget financing in order to increase its own tax potential. The newly suggested mechanism can be viewed as an attempt to a single automatically functioning mechanism for managing a region's budget expenditure and the tax flows induced by these expenditures. The rules for distributing dotations in 2011 between the budgets of RF subjects earmarked for supporting measures designed to ensure properly balanced budgets of those RF subjects that have achieved the best results in increasing regional tax potentials are approved by Decree of the Government of the Russian Federation of 27 September 2011, No 798.

7. The work aimed at identifying and eliminating technical discrepancies between national legislations of the member countries of the Customs Union (CU) and the rules established by the CU's documents has been continued. This work goes on in many directions. The terminological base

¹ This fact is mentioned, for example, by O. Firsova in her commentary on the aforesaid letter of the RF Ministry of Finance that was published in the journal *Prakticheskii bukhalterskii uchet. Oftsial'nye materialy i kommentarii* [Practical Accounting. Official Materials and Comments], 2011, No 9, based on a comparison of the draft law submitted to the RF State Duma and the official text of the approved Federal Law of 19 July 2011, No 245-FZ.

is being checked and made more precise. Thus, as part of the information issued by the Federal Customs Service of the Russian Federation concerning the movement of means of transport by physical persons between the member countries of the Customs Union, it is explained what exactly should be understood as ‘foreign means of transport’ and “means of transport” of the Customs Union’, because different customs tariffs and tax regimes are established for these two categories.

Means of transport of the Customs Union may move across the customs territory of the CU without payment of customs duties, taxes, without security, irrelevantly of the fact as to who imports a given vehicle in the Russian Federation.

Foreign means of transport registered in the Republic of Belarus or the Republic of Kazakhstan may be temporarily brought into the territory of the Russian Federation without payment of customs duties, taxes and without security against the payment of customs duties and taxes only by individuals who are permanent residents of the Republic of Belarus or the Republic of Kazakhstan. The conveyance of such vehicles into the territory of the Russian Federation and their use therein by other persons, as well as their alienation, transfer for another person’s use, and disposal of in RF territory is allowed only on condition that the customs declarations for those vehicles are submitted to the RF customs agencies and all the customs duties and taxes are paid.

8. Among the documents designed to regulate the functioning of the Customs Union, Russia adopted Federal Law of 19 October 2011, No 274-FZ, which ratified the Agreement of 19 November 2010 concerning the introduction of special protective, anti-dumping and compensatory measures during the transition period (in particular, the Agreement envisages a scheme whereby it is allowed to impose customs duties along the borders with third countries based on their shares of national producers of similar commodities).

9. By Federal Law of 19 October 2011, No 282-FZ, the Agreement on the Functioning of the Customs Union within the Framework of a Multilateral Trade System is ratified (the Agreement determines the procedure for harmonizing the rates of customs duties in the event of one of the CU member countries’ accession to the WTO).

Over the period under consideration (from late September through October 2011), the RF Ministry of Finance and the Federal Tax Service prepared some explanations designed to assist taxpayers and tax agencies in applying tax legislation.

In our previous overviews it was noted that the tax administration system in the Russian Federation often malfunctions, as demonstrated by the cases when the materials on tax violations submitted to the judicial system by tax agencies are qualified as poorly substantiated. In order to avoid the costs involved in the rejection of claims of tax agencies to the violators, the RF Ministry of Finance and the Federal Tax Service explained, in their letter of 23 September 2011, No ED-4-3/15678@, that explanatory letters of the Federal Tax Service, either coordinated with the RF Ministry of Finance or putting forth a legal standpoint similar to that expressed in the letters of the RF Ministry of Finance, will be published on the Federal Tax Service’s website, in the section Explanations by the Federal Tax Service Mandatory for Tax Agencies, by way of implementing Item 1 of Article 34.2 of the RF Tax Code concerning explanations, in the form of letters, of issues relating to the application of legislation of the Russian Federation on taxes and levies to tax agencies, taxpayers, payers of duties and tax agents. ●

THE REVIEW OF ECONOMIC LEGISLATION

I.Tolmacheva

In October, the following amendments were introduced in the legislation: the amount of the loan extended at interest to the individual-borrower for use which is not related to business activities may be repaid in advance in full or partially provided that the lender is notified at least 30 days prior to the day of repayment; the new federal auditing standards become effective.

I. Federal Laws of the Russian Federation

1. ON AMENDMENT OF ARTICLE 809 AND ARTICLE 810 OF PART II OF THE CIVIL CODE OF THE RUSSIAN FEDERATION (Federal Law No. 284-FZ of October 19, 2011)

Under the new amendments, the individual-borrower is granted the right to repay in advance an interest-bearing loan extended for personal, household and other use which is not related to entrepreneurial activities without the lender's consent provided that the lender has been notified at least 30 days in advance. Also, a shorter period of notification of the lender of the borrower's intention to repay the loan in advance may be specified in the agreement. In other cases, the principal amount extended at interest may be repaid in advance only provided that there is the lender's consent to it. In case of early repayment of the loan, the lender has the right to receive from the borrower under the loan agreement the interest which is accrued up to the day of repayment of the entire amount of the loan or a portion thereof.

The new provisions of the above law are extended to the legal relations arising from loan agreements and credit contracts which were concluded prior to the day the above law came into effect.

II. Instructions, Letters and Orders

1. Order No 99n of August 16, 2011 of the Ministry of Finance of the Russian Federation ON APPROVAL OF FEDERAL AUDITING STANDARDS AND INTRODUCTION OF AMENDMENTS TO THE FEDERAL AUDITING STANDARD (FAS 5/2010) "RESPONSIBILITIES OF THE AUDITOR AS REGARDS EXAMINATION OF UNSCRUPULOUS ACTIVITIES IN THE COURSE OF THE AUDIT" APPROVED BY ORDER NO. 90N OF AUGUST 17, 2010 OF THE MINISTRY OF FINANCE OF THE RUSSIAN FEDERATION

Registered under No. 21986 at the Ministry of Justice of the Russian Federation on October 6, 2011.

The following two new federal auditing standards have been developed:

– (FAS 8/2011) The Specifics of the Audit of Reporting Prepared in Accordance with Special Rules. The above standard sets requirements to the procedure for auditing of reporting prepared, for instance, in accordance with the rules of tax accounting, reporting that shows income and expenditure with use of a cash method (for submission to creditors), reporting which includes financial information prepared in accordance with the rules set by the authorized authority and etc.;

– (FAS 9/2011) The Specifics of the Audit of an Individual Portion of Reporting. The above standard is applied in auditing of an individual report which is a part of reporting, an individual item of the report, an individual account or a component thereof which is shown in the report (for instance, payment of dividends, accounts receivable and other).

Furthermore, (FAS 7/2011) The Audit Evidence will replace FAS No.5 having the same name. The new standard sets requirements to selection and fulfillment of procedures for receipt of information on which conclusions are made as regards adequacy of the accounting (financial) reporting which is under review. It is established that audit evidence should be obtained by way of fulfillment of risk evaluation procedures and further auditing procedures which are made up of tests of auditing facilities and audit procedures in principle. ●

CHANGES IN THE NORMATIVE BASE OF THE BUDGETARY PROCESS

M.Goldin

In September – October 2011, the following changes were introduced in the normative base of the budgetary process: special minimum limits for the government guarantees granted by the Russian Federation in regard to investment projects oriented to energy saving and improving energy cost-effectiveness were established; a letter was issued by the RF Federal Anti-monopoly Service (FAS) whereby the provisions stipulated in Law No 94-FZ concerning the setting of the initial (maximum) price of a contract were made more precise; and certain alterations were introduced in the RF Budget Code and some legislative acts of the RF.

By Decree of the RF Government of 29 August 2011, No 719 ‘On Introducing Changes in the Rules for Granting, in the Year 2011, the Government Guarantees of the Russian Federation Against Credits or Bonded Loans Attracted by Juridical Persons Selected in the Procedure Established by the Government of the Russian Federation for Implementing Investment Projects’, special minimum limits are set for the government guarantees to be granted by the Russian Federation in regard to investment project in the sphere of energy saving and improving energy cost-effectiveness.

As a rule, the sum of guarantees denominated in the RF currency must be no less than Rb 1bn. However, from now on a government guarantee can be granted to a principal in regard of one investment project in a sum of no less than the following amounts:

- a) Rb 250m – for projects oriented to energy saving and improving energy cost-effectiveness in the housing and utilities sphere;
- b) Rb 500m – for projects oriented to energy saving and improving energy cost-effectiveness in industry.

By Letter of the RF Federal Antimonopoly Service (FAS), of 13 July 2011, No ATs/27041 “On Explaining the Norms of Federal Law of 21 July 2005, No 94-FZ ‘On Placing Orders for Supplies of Goods, Performance of Work, Rendering Services for State and Municipal Needs’ in the Part Concerning the Substantiation of the Initial (Maximum) Price of a Contract”, the provisions stipulated in Article 19.1 of Law No 94-FZ are defined more precisely. In Item 1 of Article 19.1 of the Law it is specified that when the initial (maximum) price of a contract (or the price of a lot) is established, the sources of information about the prices of the goods, work, and /or services that constitute the subject of an order may be the following data: information on producer prices; publicly available results of market research; market surveys conducted on the initiative of a buyer or an empowered body. In the said letter, the RF FAS explains that market research and market surveys, as well as information on producer prices should imply analysis of price offers put forth by several companies operating on a functioning competitive market corresponding to the subject of the order to be placed by the Government.

Thus, the RF FAS believes that, so as not to impose any limitations on the number of participants in the placement of a government order when substantiating the initial (maximum) price of a contract, one should consider information on the prices offered by several companies operating on the market for those goods, work, and/or services that will be the subject of that order.

In accordance with Part 2 of Article 19.1 of Law No 94-FZ, the documentation on a tender, the documentation on an auction (including documentation on an open online auction), and the notification on a quotation inquiry should contain substantiation of the initial (maximum) price of a contract (or the price of a lot) incorporating the information or estimates received by the buyer or the empowered body and references to the sources of information on the prices of relevant goods, work and/or services used by the buyer, including references to relevant websites or other references.

In this connection, the RF FAS offers detailed explanations stating that a sufficient condition for complying with the requirements stipulated in Article 19.1 of Law No 94-FZ, irrespective of an

order's subject and the methods of obtaining information for substantiating the initial (maximum) price of a contract, should be a description, in the documentation on an auction or the notification on a quotation inquiry, of the relevant information in the form of tables, diagrams, text, etc. received by the buyer or the empowered body. Thus, no specific regulations apply to the actual form and structure of the presentation of information substantiating the initial (maximum) price of a contract.

Besides, the Letter points out that Law No 94-FZ does not prohibit the publication, as part of the documentation on an auction or the notification on a quotation inquiry, of any other documents than can serve as a substantiation of the initial (maximum) price of a contract.

The following changes were introduced by Federal Law of 6 October 2011, No 270-FZ, "On Introducing Changes in the Budget Code of the Russian Federation and Some Legislative Acts of the Russian Federation".

1. The procedure for distributing the sum of fines imposed for violation of legislation of the Russian Federation on state off-budget fund and different types of compulsory social insurance was altered. Previously, that procedure had been as follows. The established norms for the amounts of fines to be transferred were as follows:

- to the budget of the RF Pension Fund – 83%;
- to the budget of the Federal Compulsory Medical Insurance Fund – 7%;
- to the budget of a territorial compulsory medical insurance fund – 10%.

From 1 January 2012 onwards the sum of fines is to be distributed only between the budgets of the RF Pension Fund (83%) and the Federal Compulsory Medical Insurance Fund (17%).

The total sum of distributed fines, as before, amounts to 100%.

2. The entry in force of the provisions of the RF Budget Code regulating the indices of federal budget deficit related and unrelated to the oil and gas transfer for each financial year is delayed by one year – until 1 January 2015 instead of 1 January 2014.

In the RF Budgetary Code the non-oil and gas deficit in the federal budget is defined as the difference between the amount of federal budget revenue less the sum of oil and gas revenues plus the revenues generated by the management of the Reserve Fund and the National Welfare Fund and the amount of federal budget expenditure in a current financial year. In its turn, the oil and gas transfer is defined as part of federal budget resources earmarked for covering federal budget deficit unrelated to oil and gas revenues and the resources of the Reserve Fund.

3. The provisions of the RF Budget Code regulating the distribution of the monies held in the Reserve Fund and the National Welfare Fund that had previously been suspended until 1 January (1 February) 2014 are now suspended until 1 January (in some instances – until 1 February) 2015. ●

SPECIFIC ISSUES OF CORPORATE PROFIT TAXATION: NEW DEVELOPMENTS IN R&D ACCOUNTING

T.Malinina

Federal Law No. 132-FZ¹ of June 7, 2011 amendments were introduced to the RF Tax Code in regard to the R & D expenditures accounting for tax purposes. The amendments specify the existing rules of tax law, as well as create an opportunity for organizations to reduce the tax base by the amount of expenditures for planned research and development programs prior to their actual implementation. The new legal provisions come into effect from January 1, 2012

Amendments, relating to taxation of R & D implementation were made to the Tax Code in the following areas:

- 1) Harmonization of definition for research and development activities for tax purposes, as well as the procedure of recognition for tax purposes corporate profits with regard to expenses for cost effective and ineffective research and development activities;
- 2) Refinement of the R & D costs recognition for tax purposes, as well as the application of rules that allows to write off R & D expenditures in the amount of actual costs by a factor of 1.5;
- 3) The introduction of the possibility of forming reserves for future expenses on research and development.

Earlier we have drawn attention to the problems that arise in practice due to deficiencies in the legal regulation of accounting for research and development expenditures for the purposes of taxation of corporate profits². New version of Art. 262 of the RF Tax Code covers the gaps of legal framework. Thus, Paragraph 4 of Art. 262 of the Tax Code in the new edition has established that according to a general rule, corporate expenditures on R & D are recognized for tax purposes in the reporting (tax) period, in which the research and / or development (or a phase of such works) I completed, regardless of their outcome. This approach allows to avoid the ambiguity in the interpretation of the tax legislation in cases where the results of research and development began to be used in the organization activity after a certain time upon their completion.

In addition, the current version of Art. 262 of the Tax Code does not specify the structure of expenditures (as broken by objects: salaries of personnel, depreciation of capital and intangible assets, etc.), recognized for tax purposes as the cost of research and development. The new version of this Article of the Code provides for such costs.

First of all, it should be noted that the allocation for expenditures on R & D in the tax legislation is not intended to limit the deduction of the costs when assessing the tax base for corporate profit tax base. Indeed, according to a general rule, the costs of organizations are accepted for tax purposes, if they are economically justified and documented.

However, if the tax law provides benefits to taxpayers, engaged in research and development, the amount of which depends on the amount of the costs (including in the form of the deduction of such expenses with the upgrading factor of 1.5 against actual expenses), the definition of R & D expenditures in the tax law becomes necessary. First, the tax benefit, the amount of which depends on the magnitude of expenditures for research and development, without a clear definition of the list of items in the tax law could lead to abuse, manifested in attributing a part of the general production and general economic (indirect) costs to the costs of research and development. Second, the uncertainty of R & D expenses structure for tax purposes creates risks for compliant taxpayers,

1 "On Amendments to Article 95 of the first part of the Tax Code of the Russian Federation in terms of favorable tax conditions for innovative activity and to Article 5 of the Federal Law "On Amendments to Part II of the Tax Code of the Russian Federation and Certain Legislative Acts of the Russian Federation".

2 See: T. Malinina, V. Gromov. Specific issues relating to taxation of corporate profits: R & D expenditures. // Economic and political situation in Russia in February 2011. IEP Scientific Bulletin. Gaydara.ru.

as in the situation of legal uncertainties, tax authorities may interpret the rule differently than taxpayers¹.

The new version of Art. 262 of the RF Tax Code established the following list of items of expenditure on R & D for the purposes of tax benefits: the coefficient of 1.5 and reserves for future expenditures on research and development.

1. For organizations implementing in-house R & D:

a) Depreciation of fixed assets (except buildings and constructions) and intangible assets used for R & D, accrued for the number of full calendar months, during which those assets were used exclusively for research and development;

b) Amounts of compensation to employees involved in R & D activities over the period of the implementation of these workers research and development (the amount accrued in accordance with tariff rates, official salaries, piece-rates or as a percentage of revenue in accordance with the organization standard forms and systems of remuneration, benefits and / or compensatory nature related to the labor schedule and conditions, the amount of employer contributions to employees payroll referred to in Paragraph 16 of Art. 255 of the Tax Code, as well as the amount of compensation to employees under the civil law contracts, if such employees are not individual entrepreneurs).

At the same time the labor costs of employees engaged for activities not related to the implementation of research and development are included in R & D expenditure in proportion to the time during which those employees engaged in performing research and development;

At the same time, the labor costs of employees engaged for activities not related to the implementation of research and development are included in R & D expenditures in proportion to the time when those employees were engaged in performing research and development;

c) Material costs (purchase of raw and other materials, tools, fixtures, equipment, devices, laboratory equipment, working clothing and other individual and collective protection means, which is non-depreciable property, as well as costs of fuel, water, energy and power of all kinds) are directly related to performing research and development activity;

d) Other costs directly related to the R & D implementation, but not more than 75% of the cost of labor specified in paragraph "b".

Note that the legislator approached in different ways the issues of cost-sharing related and not related to R & D expenditures for various items thereof. Failure to include in the R & D depreciation cost on fixed assets and intangible assets, which are used not only for research and development is inconsistent with the approach taken with respect to labor costs of personnel (such costs are accounted for as R & D expenditures is not only employees who are engaged exclusively in research and development activities). In this case, it appears that it can hardly be explained by considerations of administration: accounting of labor time is not easier to control than the accounting data of depreciable property.

At the same time, this approach preserves the shortcomings existing in the Tax Code. According to the effective regulations (Subparagraph 2, Paragraph 2 of Art. 259.3 of the Tax Code), it is allowed to use upgrading ratio to the regular depreciation of fixed assets used for scientific and technological activities. The interpretation of this provision makes it difficult to administrate and enforce tax laws.

The new rule, formulated with the criterion of exclusive use is also not devoid of this shortcoming. Thus, it is not clear what is meant by the exclusive use of intangible assets for research and development. In particular, whether the issuance of the license to use the results of intellectual activities to another company which carries out production activities, should be treated as the case not meeting this criterion.

2. For organizations that act as the customers for R & D, the cost of the contract for research, development and technological works performance.

¹ Establishment of a list of expenditures for R & D in the Tax Code greatly reduces the uncertainty, but does not eliminate it completely. This is due to the fact that the issue of accurate assessment (including research and development activities) in practice has no uniform solution and, therefore, the taxpayer will always be at risk of a claim on the part of the tax authorities. However, it seems that this problem in this context can not be solved by amending the tax law.

In this case, as in the current edition of Art. 262 of the Tax Code, the organization serving as the executor (contractor or subcontractor) under contract to perform research, development and engineering works, the cost of the work under the contract are not recognized as expenditures on R & D, and accordingly, such expenses are not applicable to be written off the amount of actual costs by a factor of 1.5.

In addition to determining the structure of R & D expenditures, the new wording of Art. 262 of the Tax Code provides the following significant changes in terms of coefficient of 1.5 applicable to the actual costs of research and development.

1) The time of costs writing-off. At present, the amount of actual costs of research and development, taking into account the coefficient of 1.5 is deducted as R & D expenditures in the period of implementation thereof. Thus, compared to the activities not included in the list established by the Russian government, it is not only subsidizing research and development in certain areas through the tax system, but also provides benefits in terms of time for expenses deduction.

In contrast to the current edition of Art. 262 of the RF Tax Code, the new version of the Tax Code Article stipulates that R & D expenditures, to which a factor of 1.5 applies, as well as R & D costs in other areas, should be accounted for tax purposes in the reporting (tax) period in which such research or development activities (individual stages of work) are completed. This not only makes taxation more neutral, but also improves the conditions for tax administration and control over the benefit application.

2) Justification of targeted spending. The new version of Art. 262 of the RF Tax Code established that organizations engaged in research and development activities, to which a factor of 1.5 is applied, shall submit to the tax authority at the place of location a report on completed R&D works (for each scientific research, experimental development, or a completed individual stage of work). This report is provided together with the tax return as per results of the tax period in which the relevant research and development or individual phases of works are completed.

The tax authority may appoint an expert assessment of the report in the manner prescribed by Art. 95 of the RF Tax Code, in order to verify that the completed research and / or development activities are in compliance with the list established by the Government.

Failure to submit the report shall result in termination of the right to apply the factor of 1.5 to the costs of the research and / or development activities (including the separate stages of work) for which no report is submitted.

Among the significant changes in terms of cost accounting for research and development for the purposes of taxation of corporate profits, one should also note the possibility to form reserves for future expenses on research and development. Such an opportunity is provided to taxpayers by the new Art. 267.2 of the Tax Code.

In accordance with this Article, taxpayers of corporate tax may form in the tax accounting reserves for future expenses on research and development activities in the amount not exceeding 3% of proceeds from the sale of each of the reporting (tax) period (limit of the reserve), i.e., in fact, to reduce amount of such expenses when assessing the tax base prior to their actual implementation, resulting in a reduction of tax liabilities of organizations engaged in research and development.

The reserve is formed for a term not exceeding 2 years on the basis of estimates for the implementation of the approved organization research and development programs, which includes only items of expenditures on research and development, approved in accordance with Art. 262 of the RF Tax Code (see above), but not exceeding the established reserve limit.

Expenditures on research and development of relevant programs of the organizations that have established reserves for future expenses on R & D are carried out from (i.e., at the expense of) these reserves. Moreover, if the amount of the reserve was not enough for the implementation of a program approved by the organization for R & D, the balance amount is taken into account for tax purposes as R & D expenditure in the usual manner.

If the amount of the reserve has not been fully utilized during the two years since its inclusion in the reserve, underutilized balance can be restored and included in the organization non-operating income of the reporting (tax) period, when relevant contributions were made to the reserve.

It should be noted that the Tax Code does not provide any penalties for underutilization of the reserve for future expenses on R & D within the prescribed period. However, Art. 267.2 of the

RF Tax Code in the period of the bill consideration¹ did include appropriate sanctions: unused reserves should have been included in the non-operating income of the taxpayer, taking into account increases in the amount of interest estimated for the period of reserve formation, based on the interest rate equal to twice the rate of Central Bank of the Russian Federation effective on the date of the reserve formation.

The lack of appropriate sanctions actually creates opportunities for corporate taxpayers to receive interest-free credit from the state for the amount included in the reserve for up to two years. This is due, among other things, to the fact that on the basis of developed and approved by the taxpayer programs (which are the sole basis for establishing an appropriate reserve) it is practically impossible to assess the validity of the organization intention to carry out research and / or development activities. In a situation where the procedure of creating a reserve by taxpayers is extremely simplified, the absence of such sanctions involves additional risks of the benefit unfair application, which, in particular, casts doubt on its possible effectiveness for innovation encouragement. ●

1 Draft Law No. 448864-5.