



RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES 11'2010

MONTHLY BULLETIN:

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BASIC DEVELOPMENTS AND TRENDS IN NOVEMBER 2010

The socio-political background: the unknowness factor

The political background in November was indicative of the approach of the presidential election. While the results of any election (or voting) in Russia are fairly predictable per se, the 'hybrid' nature of the existing political regime coupled with lack of any institutional models of power transfer produce significant tension in the periods prior to elections. In November 2010, V. Putin reiterated that the decision as to who was going to stand as a candidate in the presidential election (and consequently – who was going to win it) – he himself, or D. Medvedev – would be made by the two of them jointly at some date closer to the time of the voting. This uncertainty will be the core theme of Russia's political life over next year; the current events are viewed by experts and the elites alike in the context of that 'riddle', thus giving rise to mounting conflicts within the apparatus and the elites.

The battering of journalist Oleg Kashin roused huge public response and provoked a new round of media and apparatus struggle. The President Medvedev's empathic and aggressive reaction was supplemented by accusations voiced by the opposition and media and directed against the leaders of pro-Kremlin youth movements who practice various informal and sometimes unlawful methods of exerting pressure on journalists and the opposition. The radical opposition demanded dismissal of deputy head of the RF President's Executive Office V. Surkov. In his turn, Prime Minister Putin made a demonstrative move by arranging a meeting with leader of pro-Kremlin youth Vassily Yakemenko. In the second half of the month D. Medvedev came forth with a political declaration in his video blog where he used some perestroika-style rhetoric, describing the existing political situation as displaying signs of 'stagnation' and effectively speaking in favor of increasing the intensity of competition at elections to the State Duma and local legislatures. However, in the President's Message published at the month's end there was no continuation of the theme of political reform. Instead, D. Medvedev focused on the populist idea of protecting children and encouraging people to have large families.

Macroeconomics and finances: the destabilizing import

The external background in November was determined by the onset of a new round of 'quantitative softening' by means of buying-out of the long-term bonds issued by the US Federal Reserve Service (FRS). Just as we had predicted, the 'price rallying' on the oil market that began in October was further carried on in November. The price for Brent (ICE) was fluctuating throughout the month in the interval between 83.16 and 89.28 USD/barrel; the mean monthly level of 86.3 USD/barrel became a new historic high for the post-crisis period. This time, however, growth of oil prices was accompanied by strengthening of the USD and weakening of the euro (1.39 USD/euro as of 1 November and 1.30 USD/euro as of 30 November); accordingly, the ruble became somewhat cheaper with regard to the USD (30.77 Rb/USD as of 2 November and 31.30 Rb/USD as of 30 November) while increasing in value with regard to the euro. At the same time, from the point of view of mean monthly values, one may predict further gradual weakening of the ruble: the mean value of the bi-currency basket increased in November to 36.07 Rb against 35.62 Rb in October (+ 1.26 %).

Interestingly, this time the Russian stock markets responded to increasing oil prices in a more moderate manner that they habitually had done before. The post-crisis historic highs reached by oil prices were marked by upsurges of stock market indices; however, as seen by the month's results (the values recorded as of 30 November by comparison with those as of 2 November), the indices remained practically at the same level: the MICEX index was 1,565 points as of 30 November against 1,537 points as of 1 November (+ 2 %), while the RTS index did not change at all (1,600 points as of 1 November and 1,597 points as of 30 November).

On the whole, in spite of the growth of oil prices, the macroeconomic situation appears to be somewhat less than stable. On the one hand, growth of oil prices is sustained by the situation on

the money markets and not by any fundamental factors: the demand for oil in Europe is declining, while the Chinese authorities are making some efforts aimed at suppressing its import. On the other hand, the focus of attention in November was – as before – the issue of Russia's balance of payments, which had first come to the fore when in August the positive balance of foreign trade fell below 8 bn USD (over the preceding periods, some similar values of the positive balance were noted in January and April 2009 when the price of oil was between 45 and 47 USD/barrel). The more rapid capital outflow is also ascribed to the worsening balance of payments and the resulting increasing pressure on the ruble. The published information on capital outflow (22 bn USD over 10 months) which was markedly different from the previous forecasts made by the Bank of Russia became the topmost news of November, while out of this total sum no less than 8 bn flowed out in August – September.

In September, the dynamics of imports became stabilized (98.9 % as compared to August and 133.7 % as compared to September 2009 - instead of 153 % in August 2010 against August 2009). However, in October (as shown by customs statistics) imports once again began to grow (105.3 % as compared to the September level). At the same time, the gradual weakening of the ruble in September – November (in November the mean value of the bi-currency basket was 5 % higher than its August level) coupled with increasing oil prices (the mean price of one barrel of Brent amounted to 83.48 USD in October and to 86.30 USD in November against 77.07 USD in August (+ 12 %)) resulted in the stabilization of the indices of trade surplus in October – November at the level of 10 bn USD. However, if the oil prices (as it had already happened before), after a period of growth caused by the situation on the financial markets and unrelated to the effect of any fundamental factors once again decline into the corridor of 70 – 80 USD/barrel, the balance of trade will once again rapidly deteriorate and create favorable conditions for a capital outflow and a threat to the ruble's stability.

As a result of the interventions on the currency market and the capital outflow, as well as of the reevaluation of the exchange rates, the international reserves of the Bank of Russia were on the decline: thus, having reached on 15 October its post-crisis historic high of 503.7 bn USD, by 26 November their index dropped to 484.6 bn (– 3.8 %).

The capital outflow and the Bank of Russia's interventions on the currency market decreased the excessive reserves held by the commercial bank: as seen by the results of October, these amounted to 1,674.6 bn Rb, which is by 12.8 % lower than their September value. The index of one of the components of banks' liquidity (their deposits with the RF Central Bank) reached 223 bn Rb – its historic low since the year's beginning. Nevertheless, the remaining surplus liquidity has been conducive to revival of crediting. As estimated by head of the Bank of Russia S. Ignatiev, the credit portfolio of Russian banks had increased by 9.4 % over 10 months. In October, the average weighted rate on the credits granted to non-financial institutions dropped to its historic low of 8.9 %; at the same time, due to inflation's acceleration the potential for any further decline of credit rates has evidently been exhausted.

As we have predicted, in November the rate of price growth reversed to its September level (weekly 0.2 % instead of 0.1 % in October), and so by the month's results it amounted to 08 % (or to 7.6 % since the year's beginning). Thus, in terms of per annum results the inflation rate is going to be no less than 8.5 %. A new impetus to inflation's acceleration was given by the seasonal increase in the prices of fruits and vegetables. However, this was by no means the only pressure factor. On the world market, growth of food prices was continuing – the phenomenon that, if one considers the role of imports on Russia's domestic market, was certainly reflected by the domestic food prices which increased in November by 1.4 %. On the other hand, there remains a trend towards an accelerated growth of prices for non-food commodities, whose monthly growth rate since November 2009 has been in the interval of 0.2 – 0.4 %, or more specifically in September – October 2010 it amounted to 0.6 %, and in November – to 0.7 %.

The real sector: the 'growth – slowdown' cycle

October became the second month during which growth was recorded after the three-month summer stagnation: industrial production in October rose by 6.6 % on October 2009 and by 4.2 % on September. However, the latter index was significantly influenced by seasonal factors (growth in the extracting industry in September 2010 amounted to 4.6 %, and that of the supply of gas,

electricity and water – to 28 %, while growth in the processing industry by September had been 0.5 %); when cleared of the seasonal factor, growth of industrial production by September, as estimated by Rosstat, had amounted to 1.5 %. The industrial production index (estimated as its ratio to the mean monthly index of 2008) demonstrates acceleration of growth (+ 0.9 % in September; + 1.5 % in October). According to the estimates made by the RF Ministry of Economic Development, growth in October – when cleared of the seasonal and calendar factors - was 1 %, similar to its rate in September. Production growth was contributed to both by the reestablishment of consumer demand (in October, the dynamics of retail turnover once again became positive after having been stagnant for a few months) and by growth of investments and the revived activity in the investments-oriented sectors (the production of machines and equipment rose by 10.2 %).

At the same time, the surveys of the economic situation conducted by Rosstat have demonstrated a slight drop of entrepreneurial confidence in the extracting and processing industries in November; the demand estimates – which had been slowly improving over several previous months – also displayed a weak negative trend. The results of surveys conducted by the Gaidar Institute demonstrate that over the last few months no changes were noted in the demand estimates, and so enterprises are preparing for a continuing stagnation; however, there are still some hopes that both demand and output may once again reach their previous growth levels. According to the data provided by the surveys, over the few past months certain obstacles to economic growth like shortage of turnover funds and low demand have become less prominent, while the influence of some other factors like shortage of personnel and competition with imports, on the contrary, has become stronger. At the same time, the balance of the expected changes in the number of personnel has been on the decline for a seventh month in a row, and in October this index became definitely negative and displayed its worst value for the year 2010. ●

POLITICAL AND ECONOMIC RESULTS IN NOVEMBER 2010

S.Zhavoronkov

In November 2010, President Medvedev addressed the RF Federal Assembly with his third annual message. It turned out to be relatively lacking in substance. Among the decisions touched upon in the Address was the (apparently) final decision that mandatory medical insurance premiums should be considerably raised for all businesses, temporarily excepting the small ones 'working in manufacturing or providing social services'. The President announced the forthcoming massive investments in maternity and child protection projects, and pointed out that monthly subsidies paid to mothers with several children had already been doubled. Contrary to expectations, the President totally omitted any mention the issue of reforming the RF political system which he himself had put to the fore in early November. Besides, in November President Medvedev stated that the pension age would not be increased. A jury acquitted all the accused in the 'Evroset' case' which had drawn a wide political response, and the prosecution indicated that it was going to appeal against the verdict.

November 2010 was the month of failed expectations – at least for analysts in the political sphere. In mid-month, Dmitry Medvedev made a video-blog statement concerning RF political life and posted it on his official website. In particular, he noted that 'for some time now signs of stagnation have begun to appear in our political life and stability has threatened to turn into stagnation'. *'If the opposition has no chance at all of winning a fair political fight it degrades and becomes marginal. If the ruling party never loses a single election, it bronzes over. For these reasons it has become necessary to raise the degree of political competition...'* Medvedev also pointed out that the ruling party should not just serve as an *'adjunct'* to executive authority. *'Whatever its specifics, a political system must be so designed that the views of all, including the very smallest social groups, can be heard and taken into account. Ideally, the voice of every single person should be heard'*, he said in conclusion.

Also, Dmitry Medvedev imposed a veto on amendments to the Law 'On Meetings, Political Rallies, Demonstrations, Processions and Picketing'. The amendments were adopted by the State Duma in October. They slightly tightened the procedure for the conduct of public assemblies. The most notorious of those amendments was designed to bar those persons who have previously been charged with violating the procedure for the conduct of such actions, from staging them (for a duration of one year), that is, from being their formal organizers. Technically, at least in the capitals, that ban would not have played an important role anyway – because the opposition there have always had enough activists to replace any organizers who might be temporarily neutralized by the ban. Much more unpleasant was another aspect of the amendment, which was designed to make it possible to advertise a protest action only from the moment when an agreement on its conduct has actually been reached with the authorities. Medvedev, however, did not specify in his letter the specific drawbacks of the law, but simply mentioned that they *'hamper the constitutional right of the Russian citizens to hold rallies, meetings, demonstrations, processions and picketing'*.

In November, there was a rise in the rumors concerning the reputed confrontation between the curator of Russian politics, First Deputy Head of the President's Executive Office Vladislav Surkov, on the one hand, and Medvedev's press secretary Natalya Timakova and the head of United Russia, Boris Gryzlov, on the other. While the root cause of the first conflict was said to be a clash between the concept of preserving the existing political system and the concept of its liberalization, the root cause of the second conflict was reputed to be contradictions regarding the composition of the ballot list of United Russia. These contradictions were mostly kept under the surface, though – except for the case of political scientist Oleg Matveychev who was expelled from United Russia and sacked from the post of Vologda Vice-Governor. Oleg Matveychev had previously worked under Surkov

and had become famous for his call that protest rallies should be '*suppressed with tanks*'. Gryzlov called him '*demented*'.

In November, journalist Oleg Kashin writing for the Kommersant newspaper and environmental activist Konstantin Fetisov were severely beaten (the latter is still in a coma). Both attacks took place in Moscow. Kasin's case was outrageous enough for the President himself to remark that it was not an '*ordinary crime*' and to vow that it would be investigated and solved. Previously, Kashin had been publicly threatened by one of United Russia's functionaries, Pskov Oblast Governor Andrei Turchak.

In general, November was characterized by the emergence of a situation that some observers took as a portent of political change. Those expectations seemed all the more plausible against the background of an annual Presidential Address being prepared at that time. Judging from Dmitry Medvedev's recent declarations, it was logical to hope for him to put forth, in his Address, some new measures designed to combat the threat of '*stagnation*' he had claimed to detect.

The political part of the Address delivered by the President on the last day of November turned out to be practically devoid of substance. Dmitry Medvedev said that Russia should introduce proportional or mixed electoral system in elections to the legislatures in urban districts and municipal raions with 20 or more deputies. '*Political competition at the bottom level will help build trust in the party system and make parties more accountable to voters...So, the State Duma election next December will take place with a political system that has been renewed at all levels*'. This idea, which has already been materialized, in a rather comical way, in a number of instances when a proportional electoral system is introduced in a tiny village or a small town where no political parties have ever existed, could be called neither reasonable nor pioneering. Let alone the fact that two years ago, public associations were deprived of the right to put forth candidate lists at the municipal level, and for six years already it has been practically impossible to register a political party in Russia. At best, the proposed 'innovation' would mean that a local association would be forced to buy a brand from one of the seven existing parties, while at worst these brands would be bought by officials.

Only two other aspects of the Address can be conditionally characterized as political: Medvedev promised to introduce a legislatively formalized procedure for organizing public discussion of draft laws, and criticized regional authorities for their desire to be '*owners of factories, newspapers and ships*', which sounded as if the right of the federal authorities to be such owners should be seen as acceptable and not disputable.

Thus, it could be stated that all the hopes that Dmitry Medvedev's activities could bring about some political change were dashed once again.

Outside the political context, most of the Address was devoted to the issue of childhood. It should be admitted that, in the main, the 'childhood part' of the President's message was purely declarative. The proposed practical measures were few in number. The President instructed the Government and regional authorities '*to design a program of free allocation of land plots to families, for house or dacha construction, when a third child is born*'. But the crux of the matter is the concrete location of a land plot, for it is clear that some land plots can be totally useless even when allocated free of charge. Dmitry Medvedev also said that '*tax refund must be increased up to 3,000 rubles¹ per month per child starting with the third child*', and that funds received from charity organizations to support children would be fully excluded from taxable income. As such aid is already partially tax exempt, the essence of the proposed changes will become clear only within the context of the corresponding draft laws which are yet to be written.

Dmitry Medvedev suggested that a number of rather interesting alterations should be introduced in the sphere of criminal law. First, he promised to eliminate bottom-line sanctions in a number of criminal offence categories contained in the RF Criminal Code, in order to enable the courts to mete out less severe sentences. As regards commercial bribery and bribe giving, Medvedev, after having lamented that even the threat of being imprisoned cannot stop bribe takers, suggested that '*thus, commercial bribery and giving or taking a bribe may be punished with fines to an amount 100 times the size of the bribe itself*'. While approving the general trend toward liberalization of laws, it is necessary to know exactly how the property of such culprits will be assessed, because

1 I.e., approximately two-fold.

it is well known that, according to the income and asset declarations submitted by many officials, they are extremely poor and have neither an apartment nor car nor cottage, etc. Dmitry Medvedev also promised that a new version of the Law on State Purchases would soon be adopted, but did not specify its major differences from the existing version of the Law.

In his Address, Medvedev announced only one personnel decision: this was the dismissal the police chief of Krasnodar Krai, Sergei Kucheruk, - who had been in charge of the Krai police for nearly a decade, since the inauguration of Governor A. Tkachev. The cause of the dismissal was the crime that had made the headlines on the national media – the murder of 12 people in Kushchevskaya, followed by the arrests of a number of persons suspected of being bosses of the criminal band terrorizing that settlement.

In the economic part of his Address, President Medvedev involved himself in the intensive dispute that was going on in November between a number of prominent economists including some ministers of the RF Government. In particular, Minister of Finance A. Kudrin declared that Russia, by raising the amount of pension insurance contributions from 26 to 34 %, acted *'as a weak state'*. Kudrin linked this decision to the intention to carry out the indexation of pensions by 46 % in the pre-election year, noting in this connection that, while it would be quite correct to increase the amount of pensions, the task itself was fraught with difficulties – *'how can this goal be achieved if the deficit in the pension system persists even after the raising of insurance contributions'*. As the measures that could be implemented instead of higher taxes, Kudrin pointed to pension reform, more efficient collection of property taxes, further increase of the rates of excises on tobacco and alcohol, and abolition of tax exemptions. Before that, in October, Kudrin had spoken directly of the possibility to raise the retirement age for men to 62 years, and for women – to 60 years.

In his interview given in early November to *Rossiiskaia Gazeta* [The Russian Newspaper], Medvedev noted from the very beginning that *'the retirement age in Russia is not going to be raised in the next few years. The decision as to at what age people will retire is not taken by the Minister of Finance – decisions like the raising of the retirement age must be made only on a political and not on the departmental level'*.

In his annual address, Dmitry Medvedev paid tribute to the economic achievements of Russia, such as this year's expected economic growth, a fifty-percent drop in unemployment, and low sovereign debt. *'After the anti-crisis measures, which were unprecedented in scale, we are now moving on to a more balanced budgetary policy. The budget deficit, unfortunately, remains quite high. We will reduce it lest it should become an obstacle to development. All the leading nations have taken up similar obligations'*. He announced a rise in taxes, but added that *'...small businesses working in manufacturing or providing social services will be given a two-year transition period with a lower premium level set at 26 percent'*. However, the true meaning of this rather abstract phrase will become clear only with the course of time.

In November, the RF Government approved the forecast privatization plan for 2011-2013. As it had been expected, the list of objects earmarked for privatization included *Rosneft*, *Rusgidro*, JSC FSK UES, *Sovkomflot*, the Russian Railways, *Sberbank*, *VTB*, *Rosselkhozbank*, and state-owned minority stakes in some companies. With some rare exceptions like *Ob"edinennaia zernovaia kompania* [The United Grain Company], such transactions represent sales of small-size parcels of shares, while the controlling stakes will remain in the hands of the State.

In November, an unexpected development occurred in one of the most scandalous 'economic' trials – the case of the former employees of *Euroset*. The case was initiated in late 2008 in response to an application filed by the company's former employee Andrey Vlaskin, who claimed that in 2003 he was abducted and forced to return the sum of 20 mln Rb that he had stolen from *Euroset*. (In due time, a criminal proceeding had been initiated against Vlaskin himself, but it was terminated after he had paid back his debt). Several managers of the company were arrested, some others were obliged not to leave the place of residence; meanwhile, the company's owners – including the well-known entrepreneur E. Chichvarkin – sold it and went abroad. They believed that the instigators of their persecution had been some of the generals from the Ministry of Internal Affairs, who had been taking revenge on the managers for exposing their role in the theft of a large consignment of telephones from *Euronet*. The telephones were seized under the false pretext of their having been imported unlawfully and then sold. It was a scandalous case - not only because the investigation

was conducted by the same persons who had confiscated the telephones from *Evroset*, but also because it was based on the testimony of only one person, without any material evidence being provided. In fact, it happened so that nearly a dozen people were deprived of freedom (or their freedom was restricted) on the basis of statements made by a single individual five years after the actual event. The case acquired a distinctly political tinge due to the fact that Yevgeny Chichvarkin was a person with a very high media profile, who was not afraid – after he had left this country – to publicize quite a few colorful details of his prosecution.

However, it is still too early to say that this case has had a happy ending – the prosecution announced their intention to appeal against the verdict. Meanwhile, the time is approaching for the announcement of the verdict in an even more notorious trial – the second trial of Mikhail Khodorkovsky. The announcement of the verdict is expected to take place on 15 December. ●

INFLATION AND MONETARY POLICY

N.Luksha

In October the inflation rate amounted to nearly a half of its September level and to 0.5 % by the month's results (against 0 % in October 2009.). However, in early November the rate of price growth once again accelerated to 0.2 % per week, and so the CPI for the first half-month amounted to 0.4 %. Since the year's beginning, the accumulated inflation rate index had passed the officially forecasted lower threshold of annual inflation rate and reached the level of 7.2 %, being still below its last year's value (8.3 %). Over a period of slightly more than a month (since mid-October) the volume of international reserves declined by 2.9 %, thus amounting to 489.3 bn USD as of 19 November. In October, the real effective exchange rate of the Ruble weakened by 2.7 %. In November, the value of the bi-currency basket slightly slid to 36.07 Rb (– 0.2 %) as of 25 November.

October saw a slowdown of the inflation rate to 0.5 % - from 0.8 % in September (see *Fig. 1*). This decline in the growth rate of consumer prices was made possible primarily due to the slowdown of the 'food' inflation rate (by 2.3 times): the prices of foodstuffs increased by 0.7 % (against 1.6 % one month earlier). At the same time, the growth rate displayed by prices for non-food commodities and commercial services rendered to the population remained at the same level as in September (0.6 % and 0 % respectively).

The factor that restricted the growth of food prices in October was the decline of the price of eggs by 0.5 %, whereas one month earlier their price had climbed up by more than one-third. The seasonal drop in the price of citrus fruits and cabbage was reflected by the decline of fruit and vegetable prices by 1.8 %. Besides, in October one could witness a slower growth of the prices of sunflower oil (+ 4.8 %), and that of grains and beans – by 2.7 times (+ 4.3 %). The growth rates displayed by the prices of other types of foodstuffs were also significantly lower than those observed in September: the price of butter increased by 3.5 % (against 4.6 % in September), the prices of milk and dairies – by 2.6 % (against 3.3 %), and that of sugar – by 0.1 % (against 5 %). The leader in terms of price growth in October was husked millet (+ 13.9 %) - it pushed buckwheat to a second place (+ 7.2 %).

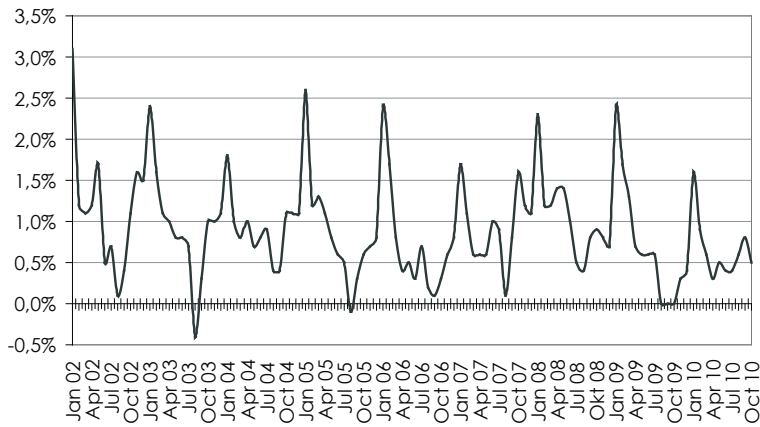
Just as one month earlier, in October the highest growth rates among nonfood commodities were demonstrated by the prices of tobacco products (+ 1.8 %), knitwear and footwear (1.3 % each). No other group of nonfood commodities showed any drop of prices.

While on the whole the prices and tariffs established for commercial services rendered to the population in October remained practically unchanged; the prices in the spheres of foreign tourism, spa treatment and health resorts, and passenger transport services continued to decline. With the onset of cold weather rose the demand for entertainment, thus increasing the prices of tickets to theaters, museums and exhibitions by 0.8 – 2 %. Sports, fitness and medical services also became more expensive (by 0.5 % each).

Similarly to what happened in the two preceding months, in October the main contribution to price growth was once again made by the prices of foodstuffs cleared of the influence of vegetable and fruit products (71.1 %)¹, this increase being the outcome of dry weather, fires and poor crops. At the same time, the contribution of nonfood commodities nearly doubled by comparison with September (46 % against 25 %), which is yet another confirmation of the fact that the 'food' inflation spread into the 'nonfood' segment.

From the beginning of November the weekly inflation rate once again increased to 0.2 %. According to the forecast made by First Deputy Chairman of the RF Central Bank A. Uliukaev, the overall

¹ With the prices of vegetable and fruit products, the contribution of foodstuffs was 54.8 %, that of nonfood commodities was 46 %, and that of commercial services amounted to 0.8 % // *Inflitsia na potrebitel'skom rynke. Oktiabr' 2010 g.* [Inflation on the Consumer Market. October 2010]. The Bank of Russia's Research and Information Department (http://cbr.ru/statistics/inf/Infl_01102010.pdf?pid=macro&sid=inf), 23.11.2010.



Source: Rosstat.

Fig. 1. Growth Rate of CPI in 2002 – 2010 (% per month)

Nevertheless, the level of the CPI in the period between 1 January and mid-November 2010 on the whole remained below its values recorded for the same period of 2009 (8.3 %).

The base consumer price index² in October 2010 was 0.8 % (having been 0.3 % in the same period of the preceding year).

In October the broad monetary base continued to shrink: as seen by the month's results, it reduced by 2.4 % - to 6,956.2 bn Rb. As of 1 November, the cash-in-circulation volume, including the cash balances of credit institutions, was 5.1 trillion Rb (+ 1.4 %), the correspondent accounts of credit institutions with the Bank of Russia amounted to 585.5 bn Rb (- 0.8 %), mandatory reserves – to 186.2 bn Rb (+ 2.,2 %), banks' deposits with the Bank of Russia – to 223 bn Rb (having decreased by 2.3 times), while the value of the Bank of Russia's bonds held by credit institutions was 866,1 bn Rb (+ 6.9 %).

In October the surplus reserves held by commercial banks³ continued to dwindle: as shown by the month's results, they amounted to 1,674.,6 bn Rb, which is by 12.8 % below the September value of this index. One of the components of banking liquidity – banks' deposits with the RF CB – hit their lowest point low since достигла since the year's beginning (223 bn Rb).

The decline of the index of surplus liquidity of the ruble resulted both from capital outflow and the interventions undertaken by the RF Central Bank (for a second month in a row, it conducted net currency sales on the market as a regulatory measure). Evidently, the sterilization of surplus liquidity was done by the RF CB in order to decrease inflation's pressure on the ruble.

Nevertheless, the remaining surplus liquidity definitely conduced to a marked revival of crediting. As estimated by the Bank of Russia's head S. Ignatiev, the credit portfolio of Russian banks over the period of the 10 first months of 2010 increased by 9.4 %⁴. At the same time, according to the Bank's First Deputy Chairman G. Melikyan, the volume of state debt against credits decreased in October by 3 %⁵.

As noted in the main directions for monetary policy in the next three years, the potential for expanding the volume of crediting granted by banks remains high⁶. This is indicated by the level

1 *Inflitsia doela dokhody*. [Inflation Has Eaten Up the Incomes] // Vedomosti [The News], 19 November 2010.

2 The base consumer price index reflects the level of inflation on the consumer market cleared of the seasonal (prices of vegetable and fruit products) and administrative (regulated tariffs for certain types of services, etc.) factors, and is also calculated by the RF Statistics Service.

3 The surplus reserves held by commercial banks at the RF CB are understood as the aggregate balance of their correspondent accounts, deposits with the RF CB and the bonds issued by the RF CB and held by commercial banks.

4 RBK Novosti [RBC News] (<http://www.rbc.ru/fnews.frame/a/all/////////20101123140727.shtml?>), 23 November 2010.

5 RBK Novosti [RBC News] (<http://rbcdaily.ru/2010/11/12/finance/562949979164168>), 12 November 2010.

6 Osnovnye napravlenia edinoi gosudarstvennoi denezhno-kreditnoi politiki na 2011 god i period 2012 i 2013 godov [Main Directions for the Government's General Monetary Policy for the year 2011 and the period of 2012 – 2013] ([http://www.cbr.ru/today/publications_reports/on_2011_\(2012-2013\).pdf](http://www.cbr.ru/today/publications_reports/on_2011_(2012-2013).pdf)), 16 November 2010.

of liquidity in the banking sector, which is determined as the ratio of aggregate bank reserves¹ to the amount of deposits included in money mass M_2 . This index rose rather significantly – from 13 % as of 1 October 2009 to 19.4 % as of 1 October 2010.

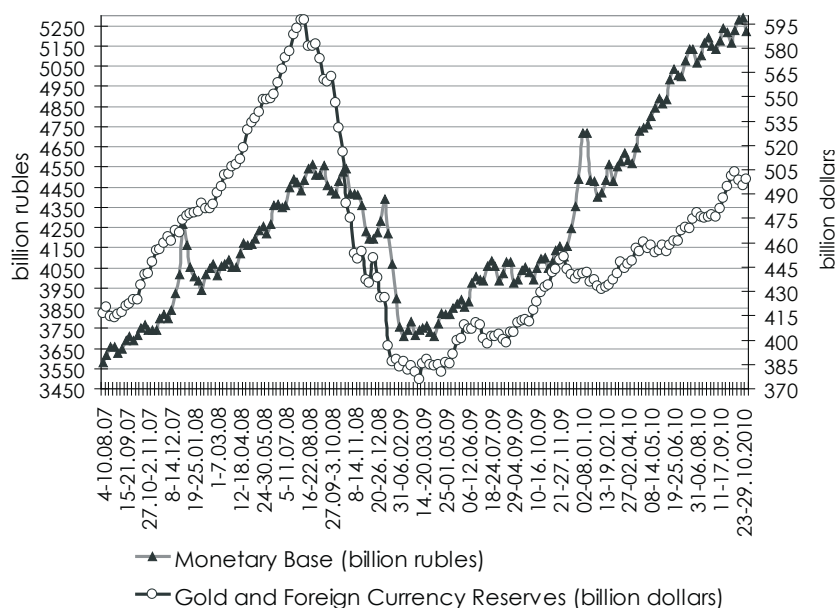
In October, the average weighted interest rate on the credits granted to non-financial organizations reached its historic low of 8.9 % (it should be reminded that its historic high was recorded in January 2009, and since then it has been gradually declining). The necessity to promote crediting to the real sector by means of cutting the interest rates on corporate credits has been continually pointed out by President D. Medvedev and Prime Minister V.

Putin. However, due to the acceleration of the inflation rate in the second half of the year 2010 and the probability of increasing inflation risks towards the year's end, the potential for any further lowering of the interest rates has been almost completely exhausted. Evidently, the rates are not going to decline below the forecasted level of per annum inflation (7 – 8 %).

The growth, in October, of the cash-in-circulation volume by 1.4 % and of that of mandatory reserves - by 2.2 % caused broadening of the narrow monetary base (cash plus mandatory reserves)² by 1.4 % - to 5,281.6 bn Rb (see *Fig. 2*).

On 8 October, the international reserves of the RF CB – for the first time since October 2008 – exceeded the level of 500 bn USD. However, two weeks later their amount began to decline. The shrinkage of reserves occurred both due to the reevaluation of the exchange rate and the Bank of Russia's interventions. In the period between mid-October and 19 November, the volume of reserves dropped by 2.9 % - to 489.3 bn USD. At the same time, the amount of reserves as of 19 November turned out to be 10.3 % higher than one year ago.

On 23 November, at a meeting of the RF State Duma, the Bank of Russia's head S. Ignatiev stated that net capital outflow in the first 10 months of 2010 amounted to 21 bn USD, pointing out that in September – October its rate accelerated and resulted in an outflow of 8 bn USD over the two-month period³. In his opinion, the accelerated outflow was associated with the marked growth of foreign assets held by non-financial organizations⁴. In mid-November the RF Central Bank adjusted its forecast of net capital outflow by the end of the year 2010, increasing this index by 2.5 times - from 8.7 to 22 bn USD.⁵



Source: RF CB.

Fig. 2. Behavior of Narrow Monetary Base and RF Gold and Foreign Currency (International) Reserves in 2007 – 2010

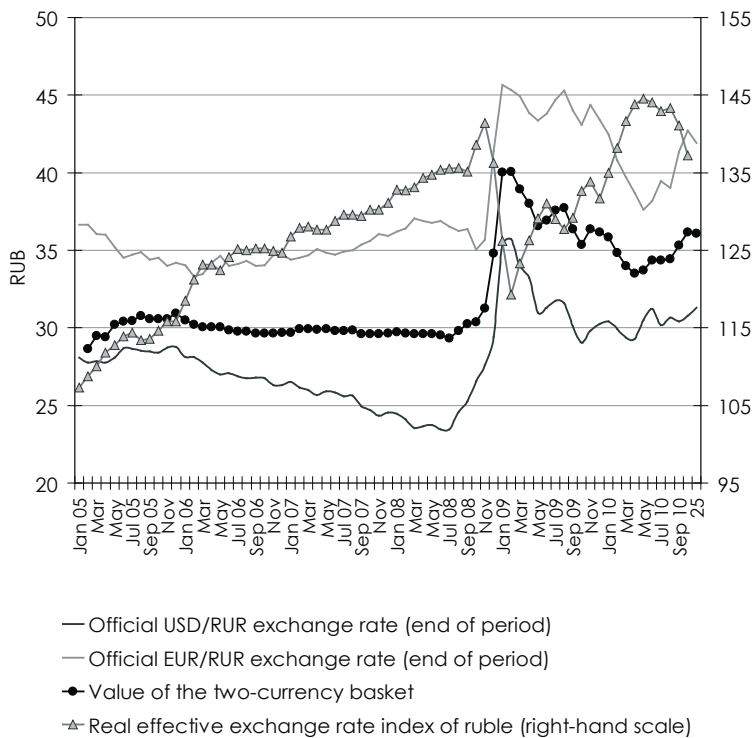
1 The aggregate bank reserves are represented by the cash residuals of credit institutions, the amounts held by them on the mandatory reserve accounts at the Bank of Russia, ruble-denominated correspondent accounts (including the averaged residuals of mandatory reserves) and deposit accounts, and their investments in bonds issued by the Bank of Russia (estimated according to their market value).

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

3 RBK Novosti [RBC News] (<http://www.rbc.ru/fnews.frame/a/all/////////20101123133353.shtml?>), 23 November 2010.

4 RBCdaily (<http://www.rbcdaily.ru/2010/11/23/finance/562949979204626>), 23 November 2010.

5 Osnovnye napravleniya edinoi gosudarstvennoi denezhno-kreditnoi politiki na 2011 god i period 2012 i 2013 godov [Main Directions for the Government's General Monetary Policy for the year 2011 and the period of 2012 – 2013] ([http://www.cbr.ru/today/publications_reports/on_2011\(2012-2013\).pdf](http://www.cbr.ru/today/publications_reports/on_2011(2012-2013).pdf)), 16 November 2010.



Source: RF CB; the author's calculations.

Fig. 3. Changes in the Ruble's Exchange Rate in January 2005 – November 2010²

The increasing currency outflow from Russia was conducive to weakening of the ruble's real effective exchange rate, which by the end of October had dropped by 2.7 %. Respectively, the real effective exchange rate index amounted to 137.26, as demonstrated by the month's results¹ (see Fig. 3).

For four weeks – from 25 October through 25 November – the USD was strengthening against the ruble. On 18 November it climbed up almost the same level as four and a half months ago – 31.35 Rb/ USD. On the whole, in the first 25 days of November the price of USD in Russia increased by 1.7 %.

The decision made on 3 November by the US Federal Reserve System concerning the quantitative softening of the USD (through buying-out long-term US government bonds in the amount of 600 bn USD) had no effect at all on the Rb/USD exchange rate. Just as it happened in the preceding month, internal factors played a decisive role in the exchange rate's dynamics. November

also a continuing decline of the foreign trade balance and an accelerating rate of capital outflow.

Among the external factors that contributed to the strengthening of the USD's exchange rate, one may point to the military conflict between North and South Korea that happened on 23 November. Investors preferred to convert their assets into more reliable instruments – in particular, the USD.

The fluctuations of the euro's exchange rate over November were associated with the debt-related problems faced by the countries belonging to the Euro Zone. Between 1 and 25 November the euro/Rb exchange rate declined by 2.5 %: during the first two weeks of November the euro's exchange rate demonstrated a dramatic drop, and later on, after an attempt to win back the lost position, it dropped once again. The euro's decline in early November was associated with the deepening debt-related crisis in Ireland, which followed the example of Greece and appealed for financial aid to the European Union's member countries and the IMF. After a short period of growth which resulted from the European creditors' decision to provide Ireland with the requested financial support, the euro's exchange rate once again declined in response to the onset of the military conflict on the Korean Peninsula, when investors were compelled to get rid of risky assets. Besides, investors are demonstrating increasing concerns over the debt-related problems in Portugal and Spain.

In November the value of the bi-currency basket shrank by 0.2 %, thus amounting to 36.07 Rb as of 25 November.

On 12 November 2010, the Board of Directors of the RF Central Bank introduced some amendments to the draft of *The Main Directions for the Government's Single Monetary Policy in 2011 and the Period of 2012 – 2013* (which had already been approved by the RF Government in September), and then submitted the new version for the consideration by the RF State Duma.

The newly introduced changes involved an upward adjustment of the forecasted capital outflow index; a more rapid decline of the current balance of payments; and growth of imports. Thus, the forecasted value of capital outflow was increased from 8.7 to 22 bn USD. The forecasted surplus of the current balance of payments in 2011, in accordance with the three forecast scenarios (depending

1 The level of January 2002 is taken as 100.

2 The level of January 2002 is taken as 100.

on the level of oil prices¹), was decreased from 59.1 – 131.7 bn USD to 49.7 – 121 bn USD. At the same time, the estimated positive value of the balance of payments for 2010 remained the same – 144 bn USD. Among the other quantitative targets of the monetary policy (MP), the Bank of Russia set the following indices:

- growth of money aggregate M_2 in 2011 in the range of 11 – 23 %;
- growth of the narrow monetary base in 2011 in the range of – 8 – 19 %,
- net international reserves as of the end of the year 2011 in the amount of 478 – 576 bn USD.

In its Main Directions, the Bank of Russia set as its main goal for the years 2011 – 2013 the necessity to maintain inflation within the limits of 5 – 7 % per annum. Besides, it stated its intention to continue its policy towards a pure free floating exchange rate of the Ruble, while at the same time reserving the right to undertake currency interventions in order to level out any excessive volatility of the ruble's exchange rate. At the same time, the Bank of Russia did not establish any fixed quantitative restrictions on the level of the currency exchange rate.

Among the priority tasks associated with its medium-term monetary policy, the Bank of Russia established the following ones:

- strengthening of the role of its interest rate policy in bringing down the inflation rate and the inflation expectations, which implies narrowing the interest rate corridor set for the Bank's operations;
- gradual curbing of the anti-crisis measures and a switchover to standard instruments;
- further consolidation and capitalization in the banking sector;
- the need to increase the monetary policy's transparency and further improve the forecasting and modeling methods. ●

1 Variant I: oil price of 60 USD per barrel; Variant II: 75 USD per barrel; Variant III: 90 USD per barrel.

FINANCIAL MARKETS¹

N.Burkova, E.Khudko

In November 2010 the dynamics of the Russian financial market was volatile. Positive financial results of a number of major international companies, and positive investors' expectations, growth in the world oil prices, as well as the sustained key refinancing rate have led to an increase in the activity of bidders in the RF futures market. . However, the decrease in the RF foreign currency and gold reserves, volatility of the exchange rate and inflation growth provoked a drop in trading volumes in the market of government securities by 46 per cent. In the corporate bond market once again there was a very positive trend. Market volume demonstrated an increase in the background of significant increase in the number of emissions and emitters. The volume of secondary trading in corporate bonds and their index remained virtually unchanged, although the average yield increased slightly. The main problem remains with the failure of issuers to fulfill their obligations to the bondholders, although there observed the first signs of recovery after the wave of defaults.

Government securities market

In November 2010, volatility of the national currency exchange rate and inflation growth continued to discourage investors' interest in the government securities market at the background of generally rising dynamics in the yields of Russian Eurobonds.

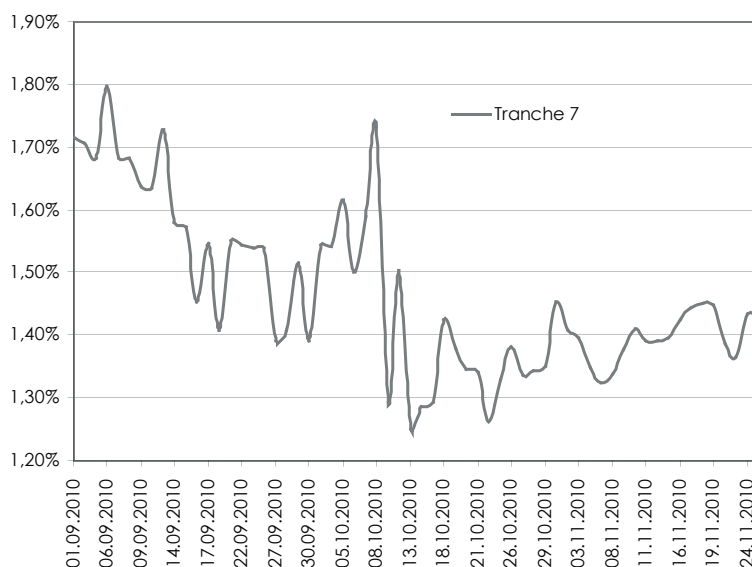
As of November 25 of the current year, the Russian Eurobonds RUS-28 yield to maturity has grown as compared with the level of October 24 from 5.31 to 5.76 per cent per annum (by 8.57 per cent), RUS-18 – from 4.04 to 4.48 per cent per annum (by 10.73 per cent), RUS-30 – from 4.17 to 4.65 per cent per annum (by 11.44 per cent), RUS-20 – from 4.34 to 4.81 per cent (by 10.91 per cent) and RUS-15 from 3.03 to 3.2 per cent (by 7 per cent) (herewith, at the beginning of the month a downgrading trend in the yields of Eurobonds was recorded. In the same period, a similar trend was observed in the yields of external currency debt bonds. Thus, the yield to redemption of the seventh tranche of external currency debt bonds has increased, unlike a month before, from 1.26 to 1.43

per cent per annum (by 13.40 per cent) (see Figs 1- 2) against the background of volatile trends.

Within the period from October 25 to November 25 the total turnover of the secondary market of government bonds amounted to approximately RUR 96/51 billion with an average daily turnover of RUR 4.2 billion (about RUR 162.08 billion with an average daily turnover of RUR 7.72billion in October), which means a significant decrease of an average monthly turnover by 46 per cent.

In the period from October 25 through November 25, there were two auctions for government bonds placement at the primary government bonds market (a month before there were no auctions).

However, in the period under review there were five auctions for government



Source: "Finmarket" Information Agency data.

Fig. 1. Minfin bonds' yields to maturity in September – November 2010

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

bonds on additional government bonds placement in the secondary market (no auctions a month earlier). Thus, on October 27 there was an auction for government bonds series 25075 for the total volume of RUR 30 bn; the actual volume of placement made RUR 4.51 bn with an average weighted yield of 6.95 per cent per annum. On November 17 there was an auction on government bonds placement series 26203; the total placement volume was RUR 30 bn, the actual volume of placement made RUR 11.6 with an average weighted yield of 7.35 per cent per annum. Therefore, the total actual volume of placement of the government bonds series in the secondary market for the period under review made 27 per cent of the estimated volume. In addition, within the period under review there were also six auctions on additional government bonds placement (five auctions a month before), one of which (on November 3, series 26203) was recognized as invalid. On November 3 there was an auction for government bonds series 25073 placement for the total actual volume of RUR 3.21 bn with an average weighted yield of 5.75 per cent per annum. On November 10 there were two auctions for government bonds series 25071 and 25074 for the total volume of RUR 15 bn each; the actual volume of placement made RUR 1.36 and 0.5 bn with an average weighted yield of 6.78 and 4.29 per cent per annum, accordingly. Therefore, the total actual volume of placement of the government bonds series in the secondary market for the period under review made 46 per cent of the estimated volume.

As of November 25, the volume of government bonds market made RUR 1,899.66 bn at face value and RUR 1,911.94 bn at the market value (as compared with RUR 1,849.05 bn and RUR 1,872.5 bn accordingly as of October 24). The duration of the OFZ market portfolio was 1,405.44 days, having decreased by 38.25 days as compared with the preceding month (as of October 24).

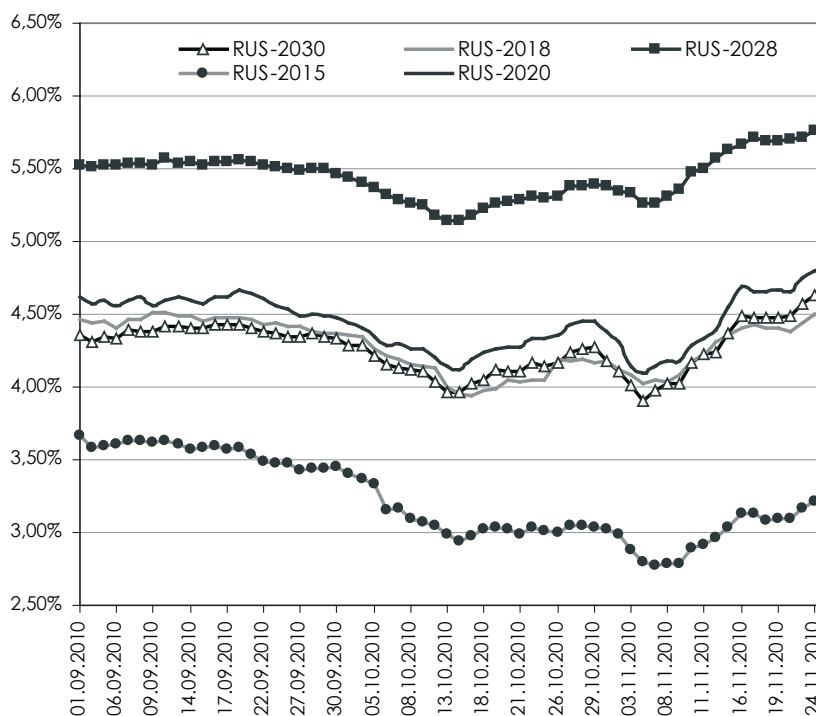
Stock market

Stock market situation

In November 2010, trading volumes in the stock market showed some decline in market turnover as compared with the previous month at the background of positive financial reporting of a number of the largest Russian companies and the RF Central Bank sustained refinancing rate at the level of 7.75 per cent, on the one hand, but decreased foreign currency and gold reserves, as well as reduce international rating outlook Novatek and Gazprom Neft from “stable” to “negative” by Standard & Poor’s agency on the other hand.

The maximum value within the month the MICEX index has reached on November 9, having reached – 1,594.72 points (1,528.11 points in the preceding month). The minimum value for the period the MICEX index has reached on November 16 – 1,526.64 points (against 1,441.58 points in the preceding month) (*Fig. 3*).

In general, within the period from October 25 to November 25, the MICEX index has increased by 3.42 per cent, what makes about 52.01 points in absolute terms (within the year, from November 26, 2009 through November 25, 2010, the MICEX index has been upgraded by 23.83 per cent). Within a month,



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

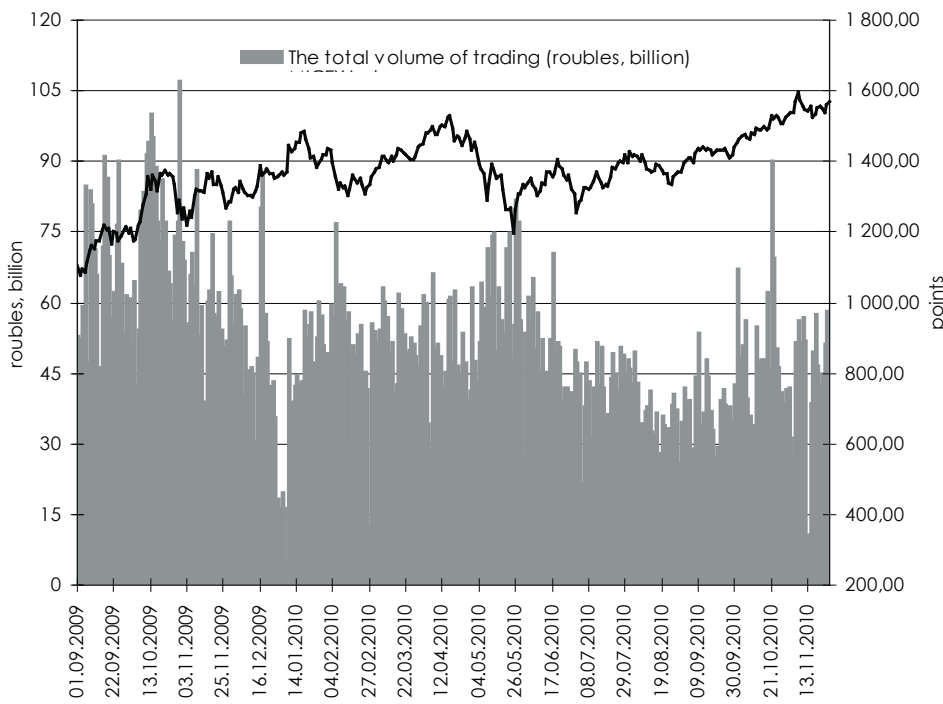


Fig. 3. Dynamics of MICEX Index and trading volume

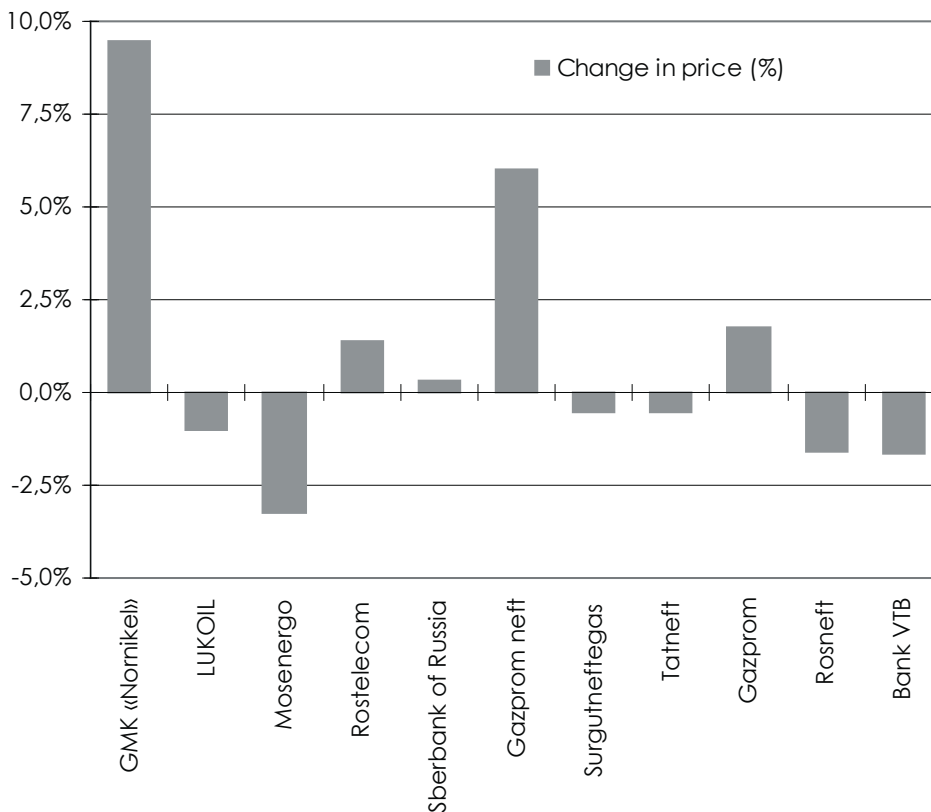


Fig. 4. Dynamics of the Russian Blue Chips from October 25 to November 25, 2010.

the turnover of trades in securities included in the MICEX index made about RUR 1,099.83 bn at an average daily turnover of RUR 47.87 bn (against about RUR 1,061.11 bn with an average daily turnover of RUR 50.53 bn in the preceding period). Therefore, the investors' average daily activity in the stock market in November has decreased as compared with the preceding period by 5.36 per cent. The indicators of maximum and minimum daily turnover in the market trades made, accordingly, RUR 58.01 bn (as of November 24) and RUR 10.55 bn (on November 13).

As of the month results (from October 25 through November 25), the "blue chips" securities have shown a volatile dynamics. The leaders in the growth were GMK Nornickel (what was supported by the growth of the world price for nickel) and Gazprom Neft (which have demonstrated good performance over 9 months of 2010), grown by 9.47 and 6.01 per cent accordingly. They were followed by Gazprom, increased by 1.76 per cent, Rostelecom, increased by 1.4 per cent, Sberbank of Russia (0.29 per cent). A reverse trend was demonstrated by Mosenergo, VTB Bank, Rosneft and LUKOIL, the value of which has downgraded by 3.27, 1.63, 1.59 and 1.02 per

cent, accordingly. Significantly lower rates of growth were demonstrated by Tatneft (by 0.54 per cent) and Surgutneftgas (by 0.52 per cent) (Fig. 4). In November of the current year the MICEX turnover leaders were: Sberbank of Russia (35.97 per cent of the total turnover), Gazprom (16.94 per cent), GMK "Nornickel" (7.91 per cent), VTB Bank (6.12 per cent) and LUKOIL (4.60 per cent).

The total volume of transactions with the shares of those five «blue chips» was about 71.5 per cent (all «blue chips» - 78 per cent) of the total trades in shares at the MICEX stock market over the period from October 25 through November 25.

According to MICEX information, as of November 25, the top five leaders of the domestic stock market in terms of capitalization were: “Gazprom” – RUR 4,080.6 bn (RUR 3,960.34 bn a month earlier), “Rosneft” – RUR 2,264.62 bn (against RUR 2,301.61 bn), “Sberbank of Russia” - RUR 2,202.73 bn (against RUR 2,213.74 bn), “LUKOIL” - RUR 1,470.51 (against RUR 1,488.08 bn) and GMK Norinickel – RUR 1,165.68 (against 1,045.26 1 031.12 bn rubles).

Futures and Options Market

In November the average daily turnover in the MICEX futures market has increased by 36 per cent as compared with the preceding month. Thus, in the period from October 25 through November 25 the total turnover in the MICEX (futures) market made approximately RUR 239.14 (687.05 thousand of transactions) with an average daily turnover of RUR 10.4 bn against about RUR 161.15 (652.15 thousand of transactions) with an average daily turnover of RUR 7.67 bn in October.

The largest volume of trading in November, like a month before, was observed in contracts for futures and equity instruments, amounting to RUR 172.1 billion (670.1 thousand of transactions). Herewith, in terms of the trading volume in this section, the MICEX derivatives market after the settlement of futures contracts for the MICEX index are followed by the futures supply contracts for the shares of Sberbank, Norilsk Nickel, Gazprom, and LUKOIL. We would like to note, that the value of the MICEX index (the price of transactions) for December 2010 was mainly in the range of 1,520–1,580 points, and for March 2011 – at the level of 1,520–1,570 points.

The second place in terms of trading volume within the month of November was taken by foreign currency futures (RUR 63.2 bn). Herewith, contracts for the US dollar were in the first place in terms of trading in the MICEX futures market, followed by futures contracts for Euro/USD rate and for Euro/RUR rate. It is worth noting that prices of futures contracts, concluded in October for RUR/USD futures in the MICEX market were within RUR/USD 30.8–31.4 for December 2010, and RUR/USD 31–31.5 for March 2011. Trading volume in futures for commodity assets within the period under review has made 3.83 per cent. There were no contracts for interest rate in November.

Similar trends were observed in the RTS FORTS futures market, where the investors' average daily activity has increased by 11 per cent as compared with the previous month. Thus, in the period from October 25 through November 25 the total market turnover of futures and options in RTS made about RUR 3,571.07 billion (11.07 million of transactions, 72.73 million of contracts) with the average daily turnover at the level of 155.26 bn as compared with about RUR 2,934.2 billion (10.11 million of transactions, 63.23 million of contracts) with the average daily turnover of RUR 132.72 in October. The greatest demand among the market participants, as before, was demonstrated in futures: trading volume in them during the period under review amounted to RUR 3,357.55 billion (10.8 million of transactions and 69.75 million of contracts). Herewith, in the first place in terms of futures trading volume were the futures contracts for the RTS index, which were followed with a significant margin by the futures contracts for the dollar-ruble rate and for Euro/USD rate and for the shares of Sberbank of Russia and Gazprom shares. It should be noted that prices of the latest transactions, concluded in the RTS FORTS on futures contracts RUR/USD rate for the date of execution on December 15, 2010, were within RUR 30.8–31.3 /USD, and for March 15, 2011 - RUR 30.6–31.6/USD.

The value of futures contract for the RTS index (based on the prices of recent contracts) with the execution date on December 15, 2010 made 1,570–1,640 points and for March 15, 2011 was estimated on average at 1,580–1,630 points. Options enjoyed far less demand, the turnover made about RUR 213.53 bn (274.22 thousand transactions and 2.98 mln of contracts). The maximum daily turnover in the short-term RTS futures market in the period under review made RUR 224.85 billion (as of November 17), and the minimum was RUR 52.91 bn (as of November 13). We would like to note that on November 24 in the FORTS market of futures and options, trades were started for the one-month futures and options contracts for copper (basic asset is Grade Brent copper price).

External factors behind the Russian stock market dynamics

In November 2010 the Russian financial market dynamics, as a month earlier, was largely dependent on the situation in the global financial markets. Among the basic factors of positive global market indicators, affecting the Russian market in November, one should mention:

- growth in the III quarter of 2010, U.S. GDP, according to preliminary estimates, by 2 per cent and UK GDP – by 0,8 per cent;
- upgrading the UK AAA rating outlook from “negative” to “stable” by the international rating agency Standard & Poor’s;
- growth in net profit for the III quarter of 2010 of the U.S. automaker Ford Motor to 1.7 billion dollars, the Swiss bank UBS - up to 1.66 billion Swiss francs, or 1.22 billion Euro (against net loss of 415 million Euro a year earlier), the German chemical company BASF Group - 5 times to 1.25 billion Euro, the German automaker Daimler AG - nearly 30 times to 1.61 billion Euro, BMW - to 11.2-fold to 874 million Euro;
- increase in sales of new homes in the U.S. in September 2010 to 307 thousand, and orders for durable goods in the USA – by 3,3 per cent;
- preservation of key interest rate by the U.S. Federal Reserve in the range of 0-0.25 per cent per annum, by the Bank of Japan - at the level of 0-0.1 per cent;
- Growth of the world oil prices.

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

- accusation of the U.S. bank Morgan Stanley of fraud in securities;
- information about the net loss of German bank Deutsche Bank AG in the III quarter of 2010 amounting to 1.2 billion Euro, U.S., as well as of insurance group American International Group Inc. (AIG) in the amount of 2.4 billion dollars;
- increase in unemployment in the Euro area in September 2010 to 10.1 per cent;
- U.S. Treasury plans to take a loan amounting to 362 billion dollars to cover expenses in view of the global financial crisis.

All those factors have generally resulted in the increased dynamics of the global stock indices in November, as of the month results. Thus, the markets of the developed countries were demonstrating a general increase in the indices by 2-6 per cent over the month, while the stock indices of the developing markets have gone down by 1-15 per cent. The exception was the index of Japan Nikkei-225, which have demonstrated a positive trend, like the basic global stock markets indices of the developing countries, demonstrating a positive trend (See *Table 2* and *Fig. 5*).

All those factors brought together provoked a volatile dynamics of the world’s major stock indices as a result of in November. Thus, there was observed some growth in the developed countries’ markets to 7.1 per cent per month, as well as a decrease by 1-3 per cent. Stock markets indices in developing countries also increased by 1-5 per cent, and decreased by 1-5 per cent for individual countries. Compared to the beginning of January 2010, the majority of stock indices of developed countries, as well as emerging markets have shown a similar volatile trend (See *Table. 1* and *Fig. 5*).

Table 1

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

| Index | Ticker | Value | Dynamics within the month(%)* | Dynamics from the year beginning (%) |
|--|--------------|-----------|-------------------------------|--------------------------------------|
| MICEX (Russia) | MICEXINDEXCF | 1 571.31 | 3.42 | 14.69 |
| RTS (Russia) | RTSI | 1 618.55 | 0.61 | 12.04 |
| Dow Jones Industrial (USA) Average (USA) | DJI | 11 187.28 | 0.49 | 7.28 |
| NASDAQ Composite (USA) | NASD | 2 543.12 | 2.57 | 12.07 |
| S&P 500 (USA) | SPX | 1 198.35 | 1.29 | 7.47 |
| FTSE 100 (UK) | FTSE | 5 698.93 | -0.74 | 5.28 |
| DAX-30 (Germany) | DAX | 6 879.66 | 4.15 | 15.48 |
| CAC-40 (France) | CAC | 3 760.42 | -2.79 | -4.47 |

Table 1, cont'd

| Index | Ticker | Value | Dynamics within the month(%)* | Dynamics from the year beginning (%) |
|--|--------|-----------|-------------------------------|--------------------------------------|
| Swiss Market (Switzerland) | SSMI | 6 502.14 | 0.39 | -0.67 |
| Nikkei-225 (Japan) | NIKKEI | 10 079.76 | 6.93 | -4.43 |
| Overpay (Brazil) | BUSP | 69 361.63 | -0.24 | 1.13 |
| IPC (Mexico) | IPC | 36 969.20 | 5.26 | 15.10 |
| IPSA (Chile) | IPSA | 4 988.63 | 4.07 | 39.29 |
| Straits Times (Singapore) | STI | 3 159.23 | -0.45 | 9.03 |
| Seoul Composite (South Korea) | KS11 | 1 927.68 | 1.60 | 14.55 |
| ISE National-100 (Turkey) | XU100 | 67 148.87 | -5.43 | 27.12 |
| BSE 30 (India) | BSE | 19 318.16 | -4.20 | 10.61 |
| Shanghai Composite (China) | SSEC | 2 898.26 | -2.58 | -11.56 |
| Morgan Stanley Emerging Frontier Markets Index | EFM | 870.63 | -0.50 | 11.22 |

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

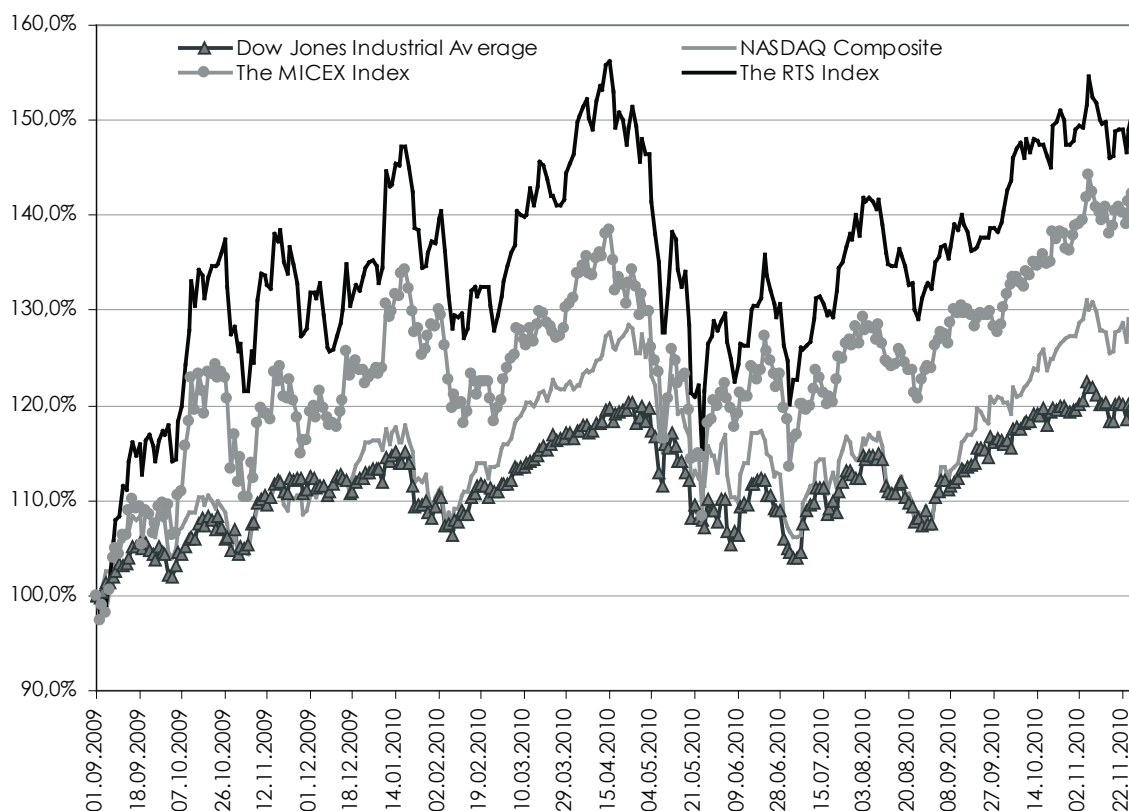


Fig. 5. Dynamics of the main USA and Russian stock indices (in % to the date 01.09.2009)

Corporate news

OAO "VTB Bank"

On October 31, 2010, VTB Bank and Bank for Investment and Development of Vietnam have signed an agreement on establishment an investment fund with the budget of \$ 500 million for the purpose of improvement the investment climate for the Russian business in Vietnam. On November 23 agency Standard & Poor's has confirmed a high level of transparency in the business of VTB Bank and included it in the top ten list as a result of the annual survey of information transparency among the 90 largest Russian public companies.

ОАО «Gazprom»

On November 2, Gazprom and RUSNANO signed a joint memorandum, outlining the key areas of cooperation between the companies in expansion the use of nanotechnology in the gas industry and implementation plan for joint projects. On November 8, 2010 OAO Gazprom has disclosed its consolidated interim condensed financial statements under IFRS for the first six months of 2010: profit attributable to shareholders increased by 67 per cent to 494.68 billion rubles, net debt decreased by 29 per cent to 974,733 million rubles. On November 13, Gazprom and the Bulgarian Energy Holding EAD have signed a Shareholders' Agreement and Articles of Association of the joint project company South Stream Bulgaria AD, incorporated on a parity basis for the project "South Stream" implementation in the territory of the Republic of Bulgaria.

ОАО «Gazprom Neft»

On November 3, Gazprom Neft has disclosed its consolidated financial results under the US GAAP for the first 9 months of 2010: earnings before interest, taxes, depreciation and amortization (EBITDA) rose by 21 per cent to 5,147 million dollars, net profit – by 24 per cent to 2,366 million dollars. On November 15, Gazprom Neft signed an agreement on joining the project to develop four oil blocks located offshore of Cuba, with the Malaysian company Petronas. On November 24 "Gazpromneft-lubricants" and "Sibur Holding" signed a three-year agreement on cooperation in the development, testing and supply of lubricants.

ОАО «LUKOIL»

On November 8 OAO LUKOIL ahead of schedule fully repaid the loan in the amount of 1.2 billion dollars, drawn in August 2009 for 3 years. On November 9 it was announced that LUKOIL took the 5th place among oil companies in Europe, Middle East and Africa, as well as the 10th place among the world's leading oil and gas in the Platts rating "250 largest energy companies in the world in 2010". On November 10, LUKOIL completed emission of Eurobond at the rate of 6.125 per cent for \$ 1 billion with maturity term in 2020. The proceeds from placement will be addressed for general corporate purposes, including repayment of existing debt. On November 16 LUKOIL also has repaid \$ 1 billion of the loan raised in August 2010, in the amount of 1.5 billion dollars.

ОАО «Mosenergo»

On November 10, Mosenergo has filed financial reporting for the nine months of 2010: net profit decreased by 57.0 per cent to 2,204 million rubles.

ОАО NC «Rosneft»

On November 1, Rosneft has disclosed its consolidated financial statements under U.S. GAAP for the first 9 months of 2010: net profit rose by 57 per cent to 7.6 billion dollars; indicator EBITDA – by 45 per cent to 13.8 billion dollars. On November 19 the international rating agency Standard & Poor's has published the results of the survey on transparency of Russian companies in 2010. The first top position in the rating, as a year earlier, with the index of transparency 80 per cent was won by Rosneft. On November 22, Rosneft and China National Petroleum Corporation (CNPC) have signed a memorandum on expanding cooperation in the exploration and development of oil and gas fields.

ОАО «Rostelecom»

On November 10, Rostelecom has submitted its unaudited consolidated results under IFRS for the first 9 months of 2010: net profit decreased by 11 per cent to 4.0 billion rubles. On November 11 an extraordinary general meeting of shareholders of the Company has decided to pay an interim dividend for the first 9 months of 2010 in the amount: 1,67 rubles per preferred share of type A and 1.11 rubles. per ordinary share.

Sberbank of Russia

On November 15, Sberbank of Russia has raised two loans from WestLB AG for the purposes of trade financing in the total amount of \$ 140,525,000 for the term of 5 years. On November 16

Sberbank of Russia has placed Eurobonds worth 400 million Swiss francs with a coupon rate of 3.5 per cent per annum for 4 years. On November 24 Sberbank of Russia and the Export-Import Bank of China have signed a framework agreement on credit lines for the amount of \$ 2 billion dollars. On November 24 Sberbank of Russia has raised credit from ZAO “Bank Intesa” for the purposes of trade financing in the amount of \$ 90 million. In addition, on November 16, Sberbank of Russia has disclosed its financial results under RAS for the first 10 months of 2010: net income increased 7-fold to 126.2 billion rubles, assets grew by 12.1 per cent to 7,965 billion rubles.; Russian enterprises were granted loans amounting to nearly 3.3 trillion rubles.; capital adequacy ratio made 18 per cent.

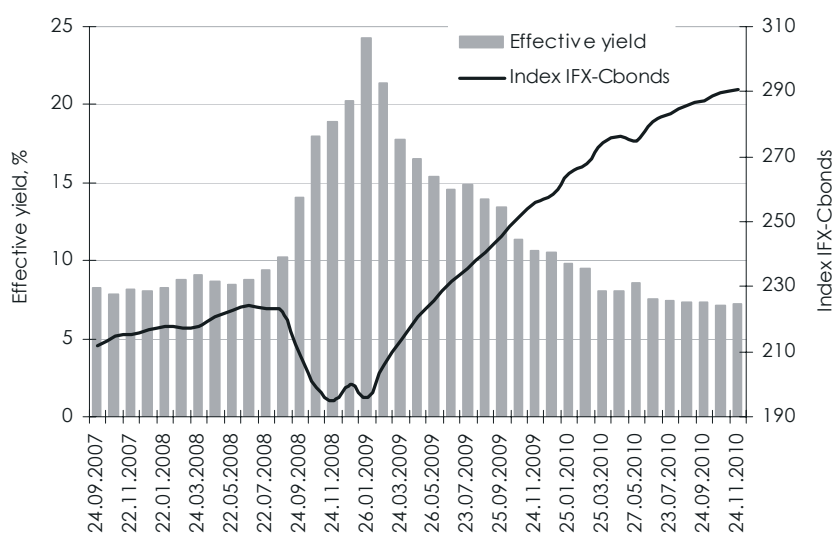
Corporate bonds market

The volume of the Russian domestic corporate bonds market (as per nominal value of shares in circulation, denominated in national currency) in November of the current year continued its growth and at the end of the month made RUR 2,751.8 bn, which exceeds the relevant indicator of preceding month by 3.7 per cent (a similar growth was recorded in October and September by 1 p.p.)¹. The growth of the market is based on the growing number of bond emissions in circulation, denominated in national currency (from 691 to 708), and the number of emitters (from 355 to 363). Such interest in bond loans on the part of issuers and investors is based on the seasonal factor, which is usually observed in the 4th quarter of pre-crisis years. There is still one emission of bonds in circulation, denominated in US dollars and one in Japanese yens.

In November indicators of the secondary market of corporate bonds remained nearly at the same high level as in preceding month. The trading volume in corporate bonds in the MICEX market in the period from October 25 through November 25 amounted to RUR 124.7 billion (for comparison, in the relevant preceding period it was equal to RUR 132.4 billion), and the number of transactions in the period under review made 25 thousand (as compared with 24.8 thousand transactions in October)².

Index of the Russian corporate bonds market IFX-Cbonds demonstrated some upward trend about 1 point. Effective yield unexpectedly showed an increase of 0.18 percentage points (From 7.09 per cent at the end of October to 7.27 per cent at the end of November) (Fig. 6). However, given that in the last six months the weighted average yield varies from about 7.1 per cent to 7.6 per cent, we can speak of the period of its stabilization. A slight increase in the yield is probably due to including with a reduction in duration of corporate bonds market portfolio - within the month it dropped by 29 days to 605 days, which was a continuation of the trend of recent months.

Among the most liquid emissions in the period under review there was noted a growing dynamics in the average effective yield. The yield of the most major financial institutions bonds has increased. The greatest growth in effective yield of their emissions have demonstrated bonds of 05 series of Bank Zenit (1.5 p.p.), although in the previous month, the bank was one of the leaders of falling yield³. There was also recorded a substantial increase in bond yield of real sector companies, in particular: “Mobile TeleSystems” (series 05 and 04 +0.95 and +0.8 p.p. respectively), OANovolipetsk Steel (Series BO-5 0 , +0.82 p.p.),



Source: Rusbonds data

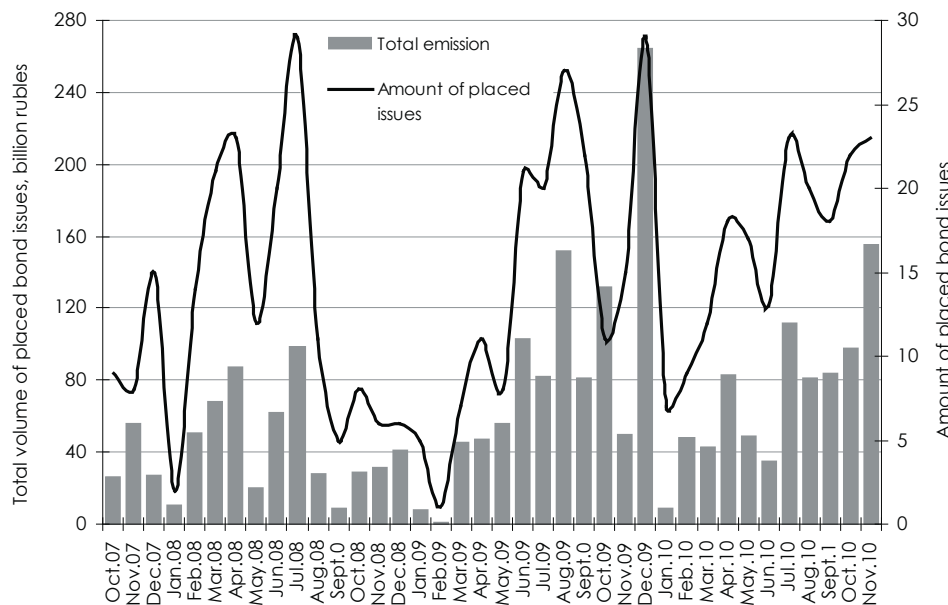
Fig. 6. Russian corporate bonds index and average weighted yield

- 1 As per Rusbonds information
- 2 As per “Finmarket” Information agency.
- 3 Finmarket” information agency data.

OAD Russian Railways (series 16 +0.67 pp). Leaders of falling effective yield of bonds became OAD Lenenergo (-0.98 p.p.), OAD “TMK” (-0.88 p.p.) and OAD Gazprombank (-0.81 p.p.).

In November of this year there were far fewer bond issues as compared with the previous month. However, this fact should not be regarded as a downturn in the bond market activity, since the number of the emitters, planning for the future to raise funds through bond emission has grown. Thus, from October 24 through November 24, thirteen emitters have registered 27 bond issues amounting to 77.7 billion rubles (as compared with 10 emitters who registered 46 bonds issues worth of 332.3 billion rubles from September 25 through October 25). During the reporting period there were a lot of debut bond issues of relatively small volumes. It is noteworthy that among the issuers was the FSUE “Post of Russia”, which uses the bond issue with the volume of 7 billion rubles for the first time to finance its activities. Over a half of the registered emissions were exchange bonds. The majority of registered emissions fell within six series of exchange bonds of OAD “KAMAZ” totaling to 15 billion rubles, 4 series of exchange bonds of CB “Globex” for the amount of 10 billion rubles, 2 series of bonds of ZAO “ING Bank (Eurasia)” for the amount of 10 billion rubles.¹

Indicators of primary bond market significantly exceeded the level of the previous month, having reached a record peak since the beginning of this year. Thus, in the period from October 26 to November 24, twenty three bonds issues were placed totaling to 155 billion rubles. (for comparison, from September 25 to October 25, bonds issues were placed totaling to 98 billion rubles.) (See Fig. 7). During the period under review, the largest bond issues were placed by GC “Bank for Development and Foreign Economic Affairs” (two series of bonds worth 25 billion rubles.), OAD “Mobile TeleSystems” (two series of bonds worth 25 billion rubles.), OAD “Federal Network Company UES” (three series of bonds totaling 20 billion rubles.), which earlier in October, has already placed three series of bonds for the amount of 30 billion rubles. Again long-term bonds of large emitters were in demand of investors - the term of the bonds yield to redemption of “Main Road” is 18 years, of the companies “Federal Network Company UES”, “Bank for Development and Foreign Economic Affairs”, “Evrast Finance “and” Mobile TeleSystems “- 10 years. Herewith, already within several months Russian Federal Financial Markets Service has not revoked any bonds due to the non-placement



Source: Rusbonds data

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

of securities, which indicates the presence of strong demand for bonds of Russian emitters².

In the period from October 26 to November 24, all issuers have redeemed their bond loans on schedule (five bond issues totaling to 16.5 billion rubles). On December 2010, redemption of 21 issues of corporate bonds totaling to 30.6 billion rubles is expected³.

The situation with the performance of current debt liabilities by emitters is still not easy, although the scale of the problem is probably starting to decline. From October 26

1 Source: Rusbonds data.

2 Data of the Russian Federal Financial Markets Service

3 Rusbonds data.

to November 24, the real default on bonds coupon yield redemption was announced by three of the emitters (against nine emitters from September 25 through October 24), one of whom managed to reach agreement with bondholders to restructure the debt. An offer (bonds purchase), like in the previous period under review, was carried out by all emitters in due time. A real default on bonds redemption at the nominal value of their bonds, planned in late October – early November, was announced by two emitters (one emitter in the preceding period), one of which has also has restructured the debt¹. ●

1 Cbonds data

REAL ECONOMY SECTOR: TRENDS AND FACTORS

O.Izryadnova

In January-October 2010 it was the expansion of internal market at the expense of simultaneous growth of both consumer and investment demand that exhibited positive influence on the economic situation. Investments in fixed assets went up by 4.7%, retail trade turnover – by 4.4% versus January-October 2009.

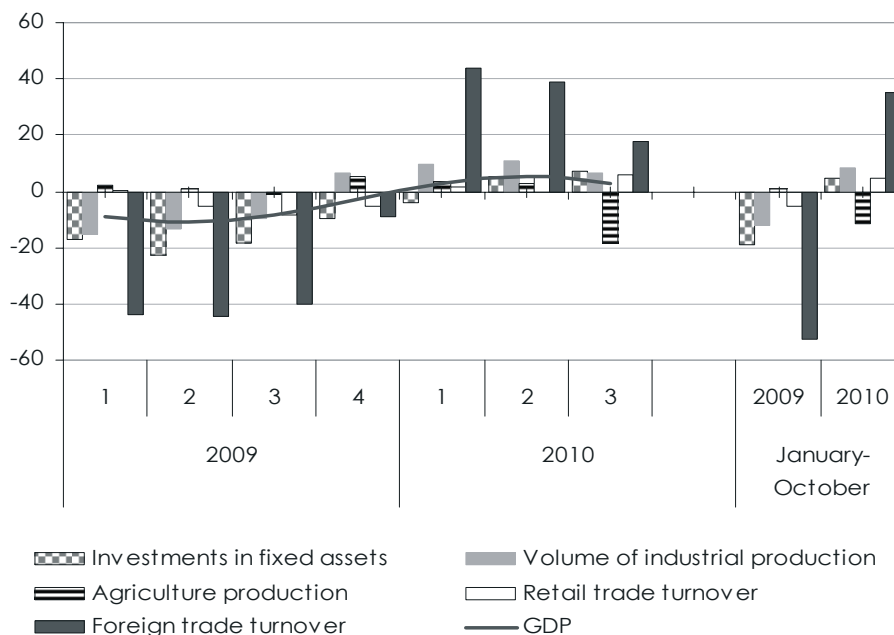
The difficulty of situation in agriculture production, anticipating growth of foodstuffs import versus domestic production as well as higher rates of growth of prices for foodstuffs as compared with prices for non-food goods and services have a profound effect on the dynamics and structure of population consumption. Against the higher inflation expectations the growth of prices according to the forecast of the RF Ministry of Economic Development will grow up to 8% by the end of 2010 versus the expected 6-7%.

According to the preliminary estimation of the RF Federal State Statistics Service the GDP growth in January-September 2010 made 103.6% versus the corresponding period of the previous year. In the 3rd quarter 2009 GDP growth rates slowed down to 2.7% against 5.2% in the 2nd quarter and 3.1% in the 1st quarter. The slowdown of the GDP dynamics in the 3rd quarter 2010 is connected with structural features of economic growth. Whereas in the 1st half of 2009 the recovery of positive dynamics of investments in fixed assets and the increase in the retail trade turnover contributed into acceleration of GDP growth rates, in the 3rd quarter the influence of these factors was insufficient to compensate the slowdown of industrial production growth rates and the drop of agriculture production volumes.

Economic situation in January-October 2010 was defined by the trends of business activity and solvent demand. This year the positive dynamics is observed in nearly all types of economic activity. In September-October 2010 it was the growth of investments in fixed assets against the background

of consumer demand recovery that had the positive influence on the dynamics of industrial production and infrastructure sectors. Over January-October 2010 while the volume of investments in fixed assets went up by 4.7% as compared with the corresponding period of the previous year index of industrial production made 108.6%, retail trade turnover index – 104.4%, freight transportation turnover – 108.1%. As a result of extreme natural and climate conditions of this summer agriculture production index made 88.4% versus the figure of January-October 2009.

In January-October 2010 minerals extraction made 103.9%, manufacturing



Source: Federal State Statistics Service

Fig. 1. Changes in Dynamics of Macroeconomic Indices by Quarters in 2009-2010, as percentage versus the corresponding period of the previous year

industries went up by 112.3%, electricity, gas and water production and distribution – by 105.0% versus the corresponding period of 2009.

In January-October 2010 index of fossil fuels extraction made 103.8% versus the corresponding period of 2009, production of the main types of primary fuel and energy resources went up by 7.0%. The volume of oil production in January-October 2010 made 419.8 million of tons (102.3% versus the corresponding period of the previous year), of natural gas production – 526 billion cu m (113.5%), coal production – 259.0 million of tons (107.3%).

In January-September 2010 the total volume of drilling in oil production went up as compared with the level of the corresponding period of the previous year by 15.3%, development drilling increasing by 14.1% and exploration drilling – by 51.5%.

In January-October 2010 oil export is estimated to be at the level of 208.3 million of tons (101.1% versus the corresponding period of 2009), which is mainly accounted for by the growth of processed oil export.

The volume of crude oil processing at Russian petroleum refineries went up by 5.6% (206.5 million of tons) and its share in production volume expanded by 1.6 percentage points as compared with January-October 2009 and made 49.2%. Index of oil products production made 104.7% in January-October 2010 versus the corresponding period of 2009. The extent of crude oil processing in January-October 2010 made 71.5% versus 72.2% over the corresponding period of 2009. Comparatively low extent of oil processing is accounted for by the insufficient use of schemes for deeper furnace fuel processing. The proportion of furnace and diesel fuel is still high in the structure of output, their supply exceeding offer of the internal market. As a result these products are exported as fuel and primary products for further processing. According to the data of the Federal State Statistics Service over January-September 2010 there were 96.8 million of tons of oil products exported (105.4% versus the corresponding period of 2009).

Throughout 2010 the internal consumption of gas in power industry, metallurgy and chemistry industry was observed to increase gradually. Gas consumption in Russia, according to preliminary data, made 360.6 billion cu m in January-October 2010 (107.9% versus the corresponding period of 2009), which was mainly due to the demand from boiler and thermal plants.

In January-October 2010 gas export made 140.9 billion of cu m (112.1% versus the corresponding period of 2009). The proportion of export in the total volume of gas production in January-October 2010 reduced by 0.3 percentage points and made 26.8%. Within Sakhalin-2 project, according to the data of the RF Federal Customs Service, more than 8million tons of liquefied gas was exported in January-September 2010.

In January-October 2010 259.0 million of tons (107.3% versus January-October 2009) of coal was produced, 27.6 million of tons being produced in October (107.5% versus September of the current year). The growth of coal production in January-October 2010 was accounted for by the increase in the demand at both the internal and external markets. 159.4 million of tons of the Russian coal was supplied to the internal market over the period (109.3% versus January-October of 2009), 78.5 million of tons of which were supplied to power plants (112.1%), 31.6 million of tons (103.6%) – for coking purposes, 18.4 million of tons (101.8%) – for the needs of population, municipal needs and agriculture production complex.

In January-October 2010 electricity, gas and water production and distribution index made 105.0% versus the corresponding period of the previous year. In this period, according to the data Unified Energy System of Russia, new facilities of 1538.77 megawatt were put into operation, while the facilities of 698.66 megawatt were decommissioned.

Over January-October 2010 840.7 billion of kilowatt-hours of electric power was produced (105.3% versus January-October 2009). The proportion of electric power production by thermal power stations expanded from 64.8% in January-October 2009 to 66.6% in January-October 2010, while the production by nuclear and hydroelectric power plants reduced correspondingly from 16.5% to 16.4% and from 18.7% to 17.0%. The decrease in electric energy production at hydroelectric power plants is connected not only with the accident at Sayano-Shushenskaya hydroelectric power plant but also with unfavorable hydrological conditions at a number of rivers in European part of the country. Thus, in January-October 2010 electric energy production at Volga-Kama series of hydroelectric power plants lowered by 12.5% versus the corresponding period of 2009, at Angara-Yenisei series of power plants – by 4.5% versus the corresponding period of the previous year.

Production of goods of intermediate demands is characterized by high growth rates versus January-October 2009. In January-September 2010 chemistry industry index made 115.7%, rubber and plastic goods production index – 121.5%, timber processing index – 111.8%.

As compared with January-October 2009 in January-October 2010 metallurgy production and finished metal goods index made 113.2%, metallurgy production index being 113.8% and finished metal goods production index – 112.8%.

The physical volume of rolled metal export made 22.7 million of tons in January-September 2010 (106.6% versus the corresponding period of the previous year), flats export making 7.6 million of tons (100.7%), profiled section export (excluding semi-manufactured materials) – 2.8 million of tons (86.9%) and semi-manufactured materials – 12.1 million of tons (116.4%). Rolled metal was predominantly exported to non-CIS countries.

In the period under consideration import of finished rolled ferrous metal increased by 54.7% in physical terms and made 3.76 million of tons as compared with 4.3 million of tons in pre-crisis period of 2008. The capacity of internal market of rolled metals made 127.3% in January-September 2010 versus the corresponding period of the previous year, and the volume of finished rolled metal – 112.7%. The proportion of the Russian metal in the internal consumption made 86.3% or 22.8 million tons in January-September.

In January-October 2010 production of steel pipes grew by 37.3% versus the corresponding period of 2009. The proportion of import pipes at the internal market made 14.7% against 10.8% in 2009 and 17.0% in 2008. Export of steel pipes in January-September 2010 was 39.7% lower than supplies in January-September 2009, which is accounted for the increase of 72.3% in the demand for pipes at the internal market.

The commissioning of tube mill at Chelyabinsk tube-rolling mill of pipes of large diameter used for construction of main pipelines (capacity of 600 thousand tons a year) had a positive influence on the internal market of steel tubes.

Index of non-ferrous metals production in January-October 2010 made 107.1% versus the corresponding period of the previous year. At the same time the growth of production was observed for the majority of basic metals as well for rolled non-ferrous metals, which is mainly used at the internal market.

The positive dynamics of investments recovering in January-October 2010 the production of investment goods is growing at the rates anticipating the aggregated figure of the dynamics of manufacturing industries. Index of machinery and equipment production made 112.7% versus January-October 2009, index of electric, electronic and optic equipment production – 123.8%, of transport vehicles and equipment production – 131.8%.

In January-October 2010 production of passenger cars went up by 95.7% versus the corresponding period of the previous year, production of trucks – by 66.8%, buses – by 35.8% and commercial vans – by 65.6%.

The analysis of the passenger cars production dynamics demonstrates that in January-September 2010 the highest growth rates are characteristic for companies that take part in utilization program. The volumes of open joint-stock company AvtoVAZ increased by 1.9 times over January-September 2010 as compared with the corresponding period of the previous year, and the production of “LADA classic” model that is oriented to utilization program went up by 2.9 times. The dynamic growth of production is also characteristic by open joint-stock company UAZ (Uljanovsk, by 1.7 times versus January-September 2009) and GAZ Ltd. (Nizhny Novgorod, by 3.4 times).

Comparison of the data on the volume of domestic cars production and import demonstrate that the change in the production structure due to anticipating production of cars of foreign models produced in Russia acted as a factor that supported the position of automobile industry at the internal market.

In the segment of passenger cars and trucks the production of cars of foreign models assembled in Russia went up at the rates that exceeded the rates of domestic models production. The trend for the contraction of the volume of new passenger cars import as compared with the growth of new cars import in other segments of the market versus the production of domestic models and foreign models assembled in Russia was a characteristic trend of January-September 2010.

In January-September 2010 the acceleration of sales at the Russian cars market was observed in all sectors of the market. The growth rates of the trucks market went up to 81.7%, of the buses

market – to 50.2%. The sales of passenger cars continued to grow. Whereas in first six months of 2010 as compared with the first half of 2009 the expansion of the market made 1.1%, as a result of three quarters of 2010 it reached 17.1%.

According to the data of ASM-holding, the total volume of passenger cars sales at Russian market made 1257.3 thousand in January-September 2010. The comparison of passenger cars market structure basing on the place of automobile origin over January-September 2009-2010 allows finding the following changes that took place during the year, First of all, it is a considerable increase in sales of cars of domestic models and especially the cars of foreign models assembled in Russia (to which utilization program conditions can apply). The total proportion of cars assembled in Russia (of domestic and foreign models) made 65.1% of the market as compared with 48.0% in January-September 2009. Sales of new imported cars reduced by 20.8% to 432.7 thousand, their share at the market contracting from 50.9% to 34.4%. Import of used cars by corporate importers ceased to have any considerable effect on the market. The used import cars accounted only for 0.5% of the market versus 1.1% a year ago.

The recovery of the market of trucks that started in March 2010 proceeded successfully in the following months. Over nine months of the year 138.39 thousand of trucks were sold, which corresponds to 81.7% growth a year. Despite such a remarkable rate of market recovery the sector of trucks still experiences a noticeable drop in sales (60.4%) versus January-September 2008, when nearly 349.6 thousand of trucks were sold. The sales of domestically produced trucks increased from 49.06 thousand to 83.60 thousand of cars but their share at the market has reduced by 4 percentage points to 60.4% in connection with the anticipating growth of sales in the segments of new imported cars and cars of foreign models assembled in Russia. The sales of foreign model cars assembled in Russia went up considerably both in absolute terms (from 3.9 thousand to 9.4 thousand) and in proportion of the market (from 5.1% to 6.8% of the market). Sales of new imported trucks increased by 2.5 times up to 37.16 thousand, their share at the market expanding from 18.8% to 26.9%.

A noticeable improvement of situation is observed at the market of buses. This sector of Russian automobile market which was the first to be hit by the economic crisis, has been coming out of the recession at high rates starting with February 2010. The sales of domestic bus plants went up by 42.4% to 24.6 thousand of buses, although their share at the market reduced from 76.9% to 72.9%. The limited possibilities for satisfaction of the growing demand at the expense of internally produced buses and provided a stimulus for import supplies growth. Whereas a year ago the volumes of import were completely covered by new buses export, as a result of January-September 2010 foreign trade balance for buses was upset, import prevailing over export.

Comparative analysis of the production dynamics and the internal market of cars in 2009-2010 demonstrates that the adoption of anti-crisis measures in automobile industry has stimulated domestic production and supported the internal market.

Table 1

STRUCTURE OF CARS MARKET IN JANUARY-SEPTEMBER 2009 AND 2010

| | Internal market, thousand of units | | Proportion at the market, % | | Proportion in the segment of the market, % | | Growth rates, % |
|---|---------------------------------------|--------|--------------------------------|------|--|------|--------------------|
| | 2009 | 2010 | 2009 | 2010 | 2009 | 2010 | |
| Cars, total | 1172.2 | 1429.4 | 100 | 100 | | | 121.9 |
| Passenger cars, including: | 1073.5 | 1257.3 | 91.6 | 88.0 | 100.0 | 100 | 117.1 |
| produced domestically | 514.9 | 818.4 | 43.9 | 57.3 | 48.0 | 65.1 | 158.9 |
| – Russian models | 299.2 | 399 | 25.5 | 27.9 | 27.9 | 31.7 | 133.4 |
| – foreign models assembled in Russia | 215.7 | 419.4 | 18.4 | 29.3 | 20.1 | 33.4 | 194.4 |
| New import cars | 546.5 | 432.7 | 46.6 | 30.3 | 50.9 | 34.4 | 79.2 |
| Used import cars | 12.1 | 6.2 | 1.0 | 0.4 | 1.1 | 0.5 | 51.2 |

Source: ASM-holding

The dynamics of passenger cars market was considerably influenced by the rates of population incomes changes. The trend for the recovery of consumer expenses serves as one of the main factors for internal demand in 2010. Retail trade turnover increased by 4% in January-October 2010 as compared with the corresponding period of the previous year and was sustained by the growth of real incomes of the population by 4.2%, and of real wages – by 2.5%. The sales of foodstuffs increased at anticipating growth rates in the structure of goods turnover. Over January-October 2010 as compared with the corresponding period of the previous year the turnover of foodstuffs market increased by 5.5%, of non-food market – by 3.4%.

The fulfillment of RF Government measures aimed at stimulation of internal demand has a positive effect both on particular types of production and goods markets and on the economic situation in general. The measures of tension alleviation at the labor market resulted in the decrease in the total number of the unemployed by 10% and the number of officially registered unemployed – by 6.9% versus January-October 2009. In October 2010 the level of total unemployment made 6.8% of the economically active population, the figure fo January-October 2010 being 7.7%, which is in line with the forecast estimation of the situation at the labor market at the end of the year. ●

RUSSIAN INDUSTRY IN OCTOBER 2010

S.Tsukhlo

No considerable changes were observed in the dynamics of the majority industry indicators in October. According to Gaidar Institute for Economic Policy¹ surveys data this makes enterprises to prepare for continuation of stagnation but does not deprive of the hope for demand and output growth recovery. At the same time a discrepancy between the output plans and the level of their further fulfillment is observed. The stocks are continuing to diminish.

September: Official Statistical Data

According to official data, in September the output growth in industry made 6.2% versus September 2009 and 0.7% versus August 2010 upon exclusion of seasonality (in August the output went up by 0.3% versus July). The RF Ministry of Economic Development estimated that in September versus August the growth was equal to 1%. Such “record-breaking” values of output growth in September versus August were unexpected by the majority of analysts that still doubt the steady growth of the Russian industry.

Demand for Industrial Goods

In October there were no considerable changes in demand dynamics observed. The index balance remained within the range of -3...+3 points. Thus, the sales growth rates have been in zero neighborhood for the ninth month in a row - stagnation of demand is still continuing (*fig. 1*). These circumstances makes enterprises' attitude to the current sales volumes less critical. The satisfaction with the demand for the last three months in the Russian industry makes on average 58%, which is a record-breaking figure for the crisis period. The highest estimations (and consequently the highest level of adaptation to the current phase of the crisis) are registered in the sector of ferrous metallurgy (average satisfaction with the demand in August-October is 81%), chemistry industry and timber industry (both 71%) and foodstuffs production (69%).

In October the forecasts for the demand remained at the level of September, which is the best for the last nine months. The industry still has some hopes for the demand growth but forthcoming New Year holidays will most probably decrease the optimism in forecasts. It is ferrous metallurgy, light industry and foodstuffs production that have most optimistic expectation.

Stocks of Finished Goods

Stocks of finished goods in Russian industry continue to decrease. In October the proportion of responses “below the norm” expanded to 22% and reached the maximum figure since May 2001 (*fig. 2*). Then, at the beginning of 2001, Russian industry has become certain in the steadiness of post-default and, which is more important, non-barter demand growth and transferred to the

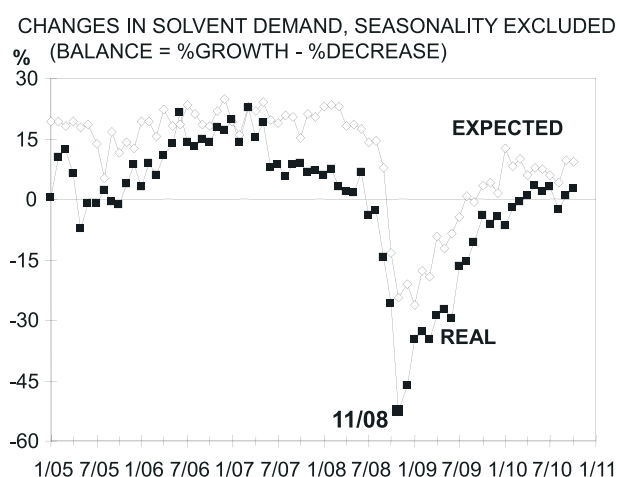


Fig. 1

¹ The surveys among the directors of the industrial enterprises have been conducted by Gaidar Institute for Economic Policy monthly starting with September 1992 in concordance with the European harmonized methodology and embrace the whole territory of the Russian Federation. The panel is about 1100 enterprises at which more than 15% of all those employed in the industry work. The panel is shifted towards large enterprises for each of the singled sectors of industry. The return of questionnaires makes 65–70%.

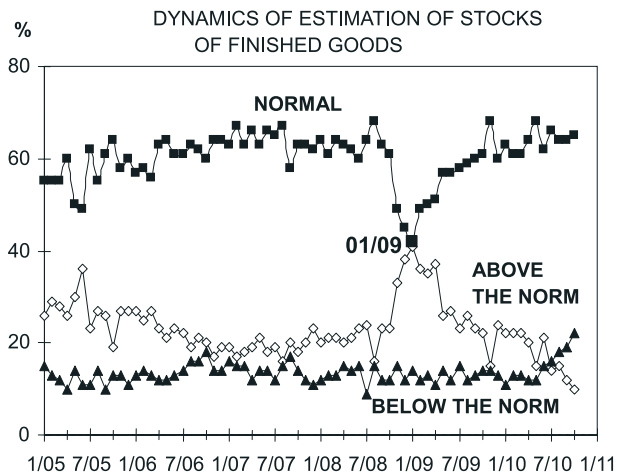


Fig. 2

them) diminished to -12 points in October and reached the figure of ten-year minimum. Negative balances were observed in all the sectors of industry, which testifies that the enterprises are uncertain concerning the beginning of the industrial growth. Earlier balances were positive in some sectors.

Output of Goods

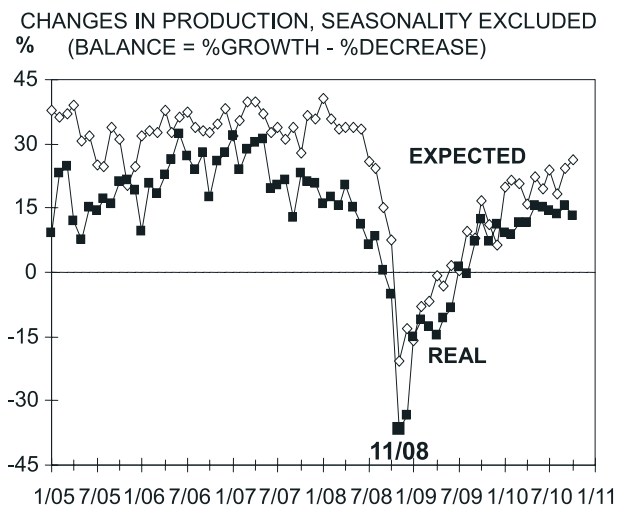


Fig. 3

Obstacles to Production Growth

Low demand is still the main obstacle for the production growth, although the frequency of its citation has reduced significantly both as compared with the crisis maximum of January 2009 (69%) and with the 3rd 2010 (55%). Only 43% of enterprises at the moment hold that the demand prevents production growth. The lack of liquid funds as a factor limiting Russian industry production growth reached its historical minimum in the 3rd quarter 2010 when the following factors seem to have coincided: faint hope for production growth, reasonable provision with own resources and the growth of banking credits availability. In the 4th quarter the frequency of this factor citation has increased by 5 points.

The factor of staff shortage was subject to the biggest fluctuations during the current crisis. Before the crisis (in the 3rd quarter 2008) half of the Russian industry suffered from the shortage of staff. Then, in the 2nd and the 3rd quarters 2009 the frequency of this obstacle citation lowered to 14%, and by the 4th quarter 2010 it went up to 32%. Thus, the enterprises experience a considerable staff deficit even now. The superposition of the lack of staff with the employment dynamics (the

policy of stocks minimization to the maintenance of the stocks excess. In contrast in the second half of 2010 the certainty in pre-crisis growth started to decrease. Because of this, more and more enterprises minimize their stocks of finished goods versus the level that is normal for the current season. At the time however this occurs due to the decrease of the proportion of enterprises with excessive stocks and the proportion of normal estimation of stocks has stabilized at a good pre-crisis level. The continuation of stagnation can result in the growth of proportion of enterprises with low stocks at the expense of the proportion of enterprises with normal estimations.

As a result of the growth of estimation “below the norm” and the decrease of the estimations “above the norm” the balance (i.e. the difference between

In October production output dynamics according to estimation of enterprises has not suffered fundamental changes. The balance (i.e. output growth rates) has however decreased by 2 points as compared with September but remained in the range of +11...+16 points, which has been observed for eight months already (fig. 3).

For the second month in a row enterprises’ production plans have stayed at the level of production maximum. The industry has not lost the hope for the recovery of industrial growth yet. So far, however, it has resulted only in the growing disagreement between the output plans and their fulfillment.

hiring process having ceased and the intentions for dismissals being widespread) testify to structural problems at the labor market as well as cautious and considered HR policy at enterprises.

Non-payments that were a matter of such concern at the beginning of the crisis are having less and less effect on the industry. At the end of 2010 their negative influence dropped to 17% as compared with 41% at the height of the crisis. In contrast, the competition with import is gradually becoming more concerning to the internal producers. At the peak of the current crisis the limiting effect of the import dropped to 13% versus 31% (the absolute maximum for the whole period of monitoring) in the middle of 2008. Over seven quarters of crisis competition with import factors has gained 10 points and represents an obstacle for 23% of enterprises. It should be noted that as a result of default and dramatic devaluation of ruble in 1998 the limiting effect of the import on Russian industry production growth dropped to 3% (absolute minimum, 3rd quarter 1999) (*fig. 4*).

Producers' Prices

Price policy of enterprises was subject to considerable changes in October. First, the highest price growth rates for the current crisis were observed in the industry. After quite a moderate increase in prices in June-September, the rate being 4-8 balance points, in October the growth rate reached 13 points (*fig. 5*). In October price growth slowdown was registered only in foodstuffs production and machine-building industries. It should be noted that the growth has stopped completely in the latter. In general, machine-building is characterized by the most moderate price policy during the current crisis, avoiding both considerable increase and considerable reductions of the sales prices. Second, price plans of enterprises have also grown considerable in October following seven months of gradual growth slowdown. Reconsideration of forecasts towards more intensive prices' growth was observed in all the sectors of industry with the exception for machine-building.

Dismissals: Real Dynamics and Plans

Absence of positive changes in the demand and output dynamics has made the enterprises stop hiring process. In October employment growth rates in the industry has obviously left positive zone but has not become negative yet: the hiring process has ceased, the dismissals have not started. It is only chemistry industry, light industry and foodstuffs production that are still characterized by the growth of the employment. The plans of enterprises, however, testify that there is a high probability of

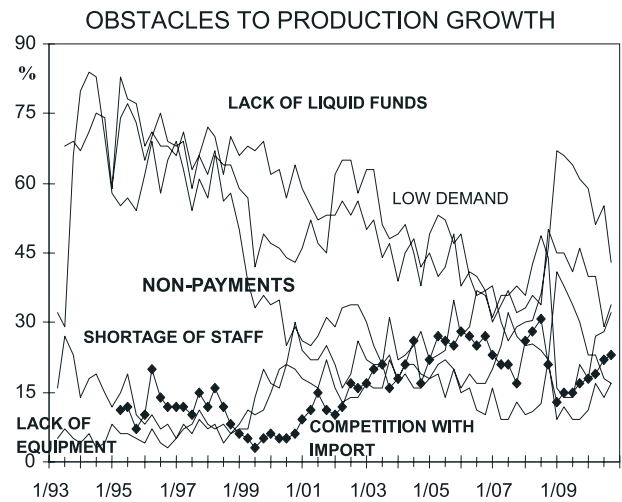


Fig. 4

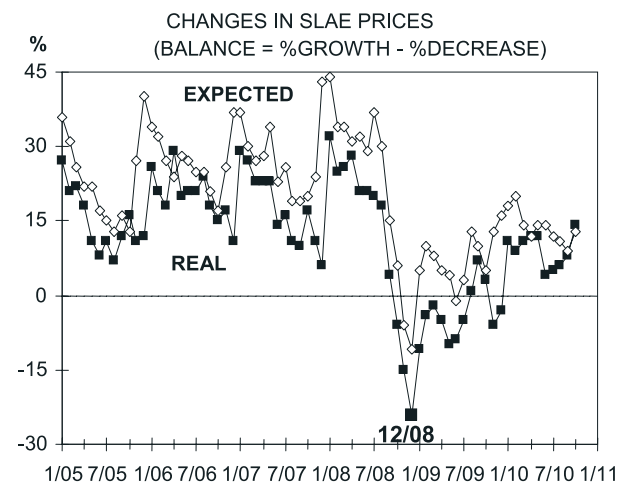


Fig. 5

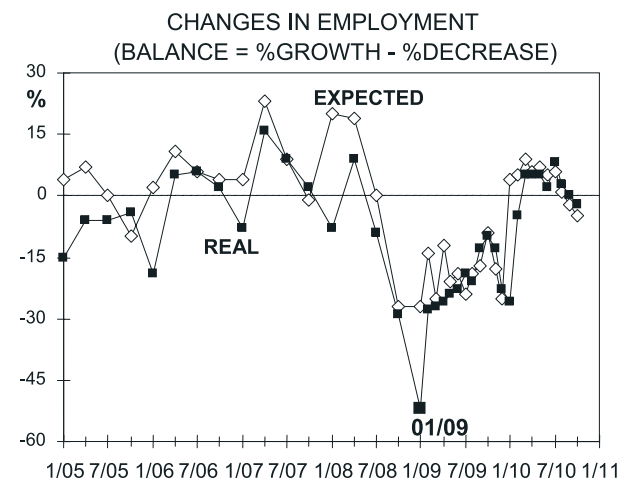


Fig. 6

negative trends sustaining in the employment dynamics. The balance of the expected changes in the number of employees has been diminishing for the seventh month in a row, becoming definitely negative and the worst for 2010 in October (fig. 6).

Industry Crediting

In October credit availability for the industry has not changed and remained at the level of 67% – that is the number of enterprises that find the conditions of banks’ credits acceptable (fig. 7). In ferrous metallurgy this figure was maximum and made 91%, in non-ferrous metallurgy it is equal to 75%, in machine-building 0 71%, in foodstuffs production – 63%. The best average per annum rate for the industry is 13%. Enterprises of metallurgy industry may borrow the money at 9% per annum, of chemistry industry – at 12.3%, of foodstuffs production and machine-building industry – at 13%. The enterprise of light industry are still characterized by the highest rates (15%) (fig. 9).

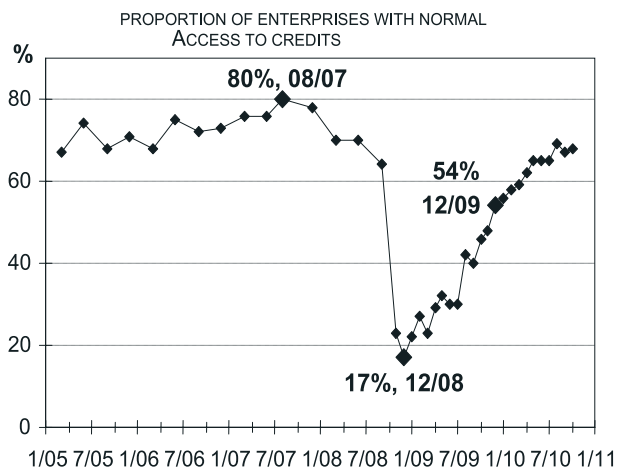


Fig. 8

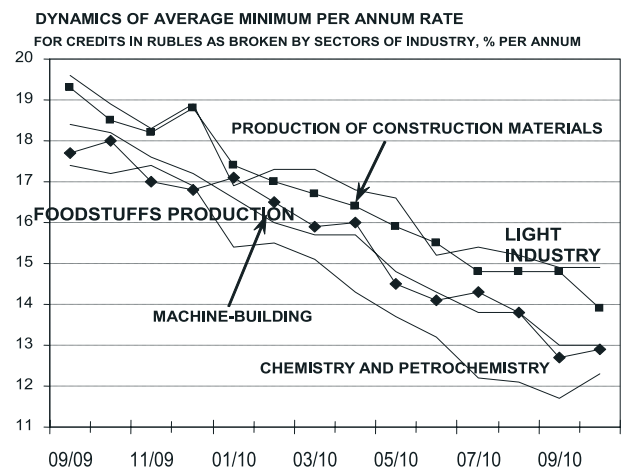


Fig. 9

FOREIGN TRADE

N.Volovik, K.Kharina

The slowdown of export growth together with the increase in import supplies over three quarters of the current year have accounted for the gradual decrease in foreign trade balance. On December 29, 2010 the Law "On customs regulation in the Russian Federation" comes into effect. The norms of the law are in general based on the norms and principles of the International convention on the simplification and harmonization of customs procedures from May 18, 1973 according to the version of Protocol on making amendments to the International convention on simplification and harmonization of customs procedures of June 26, 1999 (Kyoto convention).

In September 2010 foreign trade turnover calculated on the basis of balance-of-payments methodology made USD 57.5 billion, which is 24% more than the figure of September 2009. Export of goods from Russian in September 2010 as compared with September 2009 has increased by 18.1% and made USD 34 billion. Over the same period import into Russia went up by 33.7% up to USD 23.6 billion.

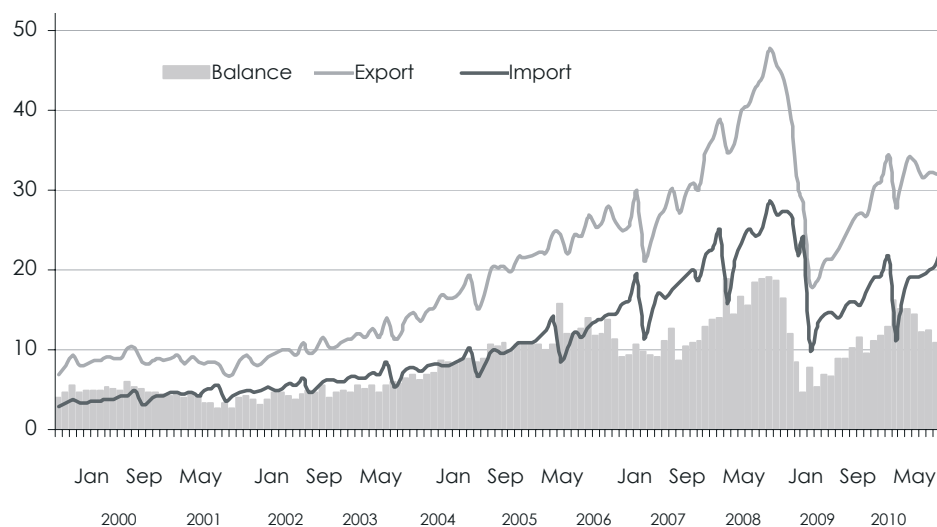
In September 2010 positive foreign trade balance of the Russian Federation decreased as %, compared with the corresponding figure of September 2009 by 6.6% and made USD 10.4 billion. At the same time as compared to August 2001 the balance has expanded by 30.7%.

At the world markets in September 2010 prices continued to grow. Reuters/Jefferies CRB index, which is calculated on the basis of 19 raw materials, went up by 8.2% in July-September, which is the highest growth starting with the 4th quarter 2009. The prices for gold and silver went up to record-breaking levels, and the price for cotton reached the maximum value since 1995.

In September 2010 price for oil grade Brent rose by 0.74% versus the previous month. At the beginning of October following a sharp drop of US dollar exchange rate, price for oil grade Brent went up to USD 82-85 per barrel. The average price for oil grade Brent in January-September 2010 was 34% higher than in the corresponding period of the previous year and made USD 76.73 per barrel versus USD 57.32 per barrel a year ago

In September 2010 the average price for Russian oil grade Urals was equal to USD 77.4 per barrel versus USD 67.15 per barrel in September 2009. Over nine months the average price made USD 75.87 per barrel whereas in January-September of the previous year it was at the level of USD 56.66. Thus, the price for oil was 33.9% higher in 9 months 2010 than in the corresponding period of the previous year.

According to monitoring data from October, 15th to November, 14th 2010 the average price for oil grade Urals made USD 82.89101 per barrel. Thus, export duty rate for oil in concordance with the Decree of the RF Government No 930 from 27.11.2010 will increase by USD 13 starting with December 1, 2010, making USD 303.8 per ton as compared with USD 290.6 per barrel in November. At the same



Source: Central bank of the Russian Federation

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

time export duty rate for light oil products will make USD 217 per ton, for dark oil products – USD 116.9 per ton. Export duty rate for oil from East Siberia will go up to USD 108 per ton starting with December 1, 2010 versus USD 98.8 per ton that was in effect in October. The Decree of the RF Government includes two codes, for which privileged duty rate is applied. Thus, up to December, 8th the code 2709009002 will be in effect, which includes 22 oil fields of East Siberia, and starting with December, 8th the code 2709009003 will come into effect, which will include two oil field of North Caspian Sea. Thus, the duty rate for the oil produced in the North Caspian Sea will also make USD 108 per ton.

This September the market of non-ferrous metals was characterized by positive dynamics – prices for all the basic metals went up. It was the positive statistics of the economy of China, low dollar exchange rate and the return of speculators who are willing to invest in non-ferrous metals to the market that were the key growth factors.

According to the data of London Metal Exchange, world prices for nickel in September 2010 went up by 5.43% versus the previous month. Prices for aluminum continued to recover throughout the whole 3rd quarter 2010. For the first time in nine months of 2010 the growth of prices for aluminum made 15% as compared with the corresponding period of 2009. The average price for copper at LME in September made USD 7709.3 per ton, which is 5.5% more than August figure.

Table 1.

AVERAGE MONTHLY WORLD PRICES IN SEPTEMBER OF THE CORRESPONDING YEAR

| | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|--------------------------------|--------|--------|--------|--------|--------|--------|--------|-------|--------|--------|-------|---------|
| Oil (Brent), USD/barrel | 22.6 | 32.15 | 26.18 | 28.26 | 27.1 | 42.68 | 61.7 | 62.1 | 75.9 | 104.7 | 68.64 | 77.76 |
| Natural gas, USD/1 million BTU | 2.62 | 5.118 | 2.204 | 3.625 | 4.678 | 5.483 | 6.75 | 8.41 | 6.46 | 7.58 | 3.774 | 4.10 |
| Petrol, USD/gallon | 0.683 | 0.941 | 0.757 | 0.797 | 0.832 | 1.26 | 1.958 | 1.596 | 2.03 | 2.63 | 1.768 | 1.94 |
| Copper, USD/ton | 1876.8 | 2037.5 | 1452.9 | 1498.3 | 1816.4 | 2892.6 | 3858.0 | 7602 | 7656.5 | 6990.9 | 6195 | 7709.3 |
| Aluminum, USD/ton | 1493.6 | 1600.2 | 1342.6 | 1294.7 | 1415.0 | 1726.0 | 1840.0 | 2473 | 2392.9 | 2525.8 | 1833 | 2202.4 |
| Nickel, USD/ton | 6932 | 8654.3 | 5040.9 | 6592.5 | 9996.1 | 13298 | 14228 | 30131 | 29605 | 17795 | 17462 | 22643.4 |

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

Table 2.

RUSSIA'S FOREIGN TRADE INDICES

| | January-September 2010 as percentage versus January-September 2009 | | 3 rd quarter 2010 as percentage versus 3 rd quarter 2009 | | September 2010 as percentage versus September 2009 | |
|--------|--|----------------|--|----------------|--|----------------|
| | Physical volume | Average prices | Physical volume | Average prices | Physical volume | Average prices |
| Export | 110.2 | 116.9 | 106.6 | 113.0 | 97.9 | 124.1 |
| Import | 130.8 | 101.2 | 144.9 | 100.2 | 145.0 | 98.9 |

Source: Federal Customs Service of the Russian Federation

Over nine months of 2010 Russia's foreign trade turnover made USD 459.3 billion, which is 35.4% more than in the same period of the previous year. Over January-September 2010 export supplies went up by 38.1% up to USD 287 billion, import supplies – by 31% - up to USD 172.2 billion. In January-September 2010 Russia's positive foreign trade balance increased to USD 11.8 billion versus USD 76.4 billion a year ago.

The increase in export value in January-September 2010 as compared with the corresponding period of the previous year is mainly connected with the growth of prices for the main goods of the Russian export. The main factor that accounted for the import growth was the increase in the physical volumes of supplies.

As compared with the corresponding period of 2009 in January-September 2010 the conditions for Russia's trade with other countries have improved: export prices grew at considerably higher rates than import prices. In January-September 2010 trade conditions index made 115.5 points (64.8 points in January-September 2009).

The total volume of Russian export still exceeds by far the import supplies volumes. However, whereas oil, gas, metals and timber are the main export products, nearly all the import supplies are comprised from the finished goods with the high proportion of added value. After a considerable decrease in 2008, the prices for the main goods of Russian import are observed to increase substantially during 2009 and at the beginning of 2010, starting with spring 2010, however, prices growth rates have slowed down.

This affected the value dynamics of the Russian export, which volumes have stabilized, while import is continuing to grow. To a considerable extent it is not connected with the expansion of consumer demand, which was the case in the pre-crisis period. This is rather the demand from producers. Although the consumer segment has always comprises and still comprises a significant proportion of Russian import supplies in the recent months consumer demand has not been observed to recover rapidly. On the contrary, its rate have slowed down against the background of population's incomes growth of 3-5% a year, the real incomes of the population before the crisis growing by more than 10% a year before the crisis. The ruble exchange rate has also stabilized, which prevent import from becoming cheaper. Finally, consumer crediting has been recovering slowly after the crisis. This allows concluding that the main demand for import goods comes from the Russian enterprises.

In January-September 2010 the proportion of metals and goods of them, textile, sewing goods and footwear, chemistry industry production, machinery, equipment and transport vehicles as well as mineral products has increased. The proportion of foodstuffs, agriculture goods, timber and pulp-and-paper goods are still decreasing.

According to the Decree of the RF Government No 893 signed on November 12, 2010 the duty for copper export from the Russian Federation at the rate of 10% was introduced. The Decree comes into effect a month after its official promulgation. At the moment the duty rate for copper export makes 0%.

Duty rates for copper and nickel were temporarily nullified by the government in January 2009, earlier nickel export was levied with 5% duty rate, copper export – with 10% duty rate. Nullification of duty rates was accounted for by the drop of world prices for metals. The duty rate for nickel was introduced in December 2009, while duty rate for copper remained zero. Starting with the beginning of the year the price for copper went up to the level of USD 7000-8000 per ton, while at the peak of the crisis it went below USD 3000. According to the calculations of the RF Ministry of Finance, introduction of 10% duty rate for copper will result in additional earnings to the budget of the Russian Federation of RUR 8.8 billion.

On November 27, 2010 president of Russia Dmitry Medvedev signed the Federal Law "On customs regulation in the Russian Federation", which was developed to secure the execution of international liabilities of the Russian Federation in connection with its participation in the Customs Union, regulation of some legal relations as well as establishment of additional conditions, requirements or specific characteristics of legal regulations in Russia.

The Law establishes the main principles of goods handling during their export to/import from Russia and transit through the territory of the Russian Federation under customs control, regulations for determination of the goods country of origin, procedure for application of customs procedures in the environment of Customs Union functioning.

The statements of the Law are generally based on the norms and principles of the International convention on simplification and harmonization of customs procedures from June 26, 1999 (Kyoto convention).

This Federal Law states considerable changes in the Russian customs legislation and adjacent fields of legislation.

Its concept originates in the following priorities:

- to provide for economic security of the Russian Federation for the purposes of foreign trade with goods;

- to avoid the increase of load on the business as compared with the RF Customs Code, to have customs regulation that does not put more load on business than that in Belorussia or Kazakhstan;

- to simplify customs procedures when exporting goods that are not levied with export duty rates and when importing high-tech and innovative goods;

- to give business an opportunity to influence formation and realization of customs rules.

The content makes the adopted Federal Law the main legislative act of the Russian Federation in the sphere of customs.

The Law has substantially curtailed reference norms by the way of inclusion of the first statements in the law. 32 acts of the Government of the Russian Federation are to be developed that are necessary for implementation of the Law (instead of 47 that were necessary for the version of the bill that passed the first reading). About 80 regulatory legislative acts of the RF Federal Customs Service are to be adopted as well (including interdepartmental acts).

Conditions have been created for the Russian economic agents working in the customs sphere to transfer smoothly to work under the conditions of changed legislation; well-grounded criteria for their exclusion from registers were established. For instance, now the norm concerning the exclusion of legal entities that operate in the field of customs from the registers in connection with administrative offence committed by these entities takes into account the volume of administrative fine levied on these entities, which characterizes the gravity of the offences.

The Federal Law includes the norms defining the procedure for application of special simplifications by the authorized economic operator, including the specific characteristics of customs transit procedure completion, procedure for this status acquisition and inclusion in the Register of authorized economic operators as well as the procedure of exclusion from it. The procedure of accounting and submission of reports to the customs officials by the authorized economic operators, as well as requirements for storage facilities, in which authorized economic operators store goods have also been specified.

The requirements for provision of necessary facilities, equipment and location of the temporary storehouses, customs storehouses and duty-free shops have been established.

The federal law includes a number of statements aimed at stimulation of innovative activity at Russian enterprises.

Article 208 of the Federal Law allows submitting the documents certifying the legal capacity of persons (statutory, constitutive and other entitling documents) once when applying for the first time to any customs body that is authorized to accept customs declarations and the full list of these documents. This simplifies the process of documents submission, allows to make one time check of the legal capacity of persons (entities) to carry out customs operations.

Article 232 of the Federal Law simplifies the customs procedure for export of non-primary goods that are not levied with export duty rates. These simplifications include the shortened list of documents submitted for customs declaration, curtailed list of data that are to be declared to customs bodies. It is separately specified that when declaring non-primary goods that are not levied with customs duty rates the customs value is not defined, is not declared and is not certified.

The Law “On customs regulation in the Russian Federation” should have come into effect on July 1, 2010. However the promulgated bill that has been developed by the RF Federal Customs Service received a large number of critical remarks from the business community. For instance, a number of contradictions with the Customs Code of the Customs Union have been pointed out as well as excessive number of references to the departmental acts of the federal service, absence of norms aimed at the improvement of administration and solution of existing problems. Upon substantial improvements the Federal Law “On customs regulation in the Russian Federation” was adopted and comes into effect on December 29, 2010. ●

THE STATE BUDGET

E.Fomina

As of 1 November 2010, the volume of revenue collection to the federal budget accounted roughly for 86% of the planned annual volume¹. Meanwhile, against the background of such a strong performance, the dynamic of the budget deficit will remain unpredictable through the end of the year. Behind the uncertainty are growth rates of budget expenditures which have proved to be far in excess of the average annual ones. But preliminary estimates suggest the budget deficit volume would be lower than the one fixed in the Act on budget and should not exceed 5% of GDP.

Analysis of main parameters of execution of the budget of the enlarged government between January through September 2010

As of 1 October 2010, the revenue part of the *enlarged government* budget had been executed at 1 p.p. of GDP up vs. the last year's dynamic, while the volume of the public sector expenditures shrank at 2.7 p.p. of GDP in relative terms against its Rb. 806 bln.- worth rise in nominal terms. As a result, over the 9 months 2010 the enlarged government budget posted a 0.3% of GDP surplus. In the same period of 2009, the enlarged government budget had deficit of 3.4% of GDP (*Table 1*).

Table 1

EXECUTION OF BUDGET REVENUE AND EXPENDITURE BY BUDGETS OF ALL TIERS OF GOVERNMENT BETWEEN JANUARY AND SEPTEMBER 2009–2010

| | January-September 2010 | | January-September 2009 | | Deviation in p. p.p. of GDP |
|-------------------------------------|------------------------|-------------|------------------------|-------------|-----------------------------|
| | As Rb. bln. | as % of GDP | As Rb. bln. | as % of GDP | |
| Federal budget | | | | | |
| Revenue | 6008.6 | 18.4 | 5114.4 | 18.7 | -0.3 |
| Expenditure | 6701.2 | 20.5 | 6441.7 | 20.9 | -0.4 |
| Deficit (-) /Surplus (+) | -692.6 | -2.1 | -1327.3 | -2.2 | +0.1 |
| Consolidated budgets of RF Subjects | | | | | |
| Revenue | 4812,7 | 14,7 | 4321,7 | 15,3 | -0,6 |
| Expenditure | 4345,1 | 13,3 | 4099,6 | 14,6 | -1,3 |
| Deficit (-) /Surplus (+) | +467,6 | +1,4 | +222,1 | +0,7 | +0,7 |
| Budget of the enlarged government | | | | | |
| Revenue | 11 419.4 | 34.9 | 9 555.0 | 33.9 | +1.0 |
| Expenditure | 11309.8 | 34.6 | 10 503.9 | 37.3 | -2.7 |
| Deficit (-) /Surplus (+) | +109.6 | +0.3* | -948.9 | -3.4 | +3.7 |
| For reference: GDP, as Rb. bln | 32 718.4 | | 28 184.8 | | |

* The surplus in the enlarged government's budget vis-a-vis the deficit of the federal budget is ascribed to a different way of accrual of funds into extrabudgetary funds by bypassing the federal budget.

Source: The RF Ministry of Finance, calculations by the Gaidar Institute.

The consolidated budget of the RF Subjects over the period of January to September 2010 also posted a 1.4% of GDP surplus vs. the 0.7% of GDP one reported on the same period of the prior year. The amount of expenditures over the nine months of 2009 tumbled at 1.3 p.p. of GDP, while their growth in nominal terms over the period in question accounted for some Rb. 250 bln. Despite a moderate growth in expenditures of the consolidated budget of the RF Subjects in the 9 months 2010 relative to the same periods of prior years, when expenditures in absolute terms would sometimes soar up to Rb. 600-900 bln., the federal government keeps encouraging regions to stick

1 The federal Act "On the federal budget for 2010 and the planned period of 2011-2012", № 308-FZ of 01.12.2009

to a conservative policy of curbing growth in their budget expenditures and seek alternative ways to replenish their budgets, thus making themselves less dependent on the federal aid.

It has also become known that by 2012 the government is going to keep just some 20¹ out of 90 different kinds of subsidies currently available for regional budgets. Preliminary assessments suggest the volume of funds the federal center annually transfers to regions may be trimmed by Rb. 60-100 bln., which is going to happen against the background of redistribution of a fraction of obligations between the levels of the national budgetary system. For example, it is planned to reassign a part of expenditures on funding the Ministry of Interior's operations on the federal level, along with scaling back a part of respective federal subsidies.

The analysis of the structure of formation of the revenue side of the enlarged government budget over the 9 months of 2010 (*Table 2*), allows ascertaining that their growth has still been to a large extent fueled by increase in revenues from foreign trade, mineral tax, corporate profit tax, and mandatory pension insurance contributions.

During the period in question, the volume of revenues *from the mineral tax and foreign trade* posted a 0.5 p. p. and 0.9 p. p. of GDP increase, respectively, which can be explained by a number of domestic and international factors. A positive effect from the price increases of energy sources (between January through September 2010 the average price of Urals hit USD 76.4/bbl vs. the last year's 58.3) was further complemented by the growing physical volume of production and export of hydrocarbons. Over the period in question, the volume of natural and oil-well gas production was up at more than 13.5%, oil – at some 2.3% vs. the same period of 2009².

Parameters of the oil export duty were being adjusted following the rollercoaster of international prices for oil and oil products, as calculation of its value is linked to the dynamic of global oil prices. The minimal value of the duty was USD 246-250/t. (in July 2010), while the maximal value – USD 273,5/t. (in September 2010). In November, the value of the oil export duty can be increased to USD 290.6/t. (vs. 266.5 in October).

The value of the influx of the budget oil-and-gas revenues over the 9 months 2010 found itself affected by appreciation of the Rb., which has reduced the Rb. equivalent of foreign trade revenues.

The fiscal burden on the mining sector is planned to increase in the upcoming three-year period.

It is proposed to raise the mineral tax rate on natural gas at 61% - from Rb. 147 up to 237 per 1,000 cubic meters with a subsequent indexation to match the envisaged price rise to Rb. 251 and 265 per 1,000 c.m. in 2012 and 2013, respectively. This measure would bring an additional Rb. 180 bln. in revenues to the budget over the three years to come. Plus, it has been planned to raise the mineral tax rate on oil – it should go up from the current Rb. 419 to 446/t. (6.5%) since 2012 and further to Rb. 470/t. in 2013 (5.4% up vis-a-vis 2012). Once implemented, this may increase the budgetary revenues by Rb. 225 bln. over the two years to come³.

In addition, an increase of the export duty on oil products is possible. As a member of the Customs Union, Russia has reserved this right and may resort to it already in the medium term⁴. While currently holding export duty rates on a relatively low level, the government pursues the policy of subsidizing the oil-refining sector, which, in the conditions of the effective tax-free trade regime within the Union, engenders preferences for the Belorussian oil refineries, thus resulting in the Russian budget missing a fraction of the oil-and-gas revenues. Should the export duties be raised, the government will be seeking other opportunities to support the national refineries (which concerns only intense downstream production).

As well, a surplus income tax may be introduced since 2012, which essentially means linking it up to profitability rate of a given well⁵. Its introduction is foreseen against retaining of the mineral tax and export duties, with the latter being a possible subject to revision.

Against the background of a notable growth in oil-and-gas revenues both in absolute and relative terms, oil-and-gas ones (???) display a looser tendency to growth.

1 http://www.rian.ru/defense_safety/20091225/201392999.html

2 The report of the RF Ministry of Economic Development "On the current situation in the economy of the Russian Federation in January-October 2009"

3 <http://bujet.ru/article/90146.php>

4 <http://www1.minfin.ru/ru/press/speech/index.php?id4=11103>

5 <http://bujet.ru/article/99825.php>

Revenues from *the corporate profit tax* to the enlarged government budget surged by 0.8 p.p. in relative terms between January and September 2010. It should be noted that between January and March the revenue dynamic with regard to this particular tax was looser than in the same period of the prior year, but the situation reversed in April. The latter may be explained by the effect from a relative improvement of the general economic environment. More specifically, over the 9 months 2010 the real sector posted Rb. 4,326 bln. in earnings, or nearly 53% up vs. the prior year's index. Meanwhile, the proportion of organizations in the black in the total number of organizations was up at 1.6 p. p. vs. the same period of 2009 and accounted for nearly 68%. The statistics mirrored a far healthier financial standing of the manufacturing sector, while the hot and rainless summer battered the agrarian sector. As a result agrarian corporations' financial performance indicators over the first 9 months 2010 were 12% down vs. the prior year's ones.

As far as the medium term is concerned, there exists a possibility for a constrained growth in revenues from the corporate profit tax due to the narrowing taxation base, as the government has planned zero corporate profit tax rate for commercial and non-profit organizations in the medical and educational spheres. In addition, it is planned to introduce some easing into the procedure of identification of the tax base for the sake of payment of the corporate profit tax in the R&D area. This set of measures aims at encouragement of using thus freed money on modernization of these economic agents' operations.

The volume of revenues to the enlarged government budget from *the personal income tax* plunged to 3.8% of GDP, or 0.4 p.p. of GDP down vs. the same period of 2009. Meanwhile, the indicator of the population's real disposable income has been up by 4.2% since the early 2010 against the previous year's dynamic. It was valorization of pension payments in early 2010 that powered the surge of the indicator in question. As a result, the population's real disposable incomes grew at 7.4% in Q1, while in Q2 and Q3 their growth rate was under 4.5%. Overall, it can be asserted that the population income growth rate is lower than the pace of the national economy's recovery.

Table 2

DYNAMIC OF THE LEVEL OF TAX BURDEN AND REVENUES FROM MAIN TAXES TO THE BUDGET OF THE ENLARGED GOVERNMENT OF RF BETWEEN JANUARY AND SEPTEMBER IN 2009–2010, AS % OF GDP

| | 9 months. 2010 | 9 months. 2009 | Deviation, as p. p. of GDP |
|--|-------------------|-------------------|-------------------------------|
| Level of tax burden (1+2+3) | 32.0 | 30.1 | +1.9 |
| Tax collection (1), including: | 19.9 | 20.6 | -0.7 |
| Corporate profit tax | 4.1 | 3.3 | +0.8 |
| Personal income tax | 3.8 | 4.2 | -0.4 |
| UST* | 0** | 2.1 | – |
| VAT | 5.5 | 5.3 | +0.2 |
| Excise taxes | 1.1 | 0.9 | +0.2 |
| Mineral tax | 3.1 | 2.6 | +0.5 |
| Contributions on mandatory pension insurance (2) | 5.1 | 3.4 | +1.7 |
| Revenues from foreign trade (3) | 7.0 | 6.1 | +0.9 |

*without regard to insurance contributions on mandatory pension insurance.

** since 2010 UST has been transformed into insurance contributions collected directly to extrabudgetary funds

Source: the RF Ministry of Finance, Rosstat, the Gaidar Institute calculations.

The volume of budgetary revenues from VAT was up at 0.2 p.p. of GDP between January and September 2010 and hit 5.5% of GDP. The progress in collection of VAT was due to the general improvement of the business climate in Russia and adopted measures on improving its administration (introduction of the declarative procedure of its refund).

The growth in the volume of collection of excise taxes to the enlarged government budget accounted for 0.2 p.p. vs. the last year's dynamic. The revenues grew thanks to the increased rates on a series of excised goods since 2010. According to recently announced variants of amendments to the Tax Code, a huge indexation of tobacco and alcohol excises is planned for 2011-2013. In

addition, between 2011 and 2014 collection of excise taxes on gas, motor fuel and oil should be reallocated between different levels of the budgetary system, with a fraction of funds being subject to collection to the federal budget for the sake of accumulation of resources to set up the Federal Road Fund. In 2011, some 30% of respective revenues should be collected into the federal budget, in 2012 -23%, and in 2013- 28%. It is assumed that missing volumes of regional revenues to some extent should be compensated with an increase in excise rates.

Overall, it can be noted that the level of *tax burden* on the economy has been up at nearly 2 p. p. of GDP over the 9 months 2010 vis-a-vis the same period of 2009 and hit the mark of 32% of GDP. The growth of the indicator to a large extent was fueled by external factors.

Against the background of growth in revenues to the enlarged government budget in shares of GDP between January and September 2009, the volume of the *enlarged government budget expenditures* over the period in question displays a notable fall in public expenditures in relative terms, which does not contradict the 2010 concept of their taming. The budget expenditures were down by 2.7 p.p. of GDP, while it can be noted that the expenditure volume was up by Rb. 806 bln. in absolute terms.

Table 3

THE ENLARGED GOVERNMENT BUDGETARY EXPENDITURES BETWEEN JANUARY
AND DECEMBER 2009–2010 П., AS % OF GDP

| | January-September 2010 | | January-September 2009 | | Deviation in p.p. of GDP |
|--|---------------------------|----------------|---------------------------|----------------|-----------------------------|
| | As Rb. bn. | as % of GDP | As Rb. bn. | as % of GDP | |
| Expenditures, total | 11309.8 | 34.6 | 10503.9 | 37.3 | -2.7 |
| Including: | | | | | |
| General government matters | 963.9 | 2.9 | 883.3 | 3.1 | -0.2 |
| Including on servicing the public and municipal debts | 210.0 | 0.64 | 184.6 | 0.66 | -0.02 |
| National defense | 784.8 | 2.4 | 757.7 | 2.7 | -0.3 |
| National security and law- enforcement activities | 877.5 | 2.7 | 837.6 | 3.0 | -0.3 |
| National economy | 1338.9 | 4.1 | 1800.4 | 6.4 | -2.3 |
| Housing and communal sector | 631.9 | 1.9 | 616.4 | 2.2 | -0.3 |
| Environment protection | 17.4 | 0.05 | 18.1 | 0.06 | -0.01 |
| Education | 1236.5 | 3.8 | 1175.6 | 4.2 | -0.4 |
| Culture, motion picture industry, media | 223.1 | 0.7 | 215.2 | 0.8 | -0.1 |
| Health care and sport | 1113.9 | 3.4 | 1087.2 | 3.9 | -0.5 |
| Social policy | 4121.9 | 12.6 | 3102.0 | 11.0 | +1.6 |

Source: the RF Treasury, the Gaidar Institute's calculations.

Whilst considering the structure of the enlarged government budget expenditures over the 9 months 2010 function-wise, it can be noted that practically all items underwent a notable reduction in share of GDP terms. The biggest cuts were made in the "National economy"- at 2.3 p.p. of GDP, followed by "Health care and sport" and "Education" – at 0.5- 0.4 p.p. of GDP each. As well, "General government matters" was trimmed by 0.2p.p. of GDP vs. the same period of the prior year. Whilst expenditures on servicing the public debt remained stable in relative terms, growth rates of financing the public administration slowed down, specifically with regard to public servants' wages.

Meanwhile, expenditures on "Social policy" went up by 1.6 p.p. of GDP vs. the respective period of 2009.

Execution of the federal budget of RF between January and October 2010

According to the RF Ministry of Finance's preliminary data, over the 10 months 2010 *the federal budget revenues* accounted for 18.3% of GDP, or up by 0.1 p.p. of GDP vs. the same period of 2009 (*Table 4*), while in nominal terms they posted a Rb. 935 bln. growth. The growth was powered primarily by soaring revenues of the fuel and energy complex that benefited from a relatively favorable state of affairs with regard to prices of, and demand for Russian exports and the renewal of growth in the physical volume of hydrocarbon production.

While comparing the said volumes of budgetary revenues over the noted periods in question, additional revenues of the investment nature should be factored in. As a reminder, in January 2009, as much as Rb. 275.2 bln. in proceeds from oil-and-gas funds management in 2008-2009 was accrued to the budget; in January through April another Rb. 134 bln. in investment income poured into the budget.

The federal budget expenditures over the period between January and October 2010 tumbled at 2.4 p.p. of GDP vs. their respective volume in 2009; however, they rose at some Rb. 237 bln. in absolute terms. The "pension pressure" on the federal budget has remained substantial and may hit nearly 20% in its expenditures structure. A significant prevalence of social expenditures in the budget leads to cuts in other kinds of expenditures, primarily budget investments that would otherwise fillip economic growth

Table 4

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

| | January-October 2010 | | January-October 2009 | | Execution of the 2010 annual budget breakdown, as % | Отклонение | |
|---|----------------------|-------------|----------------------|-------------|---|------------|----------------|
| | As Rb. bn. | as % of GDP | As Rb. bn. | as % of GDP | | As Rb. bn. | as p.p. of GDP |
| Revenues, including: | 6722.2 | 18.3 | 5787.6 | 18.2 | 86,4 | +934,6 | +0,1 |
| Oil-and-gas revenues | 3051.4 | 8.3 | 2291.1 | 7.2 | 81,5 | +760,3 | +1,1 |
| Deductions to the Reserve Fund and the National Welfare Fund (Stabilization Fund) | 26.5 | 0.1 | 464.8 | 1.5 | – | –438,3 | –1,4 |
| Expenditures, including: | 7505.8 | 20.4 | 7268.9 | 22.8 | 73,5 | +236,9 | –2,4 |
| Interest costs | 174.2 | 0.5 | 150.3 | 0.5 | 62,1 | +23,9 | 0,0 |
| Non-interest costs | 7331.6 | 20.0 | 7118.6 | 22.3 | 73,8 | +213,0 | –2,3 |
| Surplus (deficit) of the federal budget | –783.6 | –2.1 | –1481.3 | –4.7 | 32,3 | +697,7 | +2,6 |
| Non-oil-and gas deficit | –3835.0 | –10.4 | –3772.4 | –11.8 | 61,1 | –62,6 | +1,4 |
| estimated GDP | 36 757.7 | | 31 871.8 | | | | |

Source: the RF Ministry of Finance (preliminary estimates), the Gaidar Institute calculations

Table 5 presents the dynamic of cash execution of the federal budget over the 9 months of the year according to the functional classification of budget expenditures. The dynamic of spending between January and September 2010 just insignificantly (at 0.4 p.p. to the annual budget breakdown) falls behind the pace of cash execution of the budget over the same period of 2009.

Despite some underrun of the pace of application of budget funds compared with the last year's dynamic and the regular schedule of their allocation, the financing has proved to be ahead of schedule, as far as some individual items are concerned. More specifically, this concerns the item "Interbudgetary transfers" the financing of which is at 5.5 p.p. ahead of the last year's dynamic. Such a growth in interbudgetary transfers can be ascribed primarily to a considerable increase of pensions this year, coupled with an accelerated transfer of resources to the Pension Fund of Russia. Cash execution of the federal budget by items "General government matters" and "Social policy" has accelerated by 0.6- 1.0 p.p. each vis-a-vis the respective indicators of 2009.

FEDERAL BUDGET CASH EXECUTION WITHIN JANUARY-FEBRUARY. BUDGET LINES ESTIMATES FOR THE YEAR

| | January–September 2010 | January–September 2009 |
|---|---------------------------|---------------------------|
| Expenditures, total | 65.5 | 65.9 |
| Including: | | |
| General government matters | 55.6 | 55.0 |
| Including on servicing the public and municipal debts | 59.0 | 62.3 |
| National defense | 61.4 | 62.5 |
| National security and law-enforcement activities | 65.3 | 67.3 |
| National economy | 53.2 | 69.0 |
| Housing and communal sector | 59.5 | 61.5 |
| Environment protection | 66.0 | 58.1 |
| Education | 59.7 | 62.0 |
| Culture, motion picture industry, media | 58.7 | 68.0 |
| Health care and sport | 54.9 | 58.0 |
| Social policy | 65.9 | 64.9 |
| Interbudgetary transfers | 75.2 | 69.7 |

Source: the RF Ministry of Finance, the Gaidar Institute calculations

By contrast, a tendency to delays in transfers to recipients of budgetary funds vs. the 2009 dynamics was registered across the items “National economy” – by 15.8 p.p.; “Culture, motion picture industry, media” - by 9.3 p.p., ‘Health care and sports’ – by 3.1. p.p.

As a result, over the past 9 months the federal budget was executed with deficit of 2.9% of GDP vs. 4.7% registered in 2009. According to different projections, the value of the federal budget deficit by results of the year should hit the mark of 5% of GDP, while staying within the fixed in the law parameters (5.3% of GDP). Meanwhile, the RF Minister of Finance was more optimistic to assert the value in question should make up 4.6% of GDP¹.

Preliminary data suggests that the size of the non-oil-and-gas deficit has also shrunk vs. its 2009 value and accounted for 10.4 vs. 11.8% of GDP. But its value has remained pretty high – a sizeable part of the assumed government obligations has not been secured by the non-oil-and-gas budget revenues, which makes the budgetary system yet more exposed to external impacts.

It is the Reserve Fund that has remained a major source of financing of the federal budget deficit (Table 6). Between January through October 2010 some Rb. 519.5 bln. was allocated out of the Fund in an effort to make the federal budget balanced. Notably, these resources were allocated only in March and April.

In all, over the 10 month the volume of the Fund shrank at Rb. 543.5 bln., down to 1,287.0 bln., particularly due to exchange rate fluctuations. Meanwhile, beating expectations, the Reserve Fund will not exhaust by the end of the year – a fraction of its resources will still be there to cover the 2011 budget deficit.

As of 1 November 2010, the volume of the National Welfare Fund had grown at Rb. 38 bln. Its resources are envisaged to be spent solely on co-financing pension savings or covering the federal budget deficit, should oil prices plunge drastically.

The announced privatization program also aims at beefing up federal revenues. Sales of large public assets are scheduled through 2015, thanks to which, as preliminary estimates suggest, the government should cash in Rb. 1.800 bln.

As concerns main developments in the tax and budget policy area, it is worth noting a series of modifications to be made in the Budget Code of RF since 2011².

1 <http://bujet.ru/article/103913.php>

2 <http://bujet.ru/article/93952.php>

Debated novelties comprise, in particular, a change in the structure of the functional classification of presentation of budget expenditures with an increase of the number of items from the current 11 to 14. It is proposed to single out expenditures on the public debt servicing as separate item. In the past, it fell under the “General government matters” section. The novelty is envisaged to enhance efficiency of control over the volume of the public debt, particularly in the light of its upcoming increase in the medium term.

The section “Interbudgetary transfers” is also set to change, with target transfers, such as grants, subsidies and transfers into interbudgetary funds, being redistributed between respective sections. In the same vein, separate sections will be created for “Physical culture and sport” and “Media” items.

The strive for localization in the structure of presentation of expenditures is associated with the upcoming transition to the program-based budget since 2012, under which each individual expenditure avenue will be presented in the form of public long-term programs.

Table 6

DYNAMIC OF FORMATION AND CONSUMPTION OF THE FEDERAL GOVERNMENT'S OIL-AND-GAS REVENUES IN JANUARY-OCTOBER 2009–2010, AS RB. BLN..

| Indicator | Balance as of end-2009. | Approved in the 2010 budget | Collected between January and October 2010 | Spent between January and October 2010 | | Balance as of end-October 2010. |
|--|-------------------------|-----------------------------|--|--|------------------------------------|---------------------------------|
| | | | | To balance the federal budget | To secure the oil-and-gas transfer | |
| Oil-and gas- revenues to the federal budget | X | 2057.2 | 3051.4 | | | x |
| Directions of spending oil-and-gas revenues: | X | x | | | | x |
| The oil-and-gas transfer | X | 2531.1 | 3051.4 | | | |
| Reserve Fund | 1 830.5 | 5147.5 | 0 | 519.5 | 0 | 1287.0 |
| National Welfare Fund | 2 769.0 | x | 26.5 | 2.5 | – | 2772.8 |
| Total | 4599.5 | x | 3077.9 | 522.0 | 0 | 4059.8 |

* the balances were recalculated using the 1 November 2010 exchange rate

Source: The Federal Treasury.

THE RUSSIAN BANKING SECTOR

S.Borisov

In September 2010, the Russian banking sector's assets jumped by a record 2.5 % mainly due to growth of the portfolio of credits allotted to non-financial institutions. The published statement of the profits and losses of the banking system in the first 9 months of 2010 highlighted the main sources of growth in bank profits in 2010: increase in net interest income and decline in the growth rate of expenditures allocated to reserves.

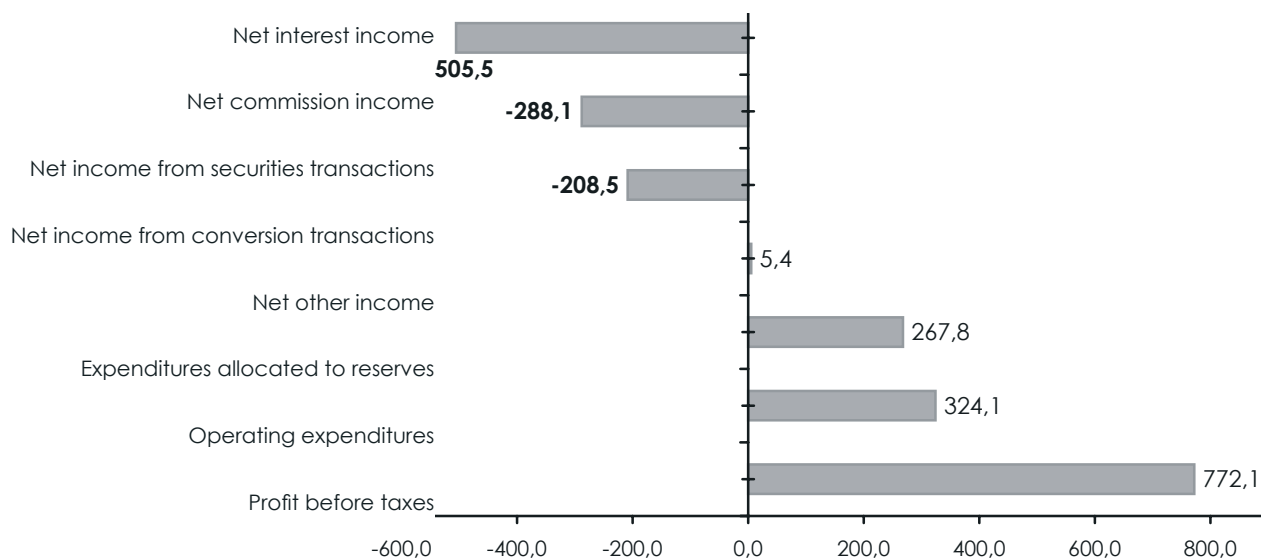
Table 1

THE MAIN INDICES OF THE RF BANKING SECTOR

| | As of 01.10.2009 (bn Rb.) | As of 01.01.2010 (bn Rb.) | As of 01.10.2010 | | |
|--|---------------------------------|---------------------------------|----------------------------|--|----------------------|
| | | | Nominal value, bn Rb | Growth since year's beginning, % | Year on growth, % |
| Assets | 28 181.8 | 29 430.0 | 31 721.7 | 7.8% | 12.6% |
| Credits allotted to non-financial institutions | 12, 715.9 | 12, 541.7 | 13, 629.4 | 8.7% | 7.2% |
| Credits allotted to physical persons | 3, 618.6 | 3, 573.8 | 3, 871.6 | 8.3% | 7.0% |
| Credits allotted to banks | 2, 907.7 | 2, 725.9 | 2, 859.5 | 4.9% | - 1.7% |
| Investments in bonds | 2, 807.6 | 3, 379.1 | 4, 190.7 | 24.0% | 49.3% |
| CB's deposits | 1, 589.1 | 1, 423.1 | 373.4 | -73.8% | - 76.5% |
| Banks' deposits | 3, 119.4 | 3, 117.3 | 3, 461.8 | 11.1% | 11.0% |
| Deposits of legal entities | 5, 311.5 | 5, 466.6 | 5, 518.2 | 0.9% | 3.9% |
| Population's deposits | 6, 704.7 | 7, 485.0 | 8, 879.3 | 18.6% | 32.4% |
| Reserves against potential losses | 1, 824.4 | 2, 050.6 | 2, 311.1 | 12.7% | 26.7% |
| Profit (current year) | 31.2 | 205.1 | 359.7 | | 1,052.9% |

Source: Bank of Russia.

The published official statistics on the RF banking sector indicate that in Q3 there occurred a palpable positive change to the better with regard to banking system's performance. The main Q3 achievements of the RF banking sector were growth in crediting accompanied by a gradual improvement of the quality of assets and a reduction in expenditures allocated to reserves. In Q3, growth in bank's assets amounted to 1,305 bn Rb which is equal to 57 % of the increase in their balance value achieved since the beginning of 2010 (2,291 bn Rb). As far as growth of credit portfolios is concerned, the period under consideration also proved to be successful for banks: the volume of credits issued to non-financial institutions rose by 4.6 % (8.7 % since the beginning of the year), while the volumes of credits issued to the population grew by 5.4 % (8.3 % since the beginning of the year). Over the July – September period, Russian banks' profits amounted to 110 bn Rb which accounts for 31 % of the volume of profit accumulated by the banking system over the first 9 months of 2010. The share of past-due debts on credits allotted to non-financial institutions declined from 6.3 % to 6.0 %, while the share of past-due debts in the portfolio of credits issued to the population became stabilized at the level of 7.5 %. The allowance for possible credit losses (reserves against credit losses) accumulated by banks in the course of the past three reporting months amounted to 70 bn Rb which accounted for 27 % of the volume of their expenditures allocated to reserves. The Bank of Russia's summary statement of profits and losses of the Russian banking system makes it possible to single out the main factors which contributed to the accelerated profits growth observed in the first nine months of 2010: growth of interest income accompanied by a less intensive growth of expenditures allocated to reserves (*Figure 1*).

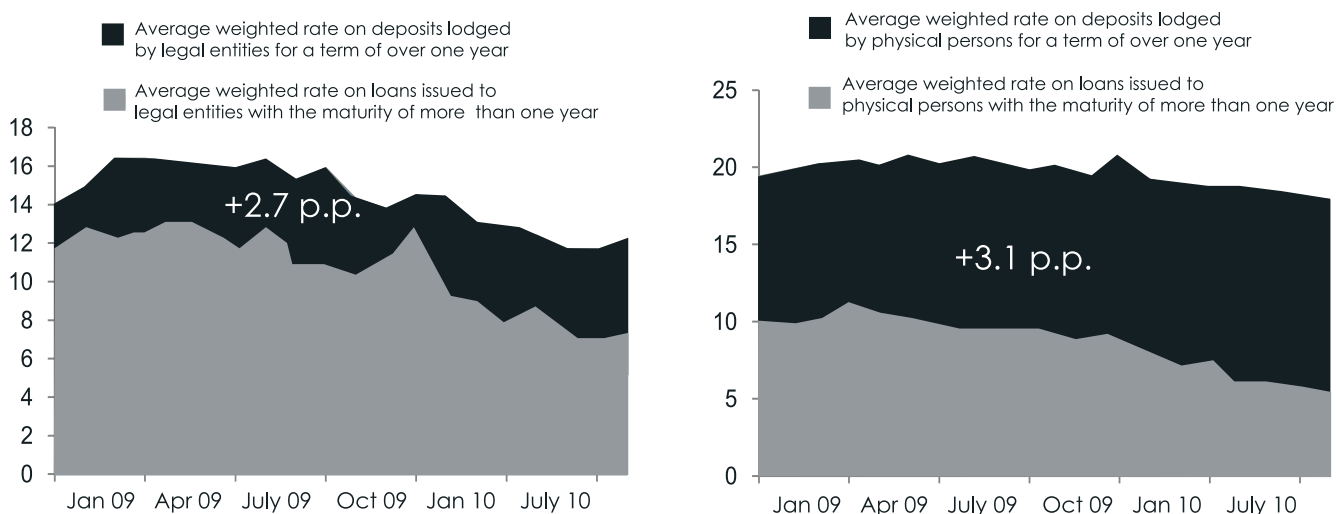


Source: The RF CB's overview of the banking sector.

Figure 1. Profits and Losses of the RF Banking System over the First 9 Months of 2010, bn Rb

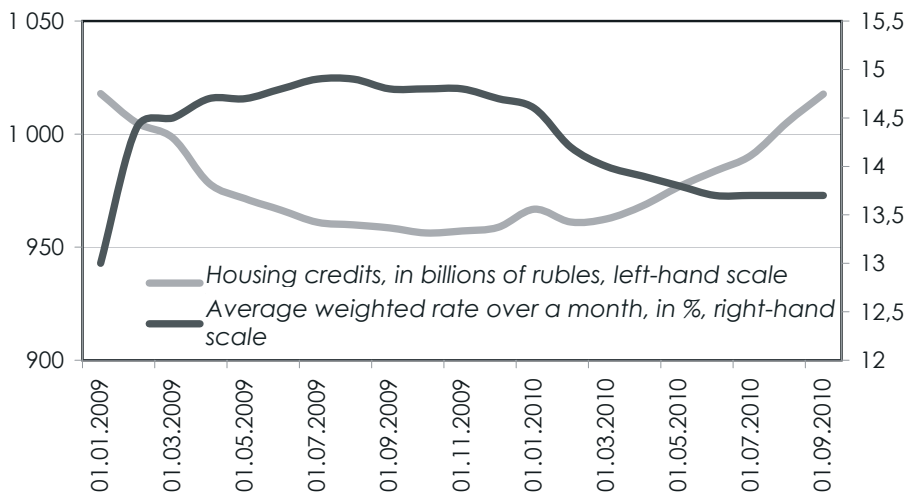
By comparison, over the same period of 2009, banks' expenditures allocated to reserves amounted to 802 bn Rb. The performed analysis of the behavior of interest rates in the period from January 2009 to August 2010 makes it possible to conclude that the main source of bank income growth was an increase in interest margins on credits extended to legal entities and physical persons for periods longer than one year (Figure 2).

One of the important factors influencing the behavior of bank's income from credits issued to the population for a period of more than one year is, undoubtedly, the behavior of housing credits. On the one hand, such credits exert downward pressure on the interest margin of banks, because the rate of housing credits is much lower than the average weighted rate on the portfolio of credits extended to the population for a term of over one year. On the other hand, 'longer' credits on real estate enable banks to plan their medium-term incomes with greater confidence. In this sense, cutting the interest rate and increasing the volumes of mortgage credit lending are the key indicators of banks' reestablished confidence in borrowers and a sound proof that the banking sector has reached sufficiently high levels of liquidity, and that consumer demand has been gearing up. According to the Bank of Russia's data, the housing credit portfolio has been rapidly growing since February



Source: The Bulletin of Banking Statistics of the RF Central Bank.

Figure 2. An analysis of the interest margin on credits with a term of over one year, in %



Source: Bulletin of Banking Statistics of the RF CB.
Figure 3. Behavior of the volume of housing credits and their interest rate, in %

2010 against the background of a sharp drop in interest rates at the beginning of the current year (Figure 3).

The decline and subsequent stabilization of the cost of borrowing on the Russian interbank credit market also contributed to a rise in interest income throughout the banking system. The Central Bank's data confirm that, since the beginning of 2010, banks have constantly been acting as net borrowers on the interbank market. The gap between deposits and loans displayed by the interbank market has been

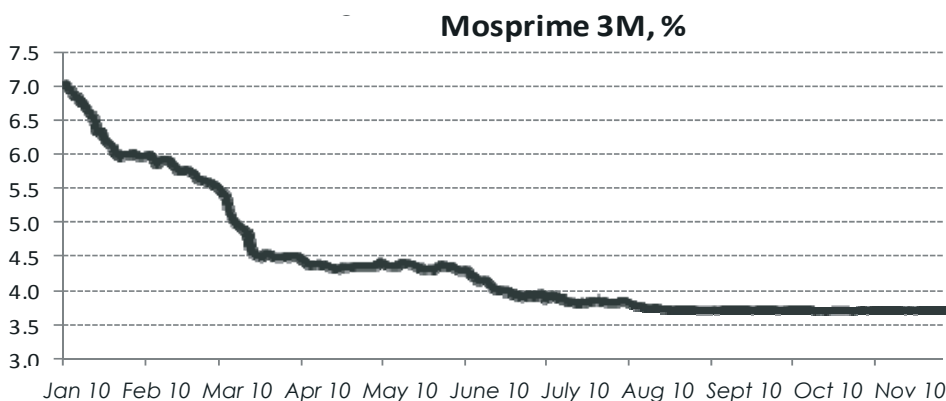
widening month on month. As of 1 October 2010 it amounted to 602 mln Rb. A relatively low level of interest rates (Figure 4) makes it possible for banks not only to accurately follow the established liquidity norms, but also to use cheaper (by comparison with the cost of deposits lodged with them by legal entities and the population) instruments of the interbank market for the purpose of short-term crediting, and thus to realize higher interest margins.

In November 2010, commercial banks' residuals on their correspondent accounts with the RF CB remained at the level of 549 bn Rb, or roughly 6 percent higher than their October level.

On the whole, it is expected that, in Q4, the banking sector will continue to display the development trends which have been taking shape in recent months. The average weighted rates on credits are unlikely to fall by more than 0.2 – 0.3 percentage points as their stability will be boosted by the newly adopted credit policy of the Russian banking giants – Sberbank, BTB and Gazprombank. Propped-up by the traditional year-end rise in demand for credits, the banking sector's assets will continue to rapidly grow in Q4. The stability of the share of hopeless and problem credits dramatically reduces the possibility of any jump in allocations to reserves.

Below is the list of the most notable events that occurred in the banking sector in October and November 2010.

- The Ministry of Finance of the Russian Federation has prepared a draft law that will make it possible for the banking sector to find its own niche in the legal field. The Draft Law 'On Consumer Credit' envisages that the borrower should have an absolute right to return a credit within 14 days



Source: National Currency Association.
Figure 4. Behavior of the volume and interest rate of housing credits, in %

from the loan date and to pay interest only for the actual number of days the credit has been used. This provision equates a credit to the majority of consumer goods that can be returned to the shop within two weeks from the purchase date for one or other reason ('I do not like it'; 'The size is wrong'; 'I have changed my mind', etc.). It should be emphasized that the borrower enjoys the right to return his or her credit

without offering any explanations. Moreover, even if the creditor fails to explain to the creditor his or her absolute right to do so, the latter all the same will retain the right to return the credit under the same terms, but this time within one month from the loan date.

- Next year the Bank of Russia will begin intensive inspections designed to verify whether or not banks are equipped with counterfeit detection devices. At present, banks detect only 50 % of counterfeit banknotes, and the task of detecting the rest of them is shouldered by the RF CB. According to the RF CB, over the January – September period of 2010, 99.5 thousand counterfeit Bank of Russia notes were detected - 11 % less than the same period of past year, when 112 thousand of such notes were spotted.

- The Bank of Russia continues to toughen its measures designed to force Russian banks to disclose their beneficial owners, especially if those banks hold household deposits. In 2011, a graphic scheme clearly illustrating the actual asset structure of a bank can become a mandatory element of each bank's web site.

- On 29 October 2010, the Board of Directors of the Bank of Russia passed a decision that its refinancing and interest rates on the RF CB's transactions should be left unchanged at 7.75 %. The last time that the RF Central Bank cut the rates was on 1 June 2010. As of to date, the rates were cut four times in the current year. At the beginning of 2010 the refinancing rate was 8.75 %.

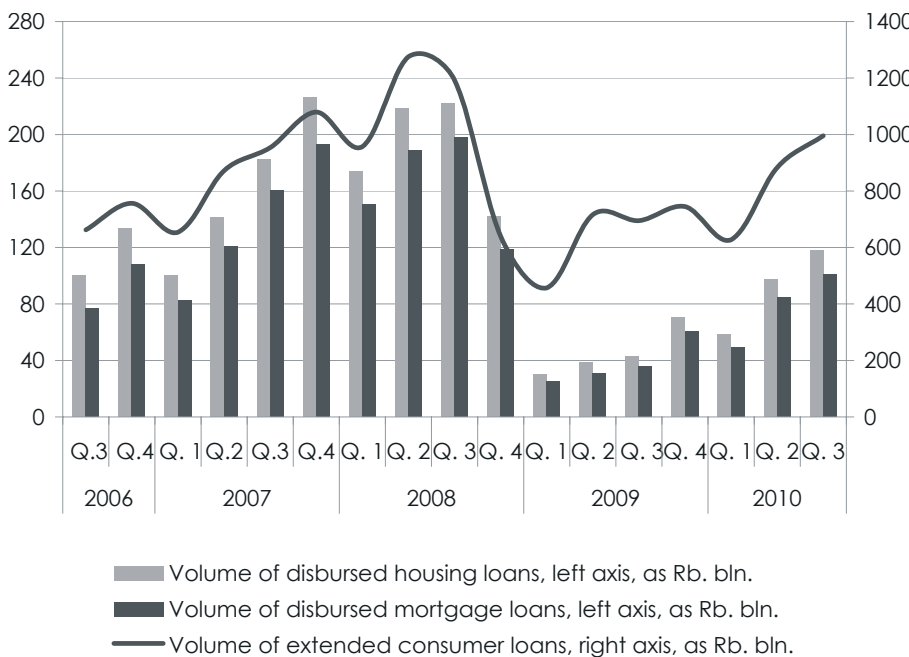
- A number of draft alterations in the law against money laundering were introduced into the State Duma for consideration. They envisage that all cash transactions in excess of 600 thousand rubles should be thoroughly controlled. Provided the alterations are adopted, bankers will get more inclined to refuse services to suspicious clients, for example to those who carry out transactions that appear economically senseless.

- As of January 2011, companies will be able to reduce the taxable basis of interest on ruble-denominated credits to a greater degree than that of interest on foreign-exchange-denominated credits. As far as the tax load is concerned, this innovation will reduce the cost of servicing ruble-denominated credits and will make the servicing of foreign-exchange-denominated debts more expensive. Experts believe that this measure will induce companies to increase their ruble-denominated borrowings and to convert foreign-currency-denominated credits into ruble-denominated ones. ●

MORTGAGE IN RUSSIAN FEDERATION

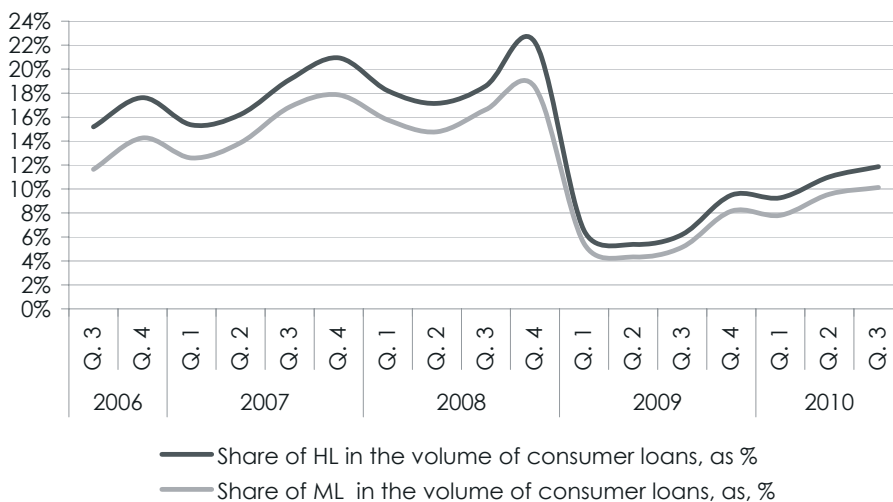
G.Zadonsky

The 3rd quarter 2010 saw volumes of housing loans soar continuously. The volume of mortgage loans extended over the three quarters of 2010 (worth a total of Rb. 234.2 bln) has been 2.55 times greater than the respective figures of 2009, while still 2.29 times lower than the respective indicators reported over the same period of 2008. As of 1 October 2010 the MIA concluded 17,352 contracts on financial guarantees for housing construction under the aegis of the ‘Stimulus’ program.



Source: the CBR data

Fig. 1 The Quarterly Dynamic of Loans to Private Individuals



Source: the CBR data

Fig. 2. The Proportion of Housing Loans and Mortgage Loans in the Volume of Consumer Loans, by Quarters

According to the CBR, over the first three quarters 2010 credit institutions extended 250,961 housing loans (HL) (worth a total of Rb. 273,390 mln.), including 187,308 mortgage loans (ML) totaling Rb. 234,210 mln. As many as 184,936 MLs were granted in Rb. equivalent, making up a total of 222,992 mln. As of 1 October 2010, the remaining ML balance accounted for Rb. 1, 069.607 mln. (as of 1 April 2010 – 1, 006. 714 mln., as of 1 July 2010 – Rb. 1,033.813 mln.), including Rb. 884,205 mln. in Rb.-denominated loans. The volume of extended over the three quarters 2010 MLs has been 2.55 times greater than the respective figures of 2009, while still 2.29 times lower than the respective indicators reported over the same period of 2008 (Rb. 537, 463 mln.). In Q3 2010, the volume of extended MLs was 2.82 times greater (Graph 1) than the one reported on Q3 of 2009.

According to the Roseestr, in the third quarter 2010 the number of registration entries on mortgaged housing for private individuals rose to 183, 137 units and over the three quarters 2010 accounted for 425,932 entries vis-a-vis 348,077 entries registered over the whole 2009.

The third quarter 2010 saw a continuously advancing rise in the volume of housing loans and mortgages vs. the volume of extended consumer loans. During the period in question the proportion of housing loans in the volume of extended consumer ones soared 1.97 times compared with the same period of the prior year, yet substantially falling behind the respective figures of the third quarter 2009 (Graph 2)

As of the end of Q3 2010, the residual debt on Rb.-denominated mortgages rose at 10.79% vs. Q3 2009, while outstanding debts posted a stunning 62.7% growth and totaled Rb. 25.02 bln, or 2.83% of the residual debt. As of 1 October 2010, the residual debt had shrunk at

11.07% vs. the respective figures of 2009, while the outstanding one climbed up by 61.97% and stood at Rb. 17.63 bln., or 9.51% of the residual debt on forex-denominated loans (Graph 3).

According to the CBR, as of 1 October 2010, the aggregate outstanding debt accounted for Rb. 42, 651 bln., or 3.99% of the residual one. Region-wise, the Republic of North Ossetia- Alania was atop the list in terms of the said proportion of outstanding Rb.-denominated debt, while the Chechen Republic held the same position, as far as forex-denominated loans.

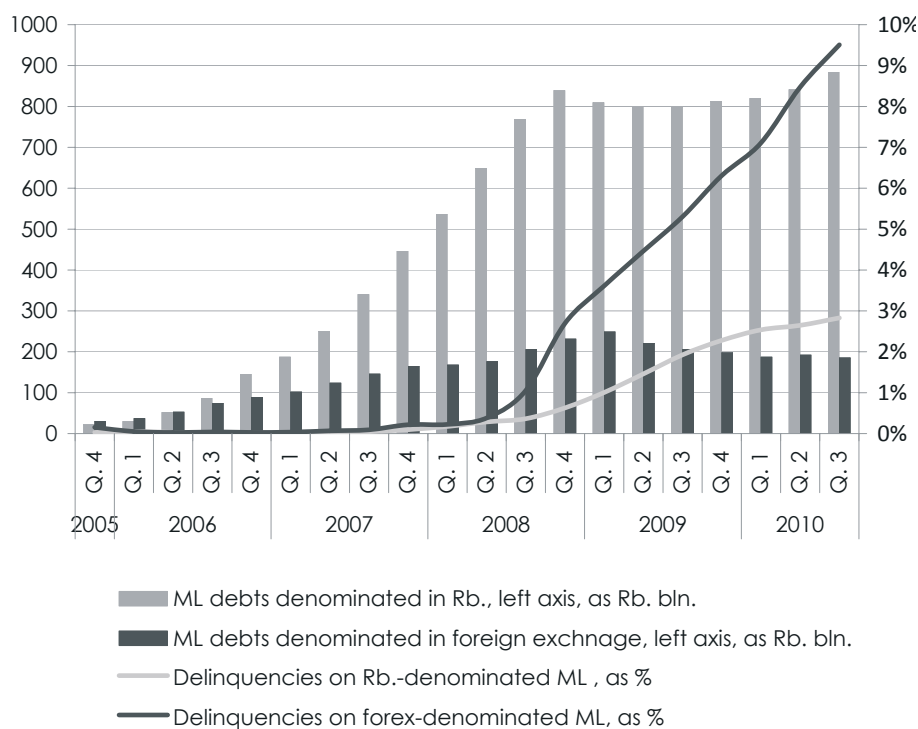
Table 1

REGIONS WITH THE HIGHEST PROPORTION OF OUTSTANDING DEBT ON MORTGAGE LOANS, AS OF 01.10.2010

| RF Subjects- leaders in terms of extended Rb.-denominated loans | Outstanding debt, as % to the residual debt on Rb.-denominated loans | RF Subjects- leaders in terms of extended forex-denominated loans | Outstanding debt, as % to the residual debt on forex-denominated loans |
|---|--|---|--|
| Republic of North Ossetia- Alania | 16,42 | Chechen Republic | 50,00 |
| Omsk oblast | 7,99 | Kabardino-Balkar Republic | 32,25 |
| Volgograd oblast | 6,59 | Tver oblast | 28,75 |
| Kemerovo oblast | 6,00 | Republic of North Ossetia- Alania | 24,14 |
| Samara oblast | 5,36 | Magadan oblast | 23,81 |
| Kaliningrad oblast | 4,67 | Amur oblast | 20,99 |

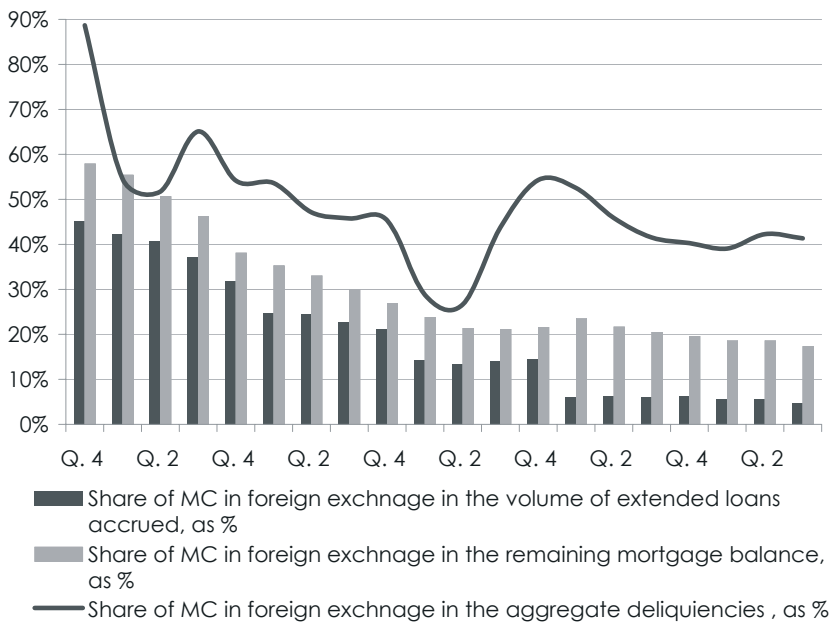
Source: the CBR data

The proportion of forex-denominated housing loans in the aggregate volume of mortgages granted in Q3 2010 tumbled from 6.07% to 4.78% vs. the same period of 2009. The proportion of debts on forex-denominated mortgages in the aggregate debt plunged from 20.51% as of 1 October 2009 to 17.33% as of 1 October 2010; however, the proportion of outstanding arrears on forex-



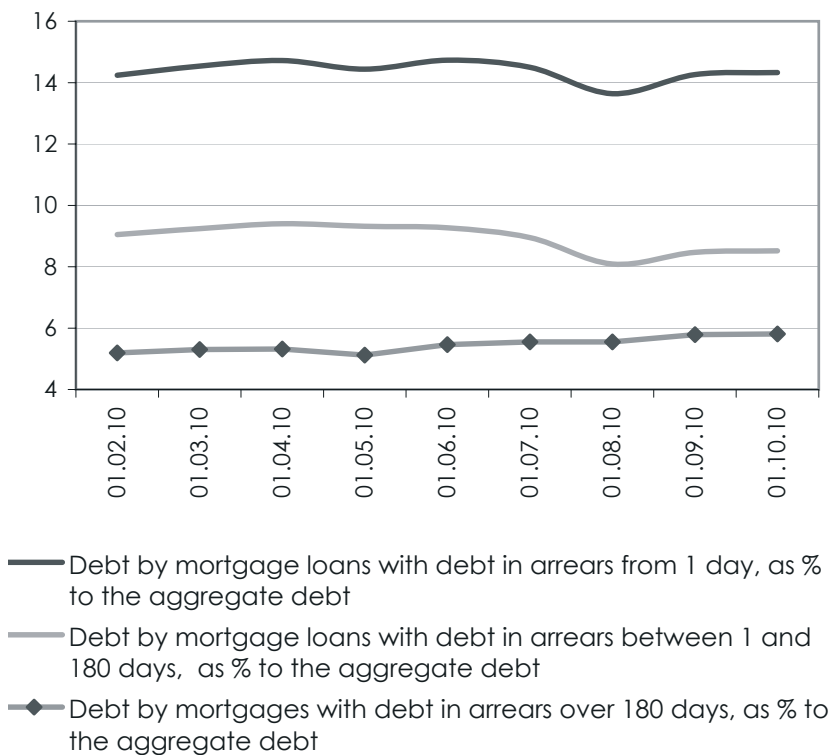
Source: the CBR data

Fig. 3.



Source: the CBR data

Fig. 4



Source: the CBR data

Fig. 5

between average-weighted over the month values of terms of Rb.-denominated mortgages and the refinanced by the MIA loans narrowed. More specifically, the Bank of Russia's data allows ascertaining that the term of loan average-weighted over the month extended to 16.7 years, while the MIA data suggests the 17.3 year term (Graph 7). The average-weighted over the year term of loan by Rb.-denominated mortgages was oscillating in the region of 16.4 years in Q3, while the one by forex-denominated loans plunged from 13.8 years in July down to 13.5 years in September.

denominated mortgages in the aggregate outstanding debt proved to be far greater accounting for 41.33% (Graph. 4)

The proportion of the residual debt on defaulted mortgages in the aggregate debt posted a slight growth in Q3 2010 – from 13.64% as of end-July to 14.33% as of 1 October. Meanwhile, overdue debts made up 3.99% of the residual debt as of the same date. The proportion of the residual debt on defaulted mortgages (with arrears over 180 days) also grew slightly by the end of Q3 from 5.55% to 5.81% of the aggregate residual balance and accounted for Rb. 62.14 bln. (Graph 5).

While the MIA has held a leading position in terms of lowering its interest rates (with the minimal one being 9.28% and maximal – 13.2%), by the end of Q2 2010 there was noticed growth in the average-weighted interest rates on Rb.-denominated mortgages the Agency refinanced over the month. The growth slowed down in Q3 under the average rate of 11.73%. According to the CBR, the average-weighted interest rate on Rb.-denominated mortgages extended over the month tended to decline and accounted for 13.2% over the period in question (Graph 3). The CBR data suggest that the decline in the average-weighted interest rate on Rb.-denominated mortgages extended over the year stopped at the 13.4% mark in Q3 2010, while the respective interest rate on forex-denominated loans slid to 11.1% in August and September.

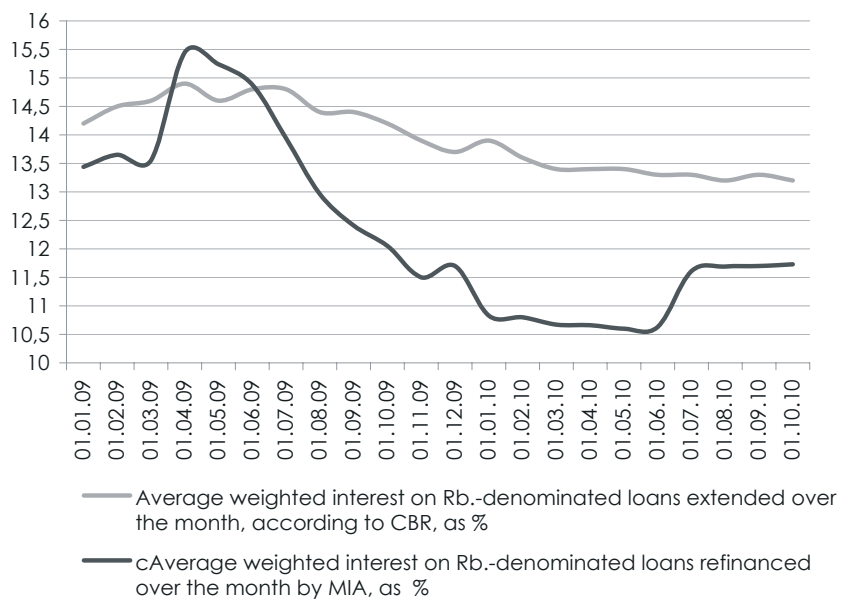
In the third quarter 2010, according to the CBR, the gap

Over the three quarters 2010 the MIA refinanced mortgage assets worth a total of Rb. 37.1 bln, or at 22.5% more than it did over the whole 2009 (30.3 bln.). Since the beginning of 2010 the MIA's share in the aggregate residual debt on the mortgage market rose from 13 to 15.4%.

A task force consisting of MPs, representatives of the Ministry of Regional Development, Ministry of Economic Development, the Fund for Development of Housing and the MIA crafted amendments to the Urban Development, Land and Tax codes with the aim to encourage a comprehensive development of territories for the sake of construction of "economy-class" housing on federal and municipal lands and ensure lower housing prices.

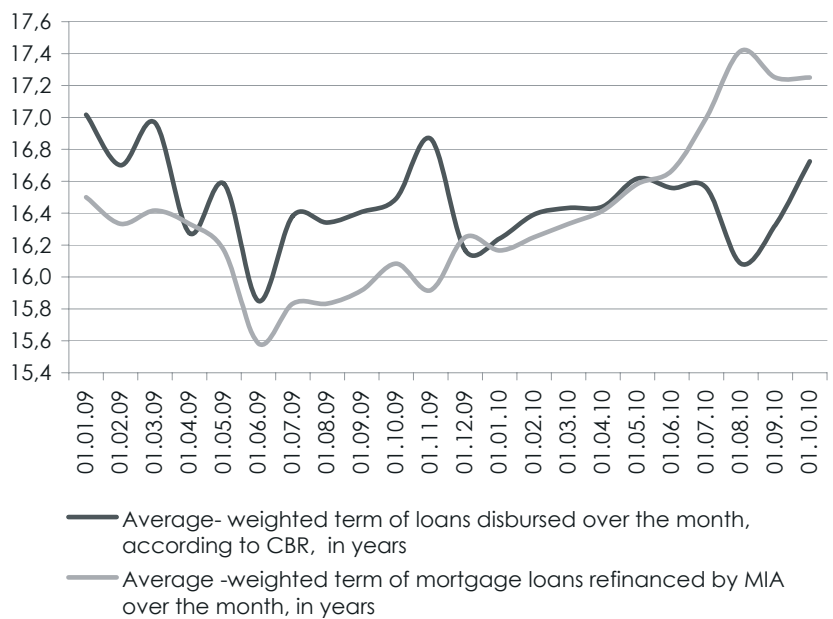
Between early 2009 and 1 October 2010 the MIA concluded 17,352 contracts on financial guarantees for housing construction in Russia in the frame of the "Stimulus" program.

The MIA devised a "Low-rise housing" program for those who are going to buy or construct low-rise housing in settlements with modern infrastructure.



Source: the CBR data

Fig. 6



Source: the CBR data

Fig. 7

REGULATION AND OVERSIGHT IN REGARD TO THE SAVINGS COMPONENT OF COMPULSORY PENSION INSURANCE IN RUSSIA AND OVERSEAS

L.Mikhaillov, L.Sycheva

The current Russian system of public regulatory and oversight agencies in the area of the savings component of the compulsory pension insurance suffers from overly atomized functions. An analysis of the allocation of functions in the area of formation and investing pension savings between public agencies shows that it is the Federal Service for Financial Markets that embraces the core function of exercise of oversight over the NPF's operations in the area of compulsory pension insurance, while normative and legal regulation in the said sphere has been assigned to three agencies – that is, the RF Ministry of Finance, the RF Ministry of Health Care and Social Development, and the FSFM.

The recently launched discussion on prospects of the Russian pension system and results of its reform has formed a perfect pretext for examination of various aspects of its efficiency. One of less discussed yet painful aspects is regulation and oversight in regard to the savings component of compulsory pension insurance. From the very onset, the peculiarity of organization of oversight in the area implied the respective mandate being split between several agencies. There might have been several reasons behind the move, including a major one – namely, the specificity of the savings system *per se*, which on the one hand, has emerged as an element of the social security architecture, while being impossible to implement without entering the financial markets. Plus, the architecture of the saving component appears complex due to co-existence of two components therein, that is, the PFR and NPF. Both types of insurers in the compulsory pension insurance area had already existed and exercised their own functions when the savings component of pension insurance was added to them. Most countries ever introducing a similar level of pension insurance opted for development of specialized institutions.

But, even with account of the aforementioned peculiarities, the current Russian system of public regulation and oversight agencies dealing with the savings component of the compulsory pension insurance suffers from an excessive atomization of their functions. Hence, a chronically delayed reaction to the dynamic environment (the situation on the financial markets, the rise and development of investment instruments). Meanwhile, there exist lacunas and discrepancies in regulation of a number of aspects (more specifically, accounting procedures in pension funds, audit of corporate executives' performance, a specialized depository, which none of the public regulatory bodies in the sphere of formation and investing of pension savings has failed so far to embrace).

Division of powers between public agencies in the area of formation and investing of pension savings

Division of powers between public agencies in the area of formation and investing of pension savings was defined by the RF Government Resolution №190 “On the authorized federal body of executive power on regulation, control and supervision in the area of formation and investing of pension savings’ and the RF Government Resolution № 669 “On the authorized federal body of executive power exercising public regulation of operations of non-government pension funds on non-government pension provision, compulsory pension insurance, supervision of, and control over the said operations”.

The activity on public regulation in the area of formation and investing of pension savings is exercised by the RF Ministry of Finance. Its functions comprise:

- Adoption of normative legal acts (issues of information disclosure standards, forms of reporting, structure of pension savings and restrictions on their investing by subjects of relations on formation and investing of pension savings (hereinafter referred to as subjects of relations);

– Forwarding to subjects of relations requests on provision of information associated with their exercise of activities on formation and investing of pension savings, as well as other information, with account of requirements set by the federal law.

Meanwhile, the RF Ministry of Health Care and Social Development exercises the function of public regulation of operations of non-government pension funds on compulsory pension insurance with respect to legal relations between the nongovernment pension fund and insured individuals and their legal successors, as well as with respect to legal relations to which the Pension Fund of RF is a subject. The Ministry has also been mandated to exercise supervision and control functions with respect to the above operations.

The Ministry's functions comprise:

1. Adoption of normative legal acts, including:
 - model insurance rules of the non-government pension fund (on the FSMS's consent);
 - model form of the contract on compulsory pension insurance (on the FSMS's consent);
 - application forms by an insured person on transition from the PFR to a non-government pension fund and vice versa, as well as from one non-government pension fund to another, guidelines of their completion, and the procedure of informing the insured of the said application forms and guidelines of their completion;
 - procedures of the exercised by the NGPF notification of the PFR and FSMS on newly concluded contracts on compulsory pension insurance;
 - the form of notification on termination of the contract on compulsory pension insurance;
 - the form in which the information of the state of the pension account of the savings part of the labor pension and results of investing of pension savings is forwarded to the insured;
 - the form of the notification by NPF of the FSMS of the volume of pension savings the previous insurer reassigned to a new one (on the FSMS's consent); the procedure of information exchange between the NPF and PFR in the electronic form;
 - a model form of the agreement between NPF and the organization on the reciprocal authentication of signature;
 - the procedure of notification by NPF of the PFR on applications for establishing the savings part of the labor pension;
 - procedures and timelines of acceptance and accounting by the PFR of data on the insured in the individual (personified) accounting system as well as entering the said data onto individual personal accounts of the insured;
 - guidelines with respect to the procedure of conduct of the individual (personified) accounting of the data on the insured.
2. To communicate with the FSMS on matters of appropriateness of conducting inspections of subjects of relations, including those conducted in the event of reorganization of non-government pension funds;
3. To forward to the FSMS and NPFs inquiries on provision of information necessary for exercise of functions within the limits of the respective mandate, as well as any other information with account of requirements of the federal law;
4. To consider, within the limits of its competence, complaints (applications, claims) lodged by private individuals and legal entities with regard to a violation of the federal Act "On non-government pension funds"
5. To exercise, within the limits of its competence, other activities foreseen by the federal Act "On non-government pension funds", other federal acts and normative legal acts by the RF Government.

As well, the RF Ministry of Health Care and Social Development:

- Submits to the Government drafts of normative legal acts that regulate the PFR's operations;
- Sets inspections of the PFR's operations.

Activities on control and supervision in the area of formation and investing of pension savings fall under the FSMS's purview. More specifically, the agency exercises the following functions:

1. Adoption of normative legal acts on the compulsory pension insurance, except for the government regulation of legal relations, which is subject to the RF Ministry of Health Care and Social Development's mandate, including establishment of:

- procedures of submission by the NPF of an application on its intention to exercise activity on the compulsory pension insurance as an insurer, its registration, and publication of data on registration of such an application;
 - procedure of identification of the market value of assets and the one of net assets in which pension savings were invested;
 - procedure of identification of an investment index (indices) for investing pension savings in a respective class of assets and, in particular, managing the investment portfolio whose structure has been identified in the form of the investment index;
 - procedure of calculation of results of investing pension savings to be reflected on pension accounts of the savings part of the labor pension;
 - compulsory conditions of a trust agreement the NPF has to enter into with a management company (on the FSMS's consent);
 - procedure of, and timelines for disclosure by the management company, which exercises trust management of pension savings formed within the NPF, of information on the structure and composition of its stakeholders (participants);
 - procedure of, and timelines for disclosure of a specialized depository, which has entered in an agreement with the NPF that exercises formation of the savings part of the labor pension and the management company that exercises investment of pension savings, of information of the structure and composition of its shareholders (participants);
2. Exercises supervision of, and control over compliance by the subjects of relations of the RF law on formation and investing of pension savings;
 3. Imposes the ban on conduct of all the operations or their fraction by the NPF or revokes its license, should there be exposed violations of requirements of the Russian law or normative acts adopted pursuant to them;
 4. Informs the Pension Fund of RF of NPFs that carry out operations on the compulsory pension insurance within 10 days upon imposition of the respective ban or revocation of the license;
 5. Forwards to the subjects of relations requests on provision of information associated with their exercise of activities on formation and investing of pension savings, as well as other information, with account of requirements set by the federal law;
 6. Conducts inspections, including those initiated by the RF Ministry of Health Care and Social Development, on the subjects of, and participants in relations;
 7. Communicate, within the limits of its competence, on issues with regard to conduct of examinations of the subjects of, and participants in relations, with federal bodies of executive power mandated to exercise regulation of professional activities of the noted entities and control over their operations as per the RF law;
 8. Issues notes of improvement to the subjects of relations to remedy exposed breaches of legal requirements;
 9. Considers audit opinions on reports by the subjects of relations;
 10. Publishes in mass media information of pension savings instruments and financial results of their investing;
 11. Publishes in mass media the list of NPFs that carry out operations on the compulsory pension insurance, along with information of such funds;
 12. Carries out, following procedures developed by the RF Government, tenders on selection of a specialized depository and managing companies, to have the PFR conclude contracts with them;
 13. Considers the PFR's reports on collection of insurance premiums on financing the savings part of the labor pension and channeling pension savings into investing; on funds factored into a special part of the insured persons' individual client accounts, payments made at the expense of the pension savings, as well as results of investing pension savings trusted to managing companies;
 14. Sets procedures and forms of, and timelines for provision by the subjects of relations of their reports (on the RF MinFin's consent);
 15. Files lawsuits in the court of law seeking protection of rights and legal interests of the owner of pension savings.

The analysis of the division of powers in the area of formation and investing of pension savings shows that core oversight functions with respect to NPFs' operations in the sphere of compulsory

pension insurance –that is, granting access to the market (their registration, competition-based selection of managing companies and the specialized depository), monitoring of their operations, interaction with the subjects of relations, evaluation, intervention and correction are all concentrated under the FSMS’s mandate. The normative and legal regulation in the noted sphere was mandated to three agencies – namely, the RF Ministry of Finance, the RF Ministry of Health Care, and the FSMS. The latter exercises a fraction of functions in the sphere of the compulsory pension insurance in its capacity as a federal agency of executive power in the area of financial markets. The PFR’s position in the system is a special one. On the one hand, the level of regulation of, and control over its operations as an insurer in the compulsory pension system is far more lenient than the one foreseen for the NPFs, while it performs some regulatory functions in the said sphere, particularly by establishing forms of a series of documents, on the other.

The record of regulation of pension funds overseas.

Due to its comprehensive nature, the organization of the government regulation of the savings pension insurance has always been a hot potato, with debates focusing on whether it is worth assigning all the functions to a single body (and to which extent this is plausible), or splitting them between a social agency and the one in charge of financial markets regulation.

As of today, only a handful of nations (including the US, UK, Chile, Mexico, Costa Rica, Hong Kong, India, Ireland, Italy Japan, to name a few) have still retained a specialized oversight agency. Meanwhile, some countries stick to the so-called semi-integrated oversight, with a single body mandated to supervise both pension funds and insurance companies’ operations. These are, as a rule, countries with a high level of the insurance companies’ participation in the market (such as Belgium, France, Finland, Spain, Portugal, and Turkey). Lastly, over 60 nations have integrated within a single supervisory agency functions of control over pension funds and insurance companies’ operations, along with the securities market, and – in some countries, banks, too. This particular group comprises Australia, Germany, Austria, Canada, DK, the Netherlands, Norway, Poland, and Kazakhstan.

Discussions of integration of regulatory agencies with supervisory ones on the financial markets, as a rule, center on banks and stock markets institutions, while pros and contras of incorporation of pension bodies into these agencies is rarely debated. Examples from the Latin American countries¹ compelled experts to note a sole negative consequence, that is, the rise of a red-tape leviathan, which ultimately finds itself separated from the sector subject to its regulation, and the subsequent lack of efficiency needed to attain objectives in the regulatory area.

As for arguments for *a specialized regulatory body* in the pension sector, OECD experts have referenced to the following ones:

- a long-standing nature of pension products;
- a wider embrace of the population vis-a-vis other savings products, which means that the circle of consumers of these services comprises the low-income and poorly educated stratum;
- frequently noted consumers’ low tolerance to risk;
- complexity of pension products;
- the need to factor in some aspects of labor contracts between employers and unions;
- (in a number of countries) a huge number of funds, which complicates oversight of their operations;
- (in a number of countries) zero profitability of pension funds, which dictates an approach to oversight other than in the case of commercial institutions;
- (in a number of countries) participation in pension plans is a must.

A high level of the government’s engagement in the pension system should also be taken into account, as this is where the fundamental peculiarity of pension funds lies, which make them special vis-a-vis other financial services. The integrated oversight may fail to display all its pluses in models wherein the government plays a greater role in the pension system, and a system with a specialized supervisory agency may prove to be more adequate. ●

¹ David Madero, Stephen Lumpkin. A Review of the Pros and Cons of Integrating Pension Supervision with that of Other Financial Activities and Services - THE INTERNATIONAL ORGANISATION OF PENSION SUPERVISORS Working Paper No.1 1 August 2007, “Finansovaya gazeta”, 2009, N 41-42

THE OUTCOMES OF THE PENSION REFORM AND LONG-TERM PROSPECTS OF THE PENSION SYSTEM'S DEVELOPMENT

V.Nazarov

In November 2010, the RF Ministry of Health Care and Social Development developed and submitted to the RF Government a report entitled "The Outcomes of the Pension Reform and Long-Term Prospects of the Pension System's Development with account of the global financial crisis".

The RF Ministry of Health Care and Social Development developed a report entitled "The Outcomes of the Pension Reform and Long-Term Prospects of the Pension System's Development with account of the global financial crisis". Some of its provisions can be questioned.

1. The thesis about existence of fundamental differences between insurance premiums raises certain doubts. The opposition between the tax and the contribution is used in the Report as a rationale for implementation of the following measures:

1) Increase of insurance premiums, which is interpreted as a lever fundamentally different from the tax burden;

2) Administration of insurance payments separately from taxes.

The difference of insurance premiums and taxes in Russia, as well as the "insurance nature" of the said contributions, appears somewhat exaggerated.

First, an employer sees no fundamental difference between paying mandatory pension contributions for an employee and paying taxes, which is why the value of insurance premiums can be conceived of as a part of the *tax burden* on corporations and the labor market. The analysis of foreign literature evidences that most researchers interpret mandatory insurance contributions collected from the labor compensations fund as a component of the tax burden.

Secondly, various components of the insurance premium used in Russia to a significant extent differ from a classical insurance, where insurance payments are determined by the value of insurance premiums:

– the savings component of the premium to a larger extent constitutes a form of compulsory saving, rather than insurance per se, as payments on the savings part of the pension to a significant degree are determined by pension funds and managing companies' operational efficiency. It may well happen that, having paid a greater premium, an employee will be entitled to a lesser savings part of his labor pension, as his savings have been invested inefficiently; meanwhile his peer might have paid a smaller premium, albeit picked a more profitable pension fund, and will ultimately enjoy greater payments. This is not a typical case in the classical insurance, where under the same level of risk, a greater volume of the premium implies a greater payment upon the contingency;

– The insurance component of the premium appears to a greater degree consistent with the classical insurance fundamentals; however, in this particular case the future pension depends both on the size of the premium and the state of the labor market as of the moment of payments of the pension;

– A solidary tariff is a tax per se, and once paid, has no impact on the size of the future pension.

It should be noted that while until 2010 "the solidary part of UST" (used for paying the basic part of the pension) accounted for 28.6% of contributions on the mandatory pension insurance, under "transition to insurance principles" and an increase of tariffs in 2011, the proportion of the solidary tariff (i.e. the tax component, essentially) in the overall tariff of the mandatory pension insurance soars to 38.5%. As a consequence, in 2011 insurance premiums will form taxes to a degree greater than the abolished UST used to be.

This is not to criticize the design of various components of the pension system, as it should not necessarily rest upon purely insurance fundamentals. It is quite permissible to have it combine mandatory insurance, mandatory savings, and tax. But the difference between these components

should not be exaggerated. A 26% “insurance premium” (and it may be increased in the future) from the salary constitutes the same fiscal burden on the economy and affects economic growth rate in the same way as a tax with the same rate would.

The conclusion on illegitimacy of the overemphasizing of differences between taxes and mandatory insurance premiums is indirectly proved by a proposal in the body of the Report on fixing with the pension Fund of yet another revenue source, which should not be associated with an increase in the fiscal pressure on the corporate labor compensations fund (for instance, a fraction of the VAT), to complement insurance premiums.

Conclusions:

1) *Employers are correct in perceiving the increase in insurance premiums as a greater tax burden; hence, tax dodging and slowdown of economic growth rates are inescapable;*

2) *The transfer of administration of the premiums from the FTS to PFR should not rest upon ascertaining a solely substantive difference between premiums and taxes.*

2. An overly positive assessment of abolition of the uniform social tax, its replacement with individual insurance premiums and transfer of their administration to extrabudgetary funds can be criticized harshly. This move ignores the past record of the 1990s, when Russia would employ a model which was based upon similar practices. The model in question proved to be inconvenient, as it engendered an excessive administrative practice both for the government and taxpayers, This was ascribed to the following factors:

- while starting a new business, taxpayers are compelled to seek registration from both registration agencies and extrabudgetary funds. This slows down the process of the start of business operations, and businesses themselves see it as a serious administrative hurdle;

- granting extrabudgetary funds’ executive arms powers to control the timely and correct payments of respective contributions, as well as the mandate on their compulsory collection fueled growth in the number of inspections carried out with respect to the taxpayers and increased corruption risks;

- the taxpayer was compelled to submit copies of documents on the request of each and every inspecting agency, which dramatically increased the paperwork for both the taxpayer and government agencies;

- each extrabudgetary fund had to have inspectors on its payroll and finance, control and inspect their activities;

- each individual supervisory agency did not have at hand all the information on the taxpayer, as the data one of inspectors obtained, was not subject to an automatic sharing with the others. As a consequence, violations of the law, related to, for example, lowering of the base on payments to extrabudgetary funds exposed by one inspector did not result in a compulsory holding the taxpayer responsible for the failure to pay contributions to all the other funds, nor it meant fines and arrears on the latter that would be subsequently added to the bill.

The return to such a system of administration seems inappropriate, as with no alternative system of sectoral and (or) regional extrabudgetary funds competing for the taxpayer’s cash, the administration of contributions to extrabudgetary funds becomes practically undistinguishable from administration of taxes and levies as per the Tax Code of RF. As a consequence, there is no practical need in assigning to executive arms of extrabudgetary funds the powers to administer the contributions.

Currently the PFR faces a drastic fall in contributions collected therein. According to preliminary estimates, the 2010 collection plan will fall short of cashing in Rb. 150 bln. The main reasons behind this are:

1) The PFR’s lesser efficiency vis-a-vis the FTS, as far as administration of payment of contributions is concerned;

2) The employers’ preventive dodging policy on the threshold of the increase of tariffs in 2011.

Conclusion: the issue of appropriateness of the transfer of administration of insurance premiums to the PFR needs to be further examined.

3. The Report accentuates drawbacks of the savings pension system and suppresses its advantages, as well as deficiencies of the distributive pension system. Counterarguments in these respect are:

First, negative assessments of efficiency of the savings component of the pension system largely rest on projections of yields of pension savings, which, as the RF Ministry of Health Care and Social Development estimates, should be far lower than the salaries and wages growth rates. Hence the conclusion that the future pensioners will find themselves in a far better position if there are no savings pension plans at all, with pensions paid exclusively at the expense of taxation of rapidly rising salaries and wages. This ratio seems untypical of budget projections independent experts and pension funds in developed economies make. It is assumed, as a rule, that salaries and wages rise at a pace close to that of the growth in GDP, while the yields rate from investment is just insignificantly ahead of the latter. If it is suggested Russia will not stick to these macroeconomic proportions in the long run (for instance, due to a drastic growth in the share of the labor compensation fund in GDP), this calls for an additional rationale and respective scenario-based forecasts and calculations. It should be noted that while the RF Ministry of Economic Development in its current forecasts sees the share of the LCF in GDP be relatively stable, it is not clear which projections the RF Ministry of Health Care and Social Development uses to put forward its concept.

Second, in contrast to the distributive pension system, the savings one better fits into the present political agenda aimed at modernization of the country. In the frame of a distributive pension system and aging population most voters favor high pensions and high taxes, which generate risks of deceleration of economic growth and public finances going bananas. In the frame of a savings pension system, voters seek a low inflation, low taxes, and the whole set of measures aiming at a higher productivity rate, attraction of investments, and value of assets on the rise. As a result, there emerges the class of owners who are interested in the modernization scenario of Russia's development.

Third, presently economists have not yet come to terms regarding an optimal way the pension system should be revamped in response to the financial crisis. Both distributive and savings pension systems have proved to be equally exposed to recession. The international financial crisis substantially battered the size of pension systems' assets worldwide. However, the global recession also affects public distributive pension systems, as budget revenues are in the decline. Governments react to these tendencies in different ways. In some cases, they indeed abandon the savings pension system, while other nations may vehemently debate the problem of transition from the redistributive pension system to the savings one. According to the World Bank report¹, presently there are a few recommendations with regard to public pension policies:

- to refrain from drastic changes of the present course, regardless of a rapidly changing state of affairs (whereas pension systems by their nature are build to function over long periods of time, a poorly prepared action in response to short-term changes can have an adverse effect on a pension system in a longer run);
- to pay attention to the fact that presently it has been just a handful of pensioners that have suffered from the crisis (a currently pursued policy should seek to mitigate this group's losses);
- to take into account the fact that the current crisis exposed the need for diversification of pension investment portfolios and orientation of the portfolio structure towards its owner's age (increasing conservativeness of investment, the closer the retirement age is).

Fourth, the Report accentuates the fact that stability of both types of pension systems depends on production growth rates. While acknowledging accuracy of the thesis, it is worth noting that a number of researchers note that it is the savings pension system that propels economic growth to a degree greater than the distributive one does, as:

- it beefs up the financial sector's stability, with institutional investors and pension funds enjoying a permanent access to cash they receive from employers and employees, hence lesser problems with liquidity constraints;
- the share of long money in the economy is on the rise, which helps finance long-standing infrastructural projects, among others, which ensure a stable basis for economic growth;
- the political agenda undergoes certain changes, which, as asserted above, should also accelerate economic growth.

Meanwhile, the economic theory has fallen short of designing an unequivocal attitude towards transition from the distributive pension system to the savings one. In this connection, an overly

1 The Financial Crisis and Mandatory Pension Systems in Developing Countries, World Bank, 2009.

stern appraisal of one of components of the pension system and one-sided quoting of respective papers does not seem an appropriate exercise.

Fifth, poor yields from the invested pension savings in today's Russia are determined by two factors:

- a relatively short period of investing;
- a “poor design” of the savings component, being in need for improvement.

Sixth, the population would conceive of an ultimate abolition or a partial takedown of the savings component of the pension system in tandem with transition of respective resources to insurance pension capital as a “robbery” – instead of funds which were fixed with every individual payer of contributions and could be inherited, the population would receive from the government an abstract liability to pay an increased pension in the future. Politically, this is a risky bet, with the election just around the corner.

Seventh, an abolition or restriction of the mandatory savings components of the pension system will have an adverse impact on non-government pension funds' financial standing and send an alarm signal to foreign investors about sustainability of Russia's financial system.

Conclusion: the main emphasis should be shifted from the thesis of appropriateness of abolition of the mandatory savings component onto development of measures aimed at boosting its efficiency.

4. The Report appears overly conservative in assessing prospects of increase of the pension age. A gradual increase of the pension age seems necessary due to the following reasons:

1) In the frame of a distributive pension system, in the long run there is no other way to increase the ratio of the average salaries and wages to the average pension (the replacement rate) without a further increase in insurance premiums.

2) Increase of the pension age for women and men, coupled with some modifications of the rules of indexation of pensions, allows lowering costs of the pension system under stabilization of the replacement rate.

3) An early retirement age encourages an early refusal of labor activity and narrows the horizon of one's productive life.

It should be noted that it is Ukraine, Belarus and Uzbekistan that are the only countries in the world where the retirement age is as low as in Russia.

The rationale against increase of the pension age does not appear ambiguous.

1) “The life expectancy rate in Russia is low and men simply do not survive until the pension age”. Behind the low expectancy rate in Russia are alcoholism, drug addiction, and road accidents. While considering the target pension-wise social group, i.e. those who have faced the risk of lower income as a result of their reaching an older age, the picture appears different. The life expectancy rate for a male who has reached the age of 60 is 73 years, while for a female – 78 years. This concerns most Russians, as some 60% of men and a. 90% of women survive until the age of 60. Plus, increasing the pension age is a very long process, for it is impossible to drastically increase the pension age once the life expectancy rate has risen – this needs to be done early and gradually.

2) “Elderly employees will not find a job” or “increase of the pension age can result in a greater unemployment rate of the young”. This perspective is explained by the recent situation in Russia, when the number of able-bodied residents was on the rise. At the time, guided by both objective and subjective reasons, employers would often favor younger employees. The impact of this particular factor should fade away in the medium term, as Russia has already entered a long-lasting period of depleting labor resources. According to the RF Ministry of Economic Development's projection, the number of the employed population should plunge by 4 mln. over the next decade, while that of able-bodied residents should tumble at 12 mln. That is why demand for both the elderly and the young on the labor market will grow inevitably.

To minimize political costs of increase of the pension age, the process should be gradual and concern only those who presently are relatively young. An optimal option seems to be a gradual increase of the pension age for those who face another 5-10 years to go before retirement, as per the effective law. The graduality of increase of the pension age should be ensured (e.g. by 3 month a year for men and 6 months- for women). So, 25-30 years should pass between the moment one makes the respective decision and the time he reaches the pension age of 65 years. By that time, given a sound demographic policy, the life expectancy rate might catch up with the present indicators

across the OECD countries in most of which the common retirement age for both genders is 65 years. Presently an increase of the pension age up to 65 years for Russian residents aged 30 should be a relatively safe move politics-wise. By contrast, if done later, when this generation has reached 50 years, it may provoke a serious political crisis.

5. The Report does not pay due attention to the problem of establishment of a scale of insurance premiums.

Today, the following decision has been realized to increase the level of balanceness of the pension system:

1) A drastic increase of the pension insurance tariff rate (it will become one of the highest across the OECD);

2) Setting the upper margin of payments to an employee for accrual of premiums at the level of Rb. 415,000 a year. The decision is explained by the fact that in the conditions of the current pension law, an increase in pension contributions leads to a symmetric increase in the pension system's liabilities with regard to pension payments, with sizeable obligations arising before the wealthier strata of the population. The rise of such obligations is considered inappropriate, which is why a two-stage scale is to be introduced since 2011, with the tariff rate accounting for 34% (of which 26 p.p. should go to the pension system) for salaries and wages under Rb. 463,000, while the one for salaries and wages above 415,000 should make up 0%.

Such an approach results in:

1) A sharp decrease in progressivity of the taxation (the needy secure their pensions and those of the current pensioners, while the wealthy pay disproportionately low premiums and, accordingly, will receive low pensions relative to their wages);

2) Impossibility to secure, at the expense of the system of premiums, pensions at least matching the subsistence level in the Far North regions;

3) A greater vulnerability of the said system vis-a-vis unanticipated inflation spikes (with an additional indexation of the upper margin of salaries and wages over the fiscal year being impossible, there is a risk that a substantially greater part of the labor compensations fund may soar above Rb. 415,000, which has not been foreseen at the time the budget was passed).

In connection with this it is suggested to consider the following proposals on reforming the scale in question:

1) To drastically increase the scale threshold (a threshold of contributions for the insurance and savings parts of the pension amounting to 200% of the average salaries and wages countrywide secures a greater territorial balanceness of the pension system to pay socially acceptable pensions in the regions where salaries and wages are substantially above the average nationwide ones; meanwhile, this option does not engender the pension system's excessive obligations before wealthy strata of the population);

2) To set the levy of sums in excess of the noted threshold at a tariff of 2-10 p.p., with the respective funds being used to finance the solidarity component of the pension system without generating additional pension obligations before the "wealthy strata of the population". So, the wealthy carry the burden of the solidarity tariff on a par with the needy. Plus, there will be lesser incentives to transfer a considerable fraction of LCF onto the wealthiest employees in order to lower the amount of contributions. It should be noted that until 2010 salaries and wages in excess of Rb. 600,000 a year were subject to the 2% UST, which was used to finance the basic part of the pension and did not result in an increase of the pension system's obligations towards the wealthiest strata of the population.

Meanwhile, the amount of the solidarity tariff to which high salaries and wages are subjected appears disputable.

First, it should not exceed the value of the solidarity tariff set for other employees. Highly paid staff can consider payment of such a tariff to be a purchase of an insurance policy with which, should their material standing is downhill in their senium years, the society will provide a certain aid to them. But the cost of the insurance should not be mondo high, and it should at least somehow correspond to an anticipated value of the insurance benefit.

Second, it would be appropriate to exercise additional progressiveness of the levy in the frame of other taxes (e.g. the real estate tax), as an excessive progressiveness of taxation of salaries and wages is a strong disincentive that hurdles the rise of the middle class.

Third, an excessive levy imposed on highly paid staff's salaries and wages may provoke tax dodging and strive to "transform" them into other kinds of revenues to minimize the burden.

Notably, the US and France employ a similar taxation mechanism: in these countries, salaries and wages above a certain threshold are subject to payment a minor 2-3 p.p. contribution.

6. The Report employs very moderate estimates of the pension system deficit that fell short of factoring into a whole series of the pension system costs which are not covered by pension premiums, but funded out of the federal budget (e.g. valorization costs).

7. A number of proposed measures need to be further specified, otherwise they would appear divorced from reality.

For example, it is asserted that "one of the most efficient measures of the state regulation of the pension system financial sustainability in the short run might become liquidation of latent salaries and wages, which between 2000 and 2009 surged from 11.1% to 13.8% of GDP and now account for half of the labor compensations fund. Collecting insurance premiums from these salaries would allow a Rb. 0.9 trln-worth drop in the PFR budget deficit already in 2011". It is absolutely unclear how, in the conditions of the growing tax burden on the LCF and introduction of a superaggressive taxation scale, this can be implemented.

8. It is proposed in the Report to limit pension payments to working pensioners. Recent practice has already demonstrated that an attempt to do so results just in a greater illegal employment, not in refusals to receive pension. That is why we believe the government should drop the temptation to deprive the working pensioners of the possibility to have the basic part of the pension paid, but employ more efficient levers, such as:

- 1) An increase of the pension age for the "young", and
- 2) Encouragement of a late, albeit voluntary, retirement (and refusal to receive pension until the moment of retirement) for the elderly. ●

RUSSIAN CONCEPT OF LOCAL SELF-GOVERNANCE VIS-A-VIS EUROPE'S: WHITHER DIVERGENCE?

I.Starodubrovskaya, N.Mironova

Whilst the Congress of Local and Regional Authorities of the Council of Europe made an unconsoling diagnosis of the state of local self-governance in Russia and suggested the nation should dump recent initiatives on limiting municipal bodies' independence and broadening their financial and political autonomy, the actual processes in Russia have taken an opposite direction. The proof to this has become passing in the second reading amendments to the municipal law that concern the possibility to integrate municipal district administration with the one of the municipality's administrative center, as well as the developing process of forcing into application in large cities of a city manager model, which drastically limits the local community's possibilities to exert influence on the local policies.

The municipal reform model in Russia was selected in 2003 due to its consistency with international standards and requirements of the European Charter of Local Self-Government (hereinafter referred to as the Charter)¹ in particular. But since then the implementation of the Charter has drifted far from the initial plans, which has stirred the national and international communities' concerns. In the autumn of 2010, the Congress of Local and Regional Authorities of the Council of Europe (the Congress) presented the third Report on the state of Russian democracy in the light of implementation of the Charter. The Report highlighted serious negative tendencies in the sphere concerned². The Report was developed by Kristopher Newberry (UK) and Knud Andersen (DK), who visited Russia twice - in December 2009 and April 2010.

Certain drawbacks in the respective Russian law had been noted before, too. Back in May 2004, the Congress labeled the division of powers between bodies of public power as an unsatisfactory one. However, in the last report (October 2010) the criticism has become far more substantial and systemic. More specifically, in order to improve the national legislation in the local-self-governance area, Russian authorities are recommended to:

- Abolish recent amendments to art. 74 of federal Act of 6 October 2003 № 131-FZ "On general principles of organization of local self-governance in the Russian Federation" that concern dismissal of city mayors so that to guarantee for them the possibility to freely exercise their powers in office without being concerned of interference or political pressure by legislative bodies or governors;
- Continue to improve the division of powers between federal, regional and local government bodies and undertake measures on cutting the number of combo mandates and spheres subjected to them;
- Appropriate respective funding for local authorities or permit them to collect taxes, as per the Charter, to make them able to exercise their mandate in the area of the public services delivery;
- To ensure that integration of localities is done only upon holding consultations with respective elected assemblies.

The list above does not comprise all the Congress's recommendations, making it clear nonetheless that they question consistency with the European Charter of some fundamental provisions of the municipal law and recent amendments adopted to further the process of introduction of substantial limits with regard to local authorities' autonomy and de-facto putting them under the regional authorities' political control. We have repetitiously emphasized in the earlier reviews the disruptive impact such measures have had on advancement of local self-governance. In 2011, the Congress representatives will monitor the Russian Government's compliance to the above recommendations. Is there any reason to assume this unconsoling tendency is going to change? The answer is, hardly any. In any case, there are no grounds to assume any other scenario.

1 By joining the Council of Europe and ratifying in 1998 the Charter, Russia has assumed certain obligations with regard to development of local self-governance

2 Sovet Evropy postavil Rossii neuteshitelnyi diagnoz.//Echo planet Itar-Tass. 10 November 2010. http://ekhoplanet.ru/world_500_8910

Yet another proof to this perspective became the State Duma's support of a recent legislative initiative put forward by Leningrad oblast. The initiative allows one not to establish a local administration in a settlement that forms the administrative center of a municipal district, but implies that its functions should be mandated to the administration of the said district. A few months ago – in the May review – we noted that the initiative had been suspended, as it fell short of winning support both of the expert community¹ and a number of federal structures. Meanwhile we doubted the new assault on the settlements' rights was effectively repelled, and our doubts proved to be far from being groundless.

The State Duma Committee on matters of self-governance considered the bill at its meeting on 2 June 2010, found “legal uncertainties” and contradictions to Russia's international obligations therein, and recommended MPs to decline it. However, in mid-summer the Committee's opinion reversed at 180 degrees, and on 7 July 2010 the amendment to the federal Act # 131-FZ, which foresees that, should no local administration is to be established in an urban municipal entity, its mandate has to be assigned to the district administration, was passed by the State Duma in the first reading. While preparing it for the second reading, the scope of effect of the amendment was extended and the possibility to establish consolidated administration was also foreseen for any settlements that form administrative centers of municipal districts. Meanwhile, MPs dumped the idea of a meticulous regulation of integration procedures and left the problem of setting concrete mechanisms of interaction between the municipal district and the settlement at the discretion of those local self-governance bodies which would seek to establish an integral administration. That occurred shortly after an attempt to regulate these problems in the law, which had been made in the course of preparation of the amendment for the second reading, de-facto failed.

Notably, the original version of the amendment in question comprised a clause which established that the circle of subjects that might put forward an initiative on liquidation of the local administration in a settlement that forms the administrative center of a municipal district should comprise the supreme executive public official of the Subject of the Federation – that is, the governor. This “reserve” has not been deployed so far to beef up centralization and further limit the local self-governance bodies' rights with regard to addressing matters associated with organization of their operations, but we cannot rule out the lawmakers would later revisit the idea (any rate, there were recent cases when earlier shelved proposals on strengthening the vertical of power have been repetitiously dusted off).

Yet another tendency on the upsurge is related to the increasingly popular local governance model which foresees that the municipality head is elected out of the local representative body, while the local administration is run by a city manager hired under a contract and with the regional authorities' vehement participation. Such a model to the greatest degree limits the local community's influence on formation of the City Hall while making sure the one of the RF Subject's administrative leadership expands.

Such a policy was typical of the previous period, too. To cite a particular example, in 2009, direct elections were abolished in Samara, Stavropol, Ryazan, Tyumen, Kazan, Ufa, Tver, among other cities. In 2010, the woeful list was extended to include Nizhny Novgorod, Smolensk, Blagoveschensk, Elista, Vladimir, Kurgan, Orenburg, Chelyabinsk, and Perm. Notably enough, this year's peculiarity became expansion of the process to conquer the urban centers exemplary for their strong and independent local governments, such as Chelyabinsk and Perm.

In the city of Perm, the procedure of abolition of direct mayoral election was launched in the spring of 2010, with the final decision taken in the summer. The initiative faced a vigorous protest from a public coalition named “For direct elections” founded by 7 local civil society organizations. While as many as 79% of local residents (the Levada Center data) upheld the idea of retaining direct mayoral elections of the head of the city administration, the representative body decided otherwise.

Similar attempts in Sverdlovsk oblast and Autonomous okrug Khanty-Mansy provoked serious conflicts. They have failed so far, but the recent record in this regard has not been particularly inspiring.

1 Motyakova O. “K voprosu o vozmozhnosti obyedineniya rayonnoy i gorodskoy administratsii//Munitsipal'naya vlast, № 2 (March-April) 2010, pp. 14-15. An appeal by the European club of experts in local self-governance to Y. Mildon, head of the Congress of Local and Regional Authorities of the Council of Europe

EXTERNAL LABOR MIGRATION: ONE MORE STEP TOWARDS RESTRICTION

L.Karachurina

Russia's state policy towards labor migration has passed through several stages. In the first half of the 1990s, against the backdrop of forced migrations that had literally been inundating the former Soviet space, this issue was nearly completely ignored by the authorities. In 2007, Russia liberalized its external labor migration policy. The most positive accomplishment of that initiative consisted in the fact that migrants, by virtue of being granted work permits, became free players in the labor market, while employers got an opportunity to attract and employ foreign workers arriving from 'visa waiver' countries without obtaining special permits for attracting foreign labor. In 2009, Russia imposed tough measures designed to protect its labor market in the interests of the national workforce and to control unemployment during the current period of economic crisis. In the framework of those measures, the authorities introduced intricate restrictive norms with regard to attraction of foreign workers. However, even after the officially announced termination of the crisis the application of the 'crisis norms' continued unabated. To put it more bluntly, the forces interested in large-scale illegal use of foreign labor have thereby scored yet another resounding victory.

In our previous publications it was repeatedly emphasized¹ that labor migration definitely came to the fore as the main migration pattern of the 2000s. At the same time, labor migration is likely to be the most problem-ridden component of the total migration inflow into the Russian Federation.

Russia's state policy towards labor migration has passed through several stages. In the first half of the 1990s, against the backdrop of the forced migration that was inundating the former Soviet space, the authorities tended rather to ignore it. In conditions of a systemic economic crisis and hyperinflation, it was actually Russians themselves who became labor migrants. The phenomenon of 'shuttling'², to which the most active part of the population then resorted, was nothing else but a manifestation of temporary labor migration³. It should be noted that the well-being estimates based on data collected, in 2000, from the population of Russia (by VTsIOM) and labor migrants (a sample of 1,650 households in four Russian regions) were strikingly different: the response 'good and very good' was given by 76 % of migrants, and only by 4.2 % of the total population⁴. As early as in the late 1997, in conditions of the newly emerged visa-free space, considerable flows of labor migrants from the CIS countries were entering Russia in search of work: every second labor migrant was from Armenia, every third – from Moldova, and every fifth – from Kazakhstan.

1 Karachurina L. B., *Ekonomika perekhodnogo perioda: Ocherki ekonomicheskoi politiki postkommunisticheskoi Rossii. Ekonomicheskii rost 2000 - 2007* [An economy in transition: Essays on the economic policy of post-communist Russia. Economic growth in 2000 – 2007], Moscow: Izdatel'stvo 'Delo' ANKh (the Academy of National Economy), 2008, Chapter 27, pp. 1036 - 1060; Idem, Migration Processes // Russian Economy in 2008. Trends and Outlooks (Issue 30), Moscow: IET, Section 4.2, pp. 320-338; Idem, Migration Processes // Russian Economy in 2009. Trends and Outlooks (Issue 31), Moscow: IET, 2010, Section 4.2, pp. 355 - 371.

2 According to some estimates, in 1996, approximately 30 million persons were involved – one way or another – in the 'shuttle business' in Russia (Leont'eva E. *Chelovek ne professiia, a diagnoz* [To be a human being is not a profession but a diagnosis] // *Rossiiskaia Federatsiia* [The Russian Federation], 1997, No 11, pp. 50 - 51), while Russia's annual commodity turnover in 'shuttle' trade in 1995 and 1996 amounted to more than 15 bn USD (Ai da chelnoki [Well done, shuttles!] // *Izvestiia*, 7 March 1997).

3 According to the definition contained in the *UN Convention on the Protection of the Rights of All Migrant Workers and Members of Their Families*, 'the term "self-employed worker" refers to a migrant worker who is engaged in a remunerated activity otherwise than under a contract of employment and who earns his or her living through this activity normally working alone or together with members of his or her family, and to any other migrant worker recognized as self-employed by applicable legislation of the State of employment or bilateral or multilateral agreements.' // Human Rights: Fact Sheet No 24, The Rights of Migrant Workers, Geneva, 1997, p. 35.

4 The survey was conducted in Irkutsk, Smolensk, Stavropol and Barnaul. Survey supervisor: Zh. A. Zayonchkovskaya. For the results of the survey, see *Migratsiia naseleniia. Vyp. 2: Trudovaia migratsiia v Rossii. Prilozhenie k zhurnalu 'Migratsiia v Rossii'* [Population migration. Issue 2: Labor migration in Russia. Supplement to the journal *Migration in Russia*]. 191 pages.

At the same time, in parallel with the nearly complete discontinuation of forced migration from Russia to the CIS, labor migration to Russia was becoming ever more wide-scale. In social discourse it began to be associated with illegal migration. As a result, in 2002 regulatory legislation was significantly toughened. Federal Law, of 25 July 2002, No 115-FZ, 'On the Legal Status of Foreign Citizens in the Russian Federation' introduced a distinction between temporary foreign residents and permanent foreign residents, and introduced a new mechanism – the quota for temporary residence permits (TRPs) issued to foreign citizens. Outside the established quota, a TRP could be issued to a foreign citizen who was born in the territory of the RSFSR and had held USSR citizenship in the past, or who was born in the territory of Russia. Also, the Law introduced 'resident permits' and 'migration cards' – an institution that was new for Russia but is actually widespread elsewhere in the world. By toughening the mechanisms applied to handle migration, the Law narrowed the possibilities for a foreigner to legally stay and work in the territory of Russia. A poll on the employment situation of migrant workers conducted by the Center of Migration Studies in 2004¹ indicated that, in fact, no more than 7 % of migrants had managed to register themselves within three days from the date of arrival, as required by the Law, and about 50 % of migrants had failed to find employment because of lack of registration. Correspondingly, two out of three migrants who had no registration received only undeclared 'wages in envelopes', and only 30 % of them received officially declared wages. The situation with registered migrants was directly opposite: 55 % of them received officially declared wages; 25 % received undeclared 'wages in envelopes'; and the rest received a combination of the two. It should be noted that, while the responsibility for the legality of staying in the country predominantly rests with the migrant, the registration of labor relations directly depends on the legal regulation of the labor market.

In 2007, Russia liberalized its external labor migration policy. The most positive achievement that resulted from that initiative was that now migrants, by virtue of being granted work permits, could become free players on the labor market, while employers got an opportunity to attract and employ foreign workers arriving from non-visa countries without obtaining special permits for attracting foreign labor. In order to regulate the presence of foreign workers, the authorities introduced an intricate mechanism of quotas, including quotas for foreign workers in some branches of the economy (retail trade, sports), and a number of other instruments. As usual, the new legislative package had both its backers and its opponents.

The former saw the liberalization of migration legislation as an opportunity for migrants to relatively freely compete for jobs with the local population, which was soon eventually to slow down any further rise in the cost of labor in some spheres of activity and increase labor effectiveness. And, most importantly, it was to create an opportunity for at least some of the migrants to leave the shadows, for the emergence of certain guarantees for the observance of human rights, and for a higher transparency of the labor market. Indeed, in many respects those expectations materialized: according to expert estimates, the proportion of legal migrant workers increased from 10 – 15 % to 30 - 40 %².

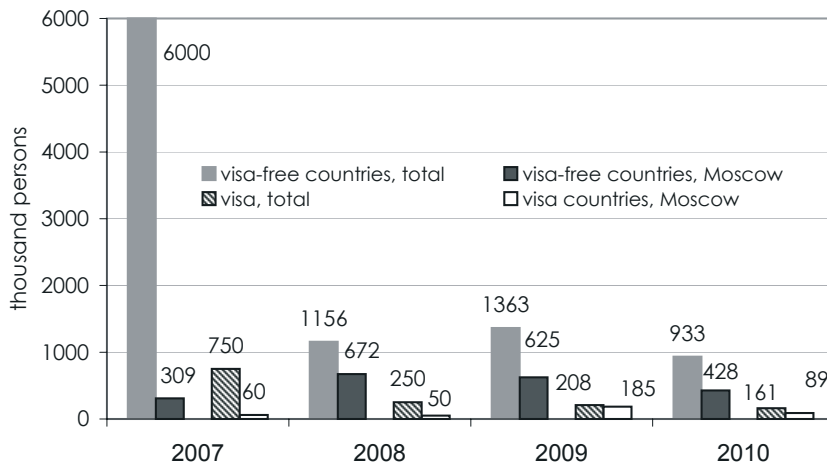
The opponents of the new legislation emphasized the emergence of knock-out prices of labor in some segments of the labor market, the displacement of native workers by migrants, and other problems like the rising crime-, sickness- and infrastructure-utilization rates.

The financial and economic crisis – which officially began in Russia in late 2008 – strengthened the hand of the restrictionists. In actual reality, however, the attack on the liberal course of the authorities had begun well before the crisis³, and the aims of this attempt at liberalization have not been achieved in full.

1 The survey was conducted in the framework of two projects undertaken by the Center for Migration Studies (under the supervision of Zh. A. Zayonchkovskaya): *Russia's New Migration Policy and the Rights of Migrants. 2003 - 2006* (McArthur Foundation) and *Transformation of the Post-Soviet Space: Its Reflection in Migrations. 2002 - 2005* (Ford Foundation).

2 Tiuriukanova E. V., Zayonchkovskaya Zh. A., *Immigratsiia: put' k spaseniiu ili troianskii kon'? // Rossiia pered litsom demographicheskikh vyzovov. Doklad o razvitiu chelovecheskogo potentsiala v Rossiiskoi Federatsii za 2008 g.* [Immigration: a road to salvation or a Trojan horse? // The demographic challenges of Russia. A report on the development of human potential in the Russian Federation in the year 2008]. A. G. Vishnevskii and S. N. Bobylev, eds. Moscow, 2009. P. 104.

3 For more details, see Vykhovanets O, Gradirovskii S. *Migratsionnaia politika Rossii poslednikh let: podvedenie itogov (2007 - 2009)* [Russia's migration policy of the past few years: Summing up (2007 - 2009)] // The Russian Archipelago Web Project of the Russian Word <http://archipelag.ru/authors/vykhovanets/?library=2766>



Sources: The RF Government's resolutions on the approval of quotas for work permits issued to foreign citizens (2006, 2007, 2008, 2009); the RF Government's resolutions on the approval of quotas for the issuance to foreign citizens of entry invitations for the purpose of engaging in labor activities

Fig. 1. The Quotas for Work Permits Issued to Foreign Citizens, As Established by the RF Government and Apportioned to RF Subjects (Less the Reserve), 2007 - 2010.

The most vivid manifestation of this trend can be observed in the framework of the measures that were then undertaken in order to protect Russia's labor market in the interests of the national workforce and to control the rate of unemployment during the period of economic crisis. In 2009, the authorities imposed a number of norms stipulating that those foreign citizens who arrived and registered (via notification) in Russia could be issued work permits that were valid only for up to 90 days. Only after that they would be able to prolong their employment period in Russia to 12 months, by submitting a draft contract with an employer, on condition that the latter had managed to obtain in advance (before 1 July of the previous year) a quota for attraction of foreign labor.

This intricate procedure gives rise to a number of serious hurdles:

- employers are not interested in hiring short-term workers because of the low economic efficiency of such employment;
- the procedure requiring that a contract should be drawn up twice is time consuming and counterproductive from the point of view of employers;
- the employer is obliged to obtain a quota for attraction of foreign labor.

The requests for the 2010 quotas had to be submitted in the summer of the (crisis) year 2009. It should be remembered, however, that even in absence of any crisis period it is by no means always easy to forecast one's demand for manpower in the next year. Thus task becomes even more difficult in crisis conditions. Only big and financially stable economic agents actually managed to adequately plan their requirements. Moreover, the interdepartmental commissions of the Russian Federation's subjects were at that time routinely refusing to issue quotas to employers, or were making substantial cuts in the requested quotas.

It should be mentioned that in December 2009, at the very onset of the crisis in Russia, the RF Government considered it appropriate to momentarily expand the previously established national 2010 quota reserve from 30 to 50 % (Fig. 1). In actual practice this move meant a palpable reduction in the regions' potential to attract foreign workforce.

Despite the formally announced termination of the crisis in 2010, there was no return to the pre-crisis status quo in the sphere of migration, which is evident even from migration statistics report forms (for example, Form 1-RD). In the current year, these forms were augmented by such entries: 'the total amount of work permits issued to foreign citizens who have arrived under a visa-free procedure for a period of up to 90 days' and '... is extended for a period of up to one year'.

The problems associated with quoting are also reflected by yet another fact: in Krasnodar Krai, where numerous Olympic facilities are currently being built, the employers had submitted requests for 70 thousand foreign workers for the year 2010, but, 'in accordance with the instructions from "above" that the quotas should be maximally reduced, the Interdepartmental Commission cut them to 25 thousand'¹. At the same time, halving the quotas has become a common practice - as transpires from Deputy Head of the Labor Migration Division of the Department of the Federal Migration Service

¹ *Kvoty – bol'noi vopros* [Quotas are a painful issue]. Speech of O. Popova at a session of the Round Table *Russian Migration Policy in the Period of the Current Demographic Slump // Rossiiskaia migratsiia: Informatsionno-analiticheskii zhurnal* [Russian migration: a journal of information and analysis]. No 4 - 5 (43 - 44), September-October 2010. P. 28.

of Krasnodar Krai O. V. Popova's statement that 'the Commission meets the Olympic organizations halfway – their requests are no longer cut in half; for example, if one asks for two thousand persons to work at an Olympic facility, maybe one and a half thousand will be allotted'¹. Moreover, a second permit, although issuable outside the quota, should be paid for again (the amount of the duty is increased to 2000 rubles, which means that the total amount due is 4,000 Rb).

The 'struggle for quotas' is reflected even in official statistics: over the first eight months of 2010, there were 1,442 instances when requests for foreign labor attraction were rejected, while in the same period of 2009 the number of rejections was 317². According to some data, difficulties with obtaining quotas are now encountered not only by small businesses but even by such heavyweights as regional divisions of OJSC *Gazprom*.

Despite the post-crisis growth rate achieved by the economy (*Table 1*) and the resulting increase in labor demand, the number of officially issued work permits dropped in 2010. This means that either there was an unprecedented rise in labor productivity as yet unreported by *Rosstat*³, or an increase in the use of illegal labor (not necessarily involving migrants).

Table 1

THE BEHAVIOR OF SOME SOCIO-ECONOMIC INDICES IN RUSSIA, JANUARY - SEPTEMBER 2010, BY COMPARISON WITH THE SAME PERIOD OF 2009

| Indices | Index as percentage of same period of last year |
|---|---|
| Work permits (number of forms issued) | 80.7 * |
| Index by 'Processing' type of activity | 112.6 |
| Volume of work performed in 'Construction' type of activity | 99.2 |
| Retail-trade turnover | 104.4 |

* January - October 2010 as a percentage of the same period of last year.

Source: data of the Federal Migration Service of Russia; *Sotsial'no-ekonomicheskoe polozhenie Rossii – 2010 [The socio-economic situation in Russia – 2010]. Rosstat, 2010.*

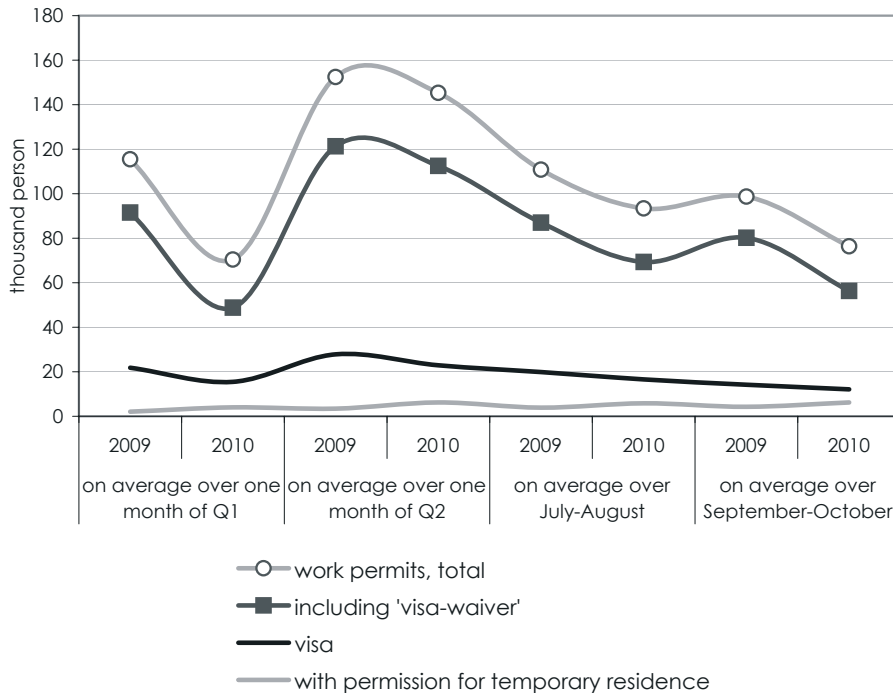
Over the first ten months of 2010, the authorities issued 986.6 thousand forms of work permits, while the number of forms issued over the same period of 2009 was 1,222.7 thousand (*Figure 2*). There was a drop in practically all the indices characterizing external labor migration: the number of work permits issued to 'visa-waiver' migrants and 'visa' immigrants fell 24.4 % and 20.4 % respectively. The ratio of the number of notifications submitted by the employers with regard to attraction and employment of 'visa-waiver' foreign workers to the number of issued work permits remained almost unchanged – 65 % in 2010 vs. 62.6 % in 2009. The number of work permits issued to foreign citizens holding temporary residence permits increased 65 % in January - October 2009. At the same time the number of issued temporary residence permits dropped by one third. The causes of the emergence of these differently directed trends are not clear. In any case, the share of foreign workers holding temporary residence permits amounts to no more than 3 to 5 percent of the total number of all work permits.

If one assumes that the number of work permits issued in November and December 2010 would remain at the level of September - October (under "normal" conditions there must be a decline in their number, because labor migrants prefer to spend the New Year's Eve and the winter months at home), the amount of work permits issued over the whole year will exceed the 2006 level (1,014 thousand) only by 12 %, and thus will be considerably lower than in 2007 (1,717 thousand).

1 Ibid, p. 29.

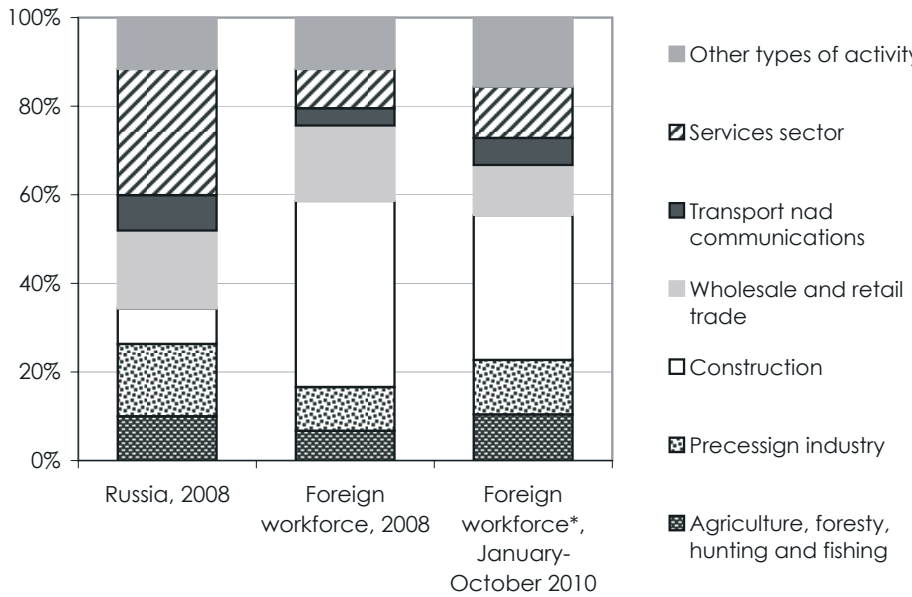
2 Moreover, in January - August 2010 the authorities cancelled 460 permits for attraction of foreign labor, while over the same period of last year only 25 such permits were cancelled. Although the number of cancellations is not significant for a country like Russia, the behavior of this trend is worthy of attention.

3 At the same time, according to *Rosstat*, in the period from 2005 to 2009 labor productivity for the Russian economy as a whole never grew by more than 7.5 %. A greater growth was typical of individual types of activity. In 2009, labor productivity in the sectors most heavily dependent on migration stood at 96.1 % of its 2008 level in construction, 92.1 % in wholesale and retail trade and 96.1 % in the processing industry, climbing to as high as 105 % only in agriculture and forestry // *Sotsial'no-ekonomicheskoe polozhenie Rossii – 2010 [The social and economic situation in Russia – 2010]. Rosstat, 2010.*



Source: data of the Federal Migration Service of Russia.

Fig. 2. Work Permits Issued to Foreign Citizens in Russia, January - August 2009.



* – according to notifications submitted by employers with regard to attraction and employment, for the purpose of engaging in labor activities, of foreign citizens who have arrived in the RF under the visa-waiver procedure;

** – financial activity; real estate transactions; education; health care; other communal, social and personal services.

Sources: data of the Federal Migration Service of Russia; *Trud i Zaniatost' v Rossii – 2009* [Labor and employment in Russia – 2009], Rosstat, 2010.

Fig. 3. Distribution of foreign workers by type of activity in Russia, in %

However, such a comparison would be only relatively correct: the data for the year 2010 given in this paper apply only to the number of drawn up work-permit forms, while the data for the previous years apply to 'the number of foreign workers engaged in labor activities in the RF'. It should be noted in this respect that, over the period of a single one year, work-permit forms can be issued to one and the same migrant several times. At the same time, the index 'number of foreign workers performing labor activities in the RF', as measured by the Federal Migration Service and published by Rosstat, is statistically fallible: it takes into account both the migrants who have arrived over the year and the migrants staying in the country as of a specific date¹. Thus, the figures given for comparison, instead of representing accurate data for (at least) the 'visible' part of external labor migration, only point to a certain trend which definitely resembles the situation with migration as it existed before the liberalization of migration legislation – that is, to migration's shift into the shadows. As for the number of work permits issued to foreign workers (this index was included in 2010 in Form 1-RD), it is by 25 thousand less than the number of issued forms.

The quota approved for 2010 in the amount of 1,361 thousand persons (plus a 30-percent reserve of 583.3 thousand persons)

1 For more details, see Chudinovskikh O. S., Statistika migratsii znaet ne vsio [Migration statistics are not omniscient] // Demoscope Weekly. 2008. No 335 - 336. <http://demoscope.ru/weekly/2008/0335/tema04.php>

will, almost certainly, be partially unrequited. This will create some additional grounds for the authorities to sequester the 2011 quota.

The current by-branch distribution of migrants shown in *Figure 3* also testifies to the existence, in the Russian economy, of a bias towards shadows: throughout recent years, migrant employment in construction did not slide below 40 % (of the whole foreign workforce), while the combined share of migrant workers employed in two branches – construction and trade – amounted to no less than 60 %. In 2010, according to the data contained in notifications submitted by employers with regard to attraction and employment of foreign workers from visa-waiver countries, the number of migrants employed in construction and trade significantly declined. The author is inclined to consider this to be an artifact: firstly, some of the employers continue to disregard the legislative requirements which prescribe that notifications on the hiring of workers from CIS countries should be submitted to the Federal Migration Service. This year, the submitted notifications covered 85 % of all permits issued to ‘visa-waiver’ workers, thus hitting an all-time high since the introduction of the new legislation. Secondly, according to survey data, employment in construction and trade remained very thinly documented even after the liberalization of migration legislation (*Table 2*).

Table 2

SOME CHARACTERISTICS OF THE EMPLOYMENT OF MIGRANTS FROM CIS COUNTRIES
(BASED ON A SURVEY OF 1575 RESPONDENTS CONDUCTED IN 2008 AND 2009), IN % OF THE
TOTAL NUMBER OF SURVEYED MIGRANTS EMPLOYED IN THE CORRESPONDING SECTORS OF THE
ECONOMY)

| Sphere of activity | Existence of work permit | Existence of written labor contract | Reception of documented wage |
|--|--------------------------|-------------------------------------|------------------------------|
| Construction | 60.9 | 51.3 | 33.4 |
| Trade | 56.5 | 48.4 | 31.3 |
| Industry | 79.7 | 75.4 | 59.3 |
| Housing and Utilities Sector | 58.0 | 56.0 | 53.0 |
| Provision of household services to population | 50.6 | 46.6 | 30.0 |
| Transport | 80.0 | 77.4 | 47.0 |
| Agriculture | 71.2 | 53.8 | 40.4 |
| Provision of domestic services (sick-nurse, nanny, housemaid, etc) | 51.4 | 51.4 | 17.1 |

Source: The survey of labor migrants from CIS countries conducted by the Center for Migration Studies (survey supervisor – E. V. Tiuriukanova) in Moscow, St. Petersburg, Astrakhan, Voronezh, Kazan and Krasnodar.

Thus, it should be stated that, by and large, the application of ‘crisis norms’ continued to be applied even after the official termination of the crisis. To put it more precisely, the forces interested in large-scale illegal use of foreign labor have scored yet another resounding victory. Moreover, the process of legislative regulation of the migration system still goes on.

The legislative innovations introduced in 2010 were the norms making it possible to hire migrants from visa-waiver countries through the application of migration patents issued in excess of the quotas established by the RF Government. The corresponding alterations introduced in Federal Law No 115-FZ have been in effect since 1 July 2010.

The introduction of the aforesaid patents was preceded by a relatively lengthy discussion. The Law establishes that the right to work under a patent should be granted to migrants from visa-waiver countries on condition that they are employed by private persons. According to the Federal Migration Service, each year approximately three to four million foreigners repair apartments belonging to Russian citizens, work as nannies, sick-nurses, handymen in the countryside, etc. However, even those of them who had legally arrived in Russia and registered as migrants were incapable of getting legally employed, because it was practically impossible for household personnel to be taken into account in the quotas. Now it will become possible to obtain a patent after having been registered under a self-notification procedure, after having been finger-printed and photographed. The patent holder will be obliged to make monthly payments in the amount of

one thousand rubles. When the entire period of a migrant's work under a patent (not to exceed 12 months) comes to an end, he or she should pay the total amount of tax (which includes advance payments). However, the total amount of tax payable (at a 13-percent rate) to the corresponding budget should be calculated on the basis of the actually received income. Thus, if a migrant's monthly earnings exceed 7,692 rubles, he or she will be obliged to make an additional tax payment once his or her activity under a patent is over. The mechanism for carrying out all these operations is not completely clear as yet.

In accordance with the new norms the employers will be obliged to inform the Federal Migration Service both on the conclusion and cancellation of a labor contract with a foreigners, as well as in an event of a leave without retention of earnings granted to a foreigner (for a period longer than one month).

The introduction of patents for foreign workers is designed to legalize some of the migrants employed by physical persons, to enlarge the budget of the country in general and local budgets in particular (because some of the revenues from the presumptive tax established at 1 thousand rubles will be accumulated in local budgets). It is still unclear how this is going to happen in actual practice. There exists an opinion that those migrants who will be unable to formalize their status within the framework of the quota but who will, nevertheless, want to work legally in Russia, are going to make attempts to acquire patents. The FMS is predicting that in 2011 the right to apply for a patent will be exercised by no less than one million foreign workers¹. By 1 November 2010, patents had been issued to 100,120 persons.

Another innovation introduced by the amendments to Federal Law No 115-FZ, which were adopted as of 1 July 2010, is designed to make easier the employment and residence regime for highly qualified specialists (HQS). Thus, for example, the quota requirements have been abolished for such workers; they and their families can get residence permits for periods of more than 5 years, and besides, they do not need to live for a year in Russia in order to get those permits – while this used to be the mandatory requirement established by legislation for each candidate for naturalization in Russia (without any exceptions). The Law places within the 'highly qualified' category those specialists who can earn 2 mln Rb or more over a period of no more than one year (that is, those who can legally earn more than 166 thousand Rb per month). Over the four months since the entry into force of this amendment, the 'HQS' work permits were issued by 1,456 persons, of which 93 % are foreigners from the 'classical abroad'². Evidently, an overwhelming majority of such migrants live and work in Moscow. The regions are going to be affected by this innovation only slightly.

Generally, it must be stated that the official end of the crisis has failed to bring with it any visible normalization on the migrant labor market – or in the migration processes taken as a whole. ●

1 Moshkin M. *Migrantov zapatentovali* [Migrants have been patented] // *Vremia novostei* [The Time of News]. 21 May 2010.

2 According to the RF FMS's data.

AN OVERVIEW OF ECONOMIC LEGISLATION

I.Tolmacheva

In November, Russia introduced the following alterations in legislation: as of 1 January 2011, it will become possible to apply for registration at the place of residence by submitting an application to the authorities through the Internet; non-commercial organizations are authorized to post reports concerning their activities on the Internet information resources of the RF Ministry of Justice.

I. Resolutions of the Government of the Russian Federation

1. *'On the Introduction of Alterations in the Rules for Registration and Deregistration of Citizens of the Russian Federation at the Place of Stay and the Place of Residence within the Russian Federation'*, of 11 November 2010, No 885.

As of January 2011, in accordance with the alterations introduced in *'The Rules for Registration and Deregistration...'* and confirmed by Resolution of the RF Government of 17 July 1995, No 713, a duly formalized application for registration at the place of residence in electronic form, an electronic copy of an identification document and an electronic copy of a document justifying the applicant's moving into a dwelling can be submitted to the authorities via the 'Joint Portal of State and Municipal Services (Functions)' federal state information system.

Citizens also have the right to notify a registration body on the duration and place of their stay via regular mail or e-mail; in the latter case, notifications should be sent via the existing common access information telecommunication networks, including the Internet and the Joint Portal.

The Resolution establishes that the certificate of registration at the place of stay can be sent – if the applicant wishes so – by regular mail to the address of the dwelling indicated in the application. The owner or hirer of the dwelling should be notified, within three days' time, that a citizen has been registered. In the event a citizen departs before time from a dwelling that is not the place of his or her residence, that citizen or the person who has provided him or her with the said dwelling for the purpose of his or her temporarily residing therein should submit an arbitrary-form application requesting for the former to be deregistered at the place of his or her stay, which should also indicate the date of his or her departure. This applications can also be sent by regular mail or e-mailed via the Joint Portal to the registration body which has registered this citizen at the place of his or her stay. In the event the owner or tenant of a dwelling receives a notification that a citizen that has not been given a permission for temporary residence thereby has been registered at the place of his or her stay, the said owner or tenant could submit, to the registration body which has registered this citizen at the place of his or her stay, an arbitrary-form application requesting that this citizen's registration be annulled.

II. Instructions, Letters, Orders

1. The press release of the RF Ministry of Justice *'On the Procedure for Posting on the Internet Reports on the Activities and Reports on the Continuation of Activities of Non-commercial Organizations'* of 1 November 2010.

It is pointed out that, if reports on the activities or reports on the continuation of activities of non-commercial organizations are posted on the Internet information resources of the RF Ministry of Justice, it is not required to submit additional reports.

According to *'The Procedure for Posting on the Internet Reports...'* confirmed by Order of the RF Ministry of Justice of 7 October 2010, No 252, non-commercial organizations are obliged to submit to the RF Ministry of Justice reports on their activities or reports on the continuation of their activities and also to post the said information on the Internet or to submit it to the mass media for the purpose of its being published thereby. This should be done annually, no later than 15 April of the year following the reporting year. The procedure and the timing of posting the said reports should be determined by the RF Ministry of Justice. It should be noted that Federal Law

of 12 January 1996, No 7-FZ, 'On Non-commercial Organizations' does not establish that reports on the activities and reports on the continuation of activities should be specifically posted on the Internet information resources of the RF Ministry of Justice.

The RF Ministry of Justice notes that posting of reports of non-commercial organizations on the RF Ministry of Justice's Internet information resources accessible through the official website of the RF Ministry of Justice (<http://www.minjust.ru/>) should be equated to the fulfillment of the obligations of non-commercial organizations envisaged by the provisions of Federal Law of 12 January 1996, No 7-FZ, 'On Non-commercial Organizations'. Thus, if the said information is posted on the Internet information resources of the RF Ministry of Justice, it is not required to submit additional reports. The date of fulfillment, by a non-commercial organization, of the obligation to submit reports should be the date of their signing and mailing.

The RF Ministry of Justice draws the attention of non-commercial organizations to the fact that, from 2 November 2010 onwards, they can post reports on their activities and reports on the continuation of their activities on the 'NCO Reports' section of one of the information portals of the RF Ministry of Justice, the NCO Portal, via the link indicated on the official web site of the RF Ministry of Justice (<http://www.minjust.ru/>). ●

AN OVERVIEW OF THE RF GOVERNMENT'S MEETINGS IN NOVEMBER 2010

M.Goldin

At its meeting in November 2010, the Presidium of the Government of the Russian Federation approved a number of amendments to the Law 'On the Transfer of Integrated Technology Rights' and confirmed the Draft Law 'On the National Payment System'.

At its meeting held on **11 November**, the RF Government considered and approved the Draft Law 'On the Introduction of Alterations in the Federal Law 'On the Transfer of Integrated Technology Rights', of 25 December 2008, No 284-FZ'.

The draft law envisages that a number of alterations should be introduced in the Federal Law in the part of conferring upon the RF Government the authority to approve the procedure for using the official website of the Russian Federation as a means of posting notifications on the conduct of open tenders for the right to conclude contracts concerning the transfer of integrated technology rights, and any other information specified in the Law.

The need to develop the Draft Law has arisen because the existing Federal Law 'On the Transfer of Integrated Technology Rights' envisages that the powers of the RF Government should be limited to determining the website for posting notifications with regard to the conduct of open tenders or open auctions for the right of concluding contracts for the transfer of integrated technology rights, and for posting any other information specified in the Law (Item 1 of Article 5 of the Law). At the same time, according to this Law, the RF Government lacks any powers to regulate the procedure for using the aforesaid website.

The amendment to the Law will make it possible to develop and establish the procedure for using the official website of the Russian Federation as a means of posting notifications on the conduct of open tenders for the right to conclude contracts concerning the transfer of integrated technology rights.

Also considered and approved at this meeting were the Draft Federal Laws 'On the National Payment System' and 'On the Introduction of Alterations in Some Legislative Acts of the Russian Federation, and on Recognizing as Null and Void the Federal Law "On the Activity Concerned with the Receipt of Payments from Physical Persons, Carried Out by Paying Agents" and Some of the Provisions Stipulated in Legislative Acts of the Russian Federation, in Connection with the Adoption of the Federal Law 'On the National Payment System'.

The Federal Law 'On the National Payment System' will establish the legal and organizational foundations of the national payment system, and specify the requirements concerning the organization and functioning of payment systems. Besides, it will form the basis for supervision and inspection within the national payment system.

The legal regulation issues addressed by the draft law is the activity of the payer organizations, including operators of payer systems and operators of services provided by the payment infrastructure (operations centers, clearing houses and payments centers), as well as their interaction in the framework of the payment systems of the said organizations.

The Law will determine some notions which so far have not been legislatively consolidated in the form of legislative norms.

Thus, the Draft Law contains the definition 'national payment system'. This is understood as the totality of operators engaged in money transfer, including electronic money operators; paying agents (sub-agents); operators of payment systems; operators of services provided by the payment infrastructure; participants of financial markets; as well as the bodies of the State Treasury and the organizations of the federal postal system when they are carrying out their activities dealing with money transfer (subjects of the national payment system). The adoption of this draft law as a federal law can be viewed as a starting point on the way towards creating a national system of payment cards. At the moment, the Russian market is dominated by two international payment

systems – VISA and MasterCard. There also exist two Russian payment systems: the one created by the Savings Bank of Russia and renamed, in 2008, as the United Russian Payment System (URPS); and the ‘Golden Crown’ system.

The draft law also offers the definition of electronic money, which is understood as the monetary means preliminarily allocated by one person (the person who has allocated the monetary means) to another person who takes into consideration the information on the amount of the allocated monetary means without opening a bank account (the responsible person), for the purpose of fulfilling the liabilities of the person who has allocated the monetary means, to third parties in respect of whom the person who has allocated the monetary means is empowered to issue authorizations with the use of electronic payment instruments.

An electronic money transfer is carried out by an electronic money operator. The draft law establishes that ‘an electronic money operator’ should be understood as a credit organization, including a non-banking credit organization, which is empowered to carry out money transfers without opening bank accounts and without conducting any other banking operations dealing with them, in accordance with the RF Federal Law ‘On Banks and Banking Activity’.

It should be noted that the notion of electronic money as stipulated in the draft law is similar to the concept of electronic money as consolidated in Directive 2000/46/EC of the European Parliament and of the Council ‘On the Taking Up, Pursuit and Prudential Supervision of the Business of Electronic Money Institutions’.

According to Directive 2000/46/EC, ‘electronic money’ should be understood as monetary value which represents a claim on the issuer, is stored on an electronic device, is issued on receipt of funds in an amount that is no less in value than the issued monetary value, and is accepted as means of payment by undertakings other than the issuer.

The draft law envisages the introduction of special provisions that are designed to establish a number of requirements to the activity of electronic money operators and the carrying out of electronic money transfers, and also the requirements to an operator’s activities that involve money transfer through the use of a payment agent.

The draft law also establishes the procedure for carrying out inspection and supervision in the national payment system, and determines the relevant powers granted to the Bank of Russia in that sphere.

Inspection in the national payment system should be understood as the Bank of Russia’s activity designed to ensure the compliance of all money transfer operators with the requirements of the laws concerning the national payment system.

Supervision in the national payment system should be understood as the Bank of Russia’s activity designed to monitor and assess the activity of all money transfer operators.

Furthermore, the draft law envisages the regulation of issues related to the functioning of international (cross-border) payment systems in the territory of the Russian Federation and the ensuring of data transfer security.

A cross-border payment system should be understood as a payment system where:

- the payment system operator and (or) operators of services provided by the payment infrastructure are situated in the territory of Russia, while one or more participants of the payment system are situated in the territory of a foreign state;
- one or more participants of the payment system are situated in the territory of the Russian Federation, while the payment system operator and (or) operators of services provided by the payment infrastructure are situated in the territory of a foreign state.

The adoption of the Draft Law ‘On the National Payment System’ requires that certain alterations should be introduced in a number of legislative acts of the Russian Federation, including the RF Civil Code, the RF Tax Code, and the RF Code on Administrative Violations, and that the Federal Law ‘On the Activity Concerned with the Reception of Payments from Physical Persons, Carried Out by Paying Agents’ and some of the provisions of RF legislative acts should be recognized as null and void.

In particular, the RF Civil Code now consolidates the money transfer institution and establishes its irrevocability and finality, brings the basic form of payments by payment orders into line with

modern banking practices, and introduces a specific form of payment by payment orders, which implies the possibility of its use for purposes of direct debiting.

The Federal Law 'On the Central Bank of the Russian Federation (the Bank of Russia)' is amended in the part of determining the tasks, functions and powers of the Bank of Russia in the field of the national payment system. ●

AN OVERVIEW OF THE NORMATIVE DOCUMENTS ON ISSUES OF TAXATION ADOPTED IN OCTOBER-NOVEMBER 2010

L.Anisimova

1. By Federal Law of 3 November 2010, No 285-FZ, changes are introduced in Article 165 of the RF Tax Code within the framework of regulating the procedure of levying VAT, at the rate of 0 %, on foreign trade swap (barter) transactions. The situation when Russian taxpayers effectively apply in the same way the provisions stipulated in RF tax legislation with regard to VAT irrespective of whether the bartered commodities are received in or outside of RF territory, or whether they are imported into RF territory or not has thus been made lawful. The commodities received outside of the RF territory under barter deals may be sold by Russian persons without those commodities being imported into RF territory on condition that:

1) the actual receipt of such commodities is confirmed by the documents envisaged by the terms of a foreign-trade barter transaction and submitted to tax agencies;

2) Russian persons, no later than within one year since the day of the actual receipt of commodities, are obliged to ensure their sale, and within a period envisaged by the terms of the deal of sale ensure that all the monies received as a result of the sale of those commodities are transferred to their accounts at authorized Russian banks.

2. By Federal Law of 3 November 2010, No 287-FZ, changes are introduced in Articles 76 and 86 of the RF TC.

The regime for the submission, to a tax agency by banks, of the information concerning the residuals on the suspended accounts of a taxpayer has been somewhat liberalized, in that the information must now be submitted within 3 days. Previously, a bank was obliged to do this no later than on the day following the date on which the decision concerning the suspension was made.

Simultaneously, the period for submitting the information concerning the opening (or closure) of personal accounts or concerning the change of the requisites thereof, as well as the period for issuing a statement to a tax agency concerning the existence of accounts or the presence of residuals on a taxpayer's accounts has been shortened – from 5 to 3 days.

3. From the date of the introduction of changes in the Law on the RF Central Bank by Federal Law of 3 November 2011, No 291-FZ, the Bank of Russia is empowered to effectuate banking operations and other transactions with international organizations (in particular, the IMF), with foreign central (or national) banks (in particular, the IBRD), and with other foreign legal entities while carrying on the activity of managing the Bank of Russia's assets in the form of foreign currencies and precious metals, including the gold and foreign currency reserves of the Bank of Russia. By the same Federal Law, changes are introduced in the procedure of levying VAT. The RF Central Bank, in the capacity of a depositary for the assets of intergovernmental international economic organizations, is made exempt from the payment of VAT on the depositary services rendered to the IMF, the IBRD, the International Development Association, etc.

4. By Federal Law of 8 November 2010, No 293-FZ, changes are introduced in the procedure for the payment of state duties on the effectuation of certain acts by state regulatory agencies in the sphere of education (accreditation, issuance of licenses, duplicates of documents, etc.). The rates have been markedly differentiated depending on the importance of the legal acts being effectuated for the functioning of a given educational organization. Thus, the duty to be paid for the issuance of a certificate of State accreditation of an educational establishment operating in the sphere of higher professional education amounts to 130 thousand Rb, plus 70 thousand Rb for each enlarged list of areas of training and higher professional education specialties offered by the educational establishment and each of its affiliations. The duty to be paid for the redrafting of a

certificate of State accreditation in connection with the change of a higher professional educational establishment's status amounts to 70 thousand Rb. The duties for the redrafting of a certificate of State accreditation of an educational establishment or a research organization in connection with State accreditation of curricula, enlarged lists of areas of training and specialties are to be paid at the established rates in the amount from 7 thousand Rb to 70 thousand Rb, etc. Thus, the threshold (in terms of money) for the granting, by the State, of the rights to conduct educational activity has been raised. Typically, the number of various tariffs increases and the amount of rates to be paid goes up whenever state monopolies make a move to regulate economic activity.

5. By Federal Law of 15 November 2010, No 300-FZ, changes are introduced in the procedure for forming the tax base for profits tax to be paid by the insurance organizations offering insurance under OSAGO [car insurance] agreements. The insurer's taxable income with regard to profits tax is not to include the monies received by the insurer that directly refunded the victim party's losses under an OSAGO agreement from the insurer that has insured the civil liability of the guilty party, within the amount of the payment made to the victim party.

The difference between the amount of the actual payments with regard to each insured event and the average amount of insurance payments settled between the insurers of the guilty and victim parties is to be reflected correspondingly either as incomes or expenses of a given insurer.

6. By Order of the RF Federal Tax Service (FTS) of 9 November 2010, No MMV-7-6/535@, for the purpose of ensuring unification of the electronic information exchange between taxpayers and tax agencies via telecommunication channels, with the use of electronic digital signatures, the Unified Format for a transport container is approved, to be introduced from the date of the enactment of the Methodological Recommendations for the Organization of Electronic Document Turnover in the framework of submission of tax declarations (or settlements) in the electronic form via telecommunication channels, approved by Order of the RF FTS of 2 November 2009, No MM-7-6/534@.

7. By Letters of the RF FTS of 22 October 2010, No ShS-37-3/13942@ and the RF Ministry of Finance of 12 October 2010, No 03-07-15/137, detailed explanations are provided with regard to the levying of VAT and the formalization, by documents, of the transactions involving the processing of customers' raw materials within the Customs Union (CU).

The zero rate of VAT is to be applied to the processing of customers' raw materials irrespective of whether or not the resulting product is transported into the territory of a member state of the Customs Union or into third countries which are not members of the CU. In order to apply the zero rate to the work involving the processing of customers' raw materials, it is necessary to submit to a tax agency, simultaneously with the tax declaration for VAT, the documents (or their copies) envisaged in Item 2 of Article 4 of the Protocol of the performance of work or rendering of services, namely:

- the agreement (or contract) concluded between taxpayers (or payers) from the member states of the CU;
- the documents confirming the fact of performance of work involving the processing of customers' raw materials;
- the documents confirming the export (or import) of the commodities produced as a result of the processing of customers' raw materials;
- the statement of the import of commodities and payment of indirect taxes drawn in accordance with the form envisaged in the Protocol on the exchange of electronic information between the tax agencies of the member states of the CU, with the tax agency's note concerning the effectuation of the payment;
- the customs declaration (or cargo customs declaration) confirming the export of products resulting from the processing of customers' raw materials from the territory of the member states of the CU;
- other documents envisaged by legislation of the member states of the CU.

The packages of necessary documents differ depending on which country the products resulting from the processing are exported to. If they are exported to a state which is not member of the CU,

the documents package must include a customs declaration confirming the export of commodities outside the Union's territory. In this case, no statement of the import of commodities and payment of indirect taxes is to be submitted. However, if the products resulting from the processing of customers' raw materials are exported to the territory of a member state of the CU, no customs declaration is required, while a statement of the import of commodities and payment of indirect taxes is necessary.

8. By Letter of the RF Ministry of Finance of 22 October 2010, No 03-03-05/230, an attempt is made to change the situation that has already existed for a number of years – when tax agencies refuse to accept as losses, for the purpose of taxation, organizations' receivables in the form of irrecoverable debts if the confirmation of the impossibility of recovering such debts is based on a bailiff's decree concerning the termination of an execution proceeding. In this Letter, the RF Ministry of Finance, with a reference to the standpoint of the RF Supreme Arbitration Court (SAC) stated in its ruling of 7 March 2008, No 2727/08, requests that tax agencies should be instructed to the effect that the receivables in respect of which a bailiff has issued a decree that an execution proceeding be terminated on the basis of Subitem 4 of Item 1 of Article 46 of Federal Law No 229-FZ 'On Execution Proceedings' should be recognized as irrecoverable on the basis of Item 2 of Article 266 of the RF TC. In an event of redemption, by a debtor, of the debt recognized in the creditor's tax records as irrecoverable, the monies or other property received as redemption of such debt must be listed by the creditor organization as part of the incomes to be taken into account for the purposes of taxation of the profits of organizations.

9. By Letter of the RF Ministry of Finance of 29 October 2010, No 03-11-09/95, the taxpayers applying the Simplified Taxation System (STS) are asked to pay attention to the standpoint of the RF Supreme Arbitration Court (SAC) on the issue of recognizing as expenditures the cost of the commodities (or work, or services) used in the course of production, the payments for which have not yet been transferred to the suppliers. Previously, the RF Ministry of Finance, with a reference to Subitem 23 of Item 1 of Article 346.16 of the RF TC has explained that those taxpayers who apply the STS and have chosen as the object of taxation their incomes less expenditures, when determining the object of taxation shall subtract from their incomes the sum of payments transferred for the commodities acquired for subsequent realization, including the cost of storage, servicing and transportation of commodities; in other words, the Ministry has emphasized that incomes and expenditures are to be estimated on a cash basis.

In Decree of the Presidium of the RF SAC of 29 June 2010, No 808/10, it is pointed out that the cost of commodities earmarked for subsequent realization should be recognized as part of expenditures, when calculating the amount of tax in accordance with the Simplified Taxation System, after the actual transfer of the commodities to the buyer, irrespective of whether the latter has paid for them or not. As no explanations are offered by the RF SAC with regard to acceptance of incomes, the situation concerning the STS cannot be considered to have been fully clarified.

10. By Letter of the RF Ministry of Finance of 2 November 2010, No 03-07-07/72, it is explained that, as guarantee repairs are carried out without any additional payment, the spare parts used in such repairs should be qualified as those applied by a taxpayer in an activity that is not levied by VAT. In this connection, the amount of VAT paid on the spare parts that have been acquired and used for the purposes of guarantee repairs should not be deducted (or set off) by the taxpayer.

11. By Letter of the RF Ministry of Finance of 29 October 2010, No 03-04-05/7-652, the issue concerning the procedure for applying the property value deduction from the personal income tax in respect of a country house ['dacha'] or a house situated on an orchard plot. The tax deduction is envisaged for dwellings, while in the text of the RF Tax Code (TC) there is no direct mention of a house situated on an orchard plot, and so there arises a problem associated with classifying a house situated on an orchard plot as a dwelling. The RF Ministry of Finance explains that, in accordance with Article 1 of Federal Law of 15 April 1998, No 66-FZ, 'On not-for profit associations of citizens owning orchard plots, vegetable garden plots, or country houses' the owner of a land plot

of that type may construct thereon a dwelling without the right of residence registration therein, or a house with the right of residence registration therein. At present, the procedure for recognizing premises as dwellings is established by Decree of the RF Government of 28 January 2006, No 47. In accordance with the aforesaid Decree, the recognition of premises as a dwelling suitable for residence is effectuated by an interdepartmental commission by means of formalizing a resolution in the established form.

In the opinion of the RF Ministry of Finance, if there exists a resolution adopted by an interdepartmental commission to the effect that certain premises should be recognized as a dwelling, then their owner enjoys the right of being granted a property value deduction from the tax, as envisaged in Subitem 2 of Item 1 of Article 220 of the RF TC.

12. By Letter of the RF Ministry of Finance of 25 October 2010, No 03-07-08/301, it is explained that in an event of export of the equipment that has been previously used in RF territory in transactions levied by VAT, the amounts of tax previously accepted for deduction must be restored and paid to the budget in the amount calculated in proportion to the residual (balance sheet) value of that equipment.

13. By Letter of the RF Ministry of Finance of 28 October 2010, No 03-04-06/6-258, the issue of the payment of the personal income tax is explained in connection with a change in the tax status of an employee – from non-resident to resident of the RF.

In accordance with the existing procedure, the remuneration received by a physical person who is not a tax resident of the RF as a result of the performance of his or her labor duties in the territory of Russia is classified as income from sources situated in the RF.

The remuneration received for the performance of labor duties (work under employment) is subject to taxation in the RF territory at the rate of 30 % in accordance with Article 224 of the RF TC (to be withheld by a tax agent), if the employer is a Russian organization and the employee has spent in RF territory no less than 183 days over a period of 12 consecutive calendar months.

If an employee has spent in RF territory more than 183 days over a period of 12 consecutive calendar months, his or her tax status is changed, and the amount of tax levied on his or her incomes is payable at the rate of 13 %. The payer's tax status is determined as of each date of the payment of his or her income. In this connection, there arise cases when excessive amounts of personal income tax are withheld by tax agents.

While previously in an event of a changed payer's status the tax agent (or the employer) refunded (or set off) the surplus of personal income tax, now – from 1 January 2011 – in accordance Item 1.1 of Article 231 of the RF TC the excessive amounts of tax are to be refunded by the tax agency with which the payer has been registered in accordance with his or her place of residence (or location), at the moment when the taxpayer submits his or her tax declaration after the end of a given tax period. Thus the refund of the previously withheld sums will be delayed and made more cumbersome.

14. By Letter of the RF Ministry of Finance of 28 October 2010, No 03-04-06/6-255, explanations are provided, for the purposes of taxation, with regard to the status of the commission payments for the issuance and servicing of bank cards for transferring wages and salaries to employees. In spite of the fact that the bank account agreements (the cards being opened only when clients have their personal bank accounts) are concluded with physical persons, and it is physical persons who are the owners of such accounts, the cost of the issuance and annual servicing of the bank cards, according to the RF Ministry of Finance, is not to be included in the incomes of physical persons levied by personal income tax, and so they are charged to the expenditures of the organizations effectuating the commission payments that are taken into account when forming the base for profits tax. Although the motivation behind such explanations is quite understandable, the correctness of the standpoint of the RF Ministry of Finance is by no means evident. This is a very important issue, and the dubious technical solution provided at present may be fraught with financial losses incurred by a very broad range of employers and employees alike. In our opinion, further legal elaboration is necessary in order to avoid a situation when it will eventually be found out that

physical persons have been effectively granted an exemption from personal income tax that is not stipulated in the RF TC, while employers have been granted an exemption from profits tax.

15. By Letter of the RF Ministry of Finance of 29 October 2010, No 03-03-06/1/673, it is explained that in accordance with Item 1 of Article 277 of the RF TC, the residual value of the fixed assets transferred by a foreign organization into the charter capital of a limited liability company is recognized as the cost of their acquisition (or creation) confirmed by appropriate documents, less the amount of depreciation charged in the country where the party that has transferred the aforesaid property is a tax resident. Besides, the value of that property cannot be higher than its market value confirmed by an independent valuator acting in accordance with that foreign country's legislation. In principle, such an approach is compatible with Item 7 of Article 258 of the RF TC, which is applied for the purposes of charging depreciation on the fixed assets that have previously been exploited by a Russian organization. In an event of acquisition of fixed assets previously used by a physical person who is not an entrepreneur, the acquirer, on the contrary, cannot apply depreciation deductions because a physical person (Russian or foreign) can provide no documents confirming the period of use and exploitation of assets in the procedure envisaged in Chapter 25 of the RF TC.

16. By joint Letter of the RF Ministry of Finance and the RF FTS of 2 November 2010, No IIIIC-37-3/14719@, the issue concerning the procedure for a switchover from the patent-based simplified taxation system (STS) to another taxation regime is explained.

In particular, the RF Ministry of Finance and the RF FTS emphasized that, when the representative bodies of municipal districts or urban okrugs, or the legislative (representative) bodies of state authority in the two cities of federal importance (Moscow and St. Petersburg) make decisions concerning the introduction of the taxation system in the form of a single tax on presumptive income (STPI) for certain types of entrepreneurial activity, the switchover to the STS will be mandatory for all the taxpayers operating in the relevant territory and engaged in the types of entrepreneurial activity envisaged in Item 2 of Article 346.26 of the RF TC.

The exceptions are listed in the same article. Thus, in accordance with Subitem 3 of Item 2.2, no switchover to STPI is necessary for those individual entrepreneurs who, in accordance with Chapter 26.2 of the RF TC, have switched over to the STS on the basis of a patent issued for the aforesaid types of activity.

If an individual entrepreneur has lost the right to apply the STS (on the basis of a patent) to one of the types of entrepreneurial activity, while in that territory a normative act is in force whereby the system of taxation in the form of STPI is to be applied to that particular type of entrepreneurial activity, that individual entrepreneur (who has lost the right to apply the patent) is obliged to switch over to the payment of STPI, to recalculate the tax base by the amount of income derived from the type of activity for which the patent was issued, and to pay STPI for the entire period covered by that patent.

As for the STS, it is necessary to make a distinction between the general-type STS and the patent-based STS. The STS of a general type is applied generally to all individual entrepreneurs, while the STS based on a patent (similarly to STPI) is applied separately to specific types of activity. If an individual entrepreneur who simultaneously applies both the patent-based STS and the STS of a general type can no longer enjoy the right to apply, he or she must then recalculate (in accordance with the general STS rules) the tax base for the incomes received over the entire period for which the patent was issued.

The right to once again switch over to the STS on the basis of a patent can be reinstated by that entrepreneur no earlier than after 3 calendar years has passed since the date of termination of that right.

17. By Order of the RF Ministry of Finance and the RF FTS of 28 September 2010, No MMB-7-8/469@, the Procedure for changing the timelines for the payment of taxes and levies (as well as penalties and fines) by tax agencies, which was issued to replace the abolished Procedure for organizing the granting of delayed payment, payment by installments, and an investment tax

credit with regard to the payment of taxes and levies (the latter was approved by Order of the RF FTS of 21 November 2006, No SAE-3-19/798).

The procedure for concluding a guarantee agreement or a pledge agreement between the Department of the RF FTS supervising the subject of the Russian Federation where a related entity or person is situated (or resides) with a taxpayer (or related person) and a guarantor or pledger.

Guarantee agreements (or pledge agreements) must be registered with a tax agency.

18. By its information release of 1 November 2010, the RF Ministry of Finance explained how the timelines for the entry into force of the changes introduced with regard to transport and land taxes in the RF TC by Federal Law of 27 July 2010, No 229-FZ should be determined for taxpayers – physical persons as a result of the altered timelines for the payment of the transport and land taxes.

In connection with the altered timelines, as established by the RF TC, the laws adopted by subjects of the Russian Federation on transport tax, or the normative legal acts adopted by the representative bodies of municipal formations with regard to the land tax must be brought in conformity with the RF Tax Code (in the wording introduced by Federal Law No 229-FZ) and officially published before 1 December 2010. As for Federal Law No 229-FZ whereby the relevant changes were introduced in the RF TC, it has no retroactive force, and in theory the alterations should be introduced from the 2011 tax period (i.e., the payment of tax in accordance with the new scheme must take place in 2012). However, the legislative (or representative) bodies of subjects of the Russian Federation and the representative bodies of municipal formations, as established by Article 5 of the RF TC, are empowered to extend the new procedure (in the case under consideration – the timelines for the payment of taxes) also to the 2010 tax period, if that new procedure (or timelines) can improve the situation of taxpayers. In this particular case, the payment of taxes under the new Law can probably be started from 1 November 2011. ●

CHANGES IN THE NORMATIVE BASE OF THE BUDGETARY PROCESS

M. Goldin

In November 2010, the normative base of the budgetary process underwent the following changes: a number of alterations were introduced in the Federal Law 'On the Federal Budget for 2010 and the 2011 and 2012 Planning Period'; orders issued by the RF Ministry of Energy and the RF Ministry of Public Health and Social Development introduced the upper limits for the past-date payables of budget-funded institutions, and in the event of those limits being exceeded there will appear grounds for dismissal of heads of such institutions.

Federal Law of 3 November 2010, No 278-FZ, 'On the Introduction of Alterations in the Federal Law 'On the Federal Budget for 2010 and the 2011 and 2012 Planning Period'' changed the major characteristics of the federal budget for the year 2010 and the 2011 – 2012 planning period.

In particular, the major characteristics of the 2010 budget were approved on the basis of the forecasted volume of gross domestic product in the amount of 45,175 bn Rb (previously: 44,957 bn Rb) and an inflation rate of no more than 8.0 % (previously: 7.0 %) (December 2009 – December 2010). The forecasted overall volume of federal budget revenues was set at 7,874,951,608 thousand Rb (previously: 7,783,778,395,8 thousand Rb); the upper limit of federal budget expenditures – at 10,256,419,940.1 thousand Rb (previously: 10,212,419,940.1 thousand Rb); the upper limit of the internal public debt of the Russian Federation, as of 1 January 2011, was approved in the amount of 3,499,198,864.6 thousand Rb (previously: 3,726,717,464.0 thousand Rb); and the federal budget deficit was set at 2,381,468,332.1 thousand Rb (previously: 2,428,641,544.3 thousand Rb).

Order of the RF Ministry of Energy of 17 September 2010, No 450, 'On the introduction of the upper permissible values of the past-date payables of federal budget-funded institutions under the jurisdiction of the Ministry of Energy of the Russian Federation, whose exceeding shall entail dissolution of labor contracts with heads of federal budget-funded enterprises, on the initiative of the employer, in accordance with the Labor Code of the Russian Federation' introduces the upper permissible limits for the past-date payables of the budget-funded institutions of the RF Ministry of Energy, whose exceeding will constitute cause for dismissal of heads of these institutions.

The upper permissible values of the past-date payables of the said institutions are as follows:

- a) a value equal to the aggregate amount of monetary funds allocated to an institution in the form of subsidies for a current year;
- b) arrears of wages to workers of an institution for two calendar months in a row;
- c) arrears in taxes and other payments to the budget for three calendar months in a row;
- d) payables exceed 10 % of the book value of an institution's assets for three calendar months in a row.

The Order, registered with the RF Ministry of Justice, No 188858, will be in force from 1 January 2011 to 1 January 2012, and will be applied to the budget-funded institutions in whose respect the RF Ministry of Energy has taken a decision that they should be granted subsidies, from the federal budget, designed to compensate them for provision of state (or municipal) services (or execution of work) in accordance with a state (or municipal) assignment.

Order of the RF Ministry of Public Health and Social Development of 6 September 2010, No 787n, 'On the confirmation of the procedure for determining the upper permissible value of the past-date payables of a federal budget-funded institution, whose exceeding shall entail dissolution of labor contracts with heads of federal budget-funded enterprises, on the initiative of the employer, in accordance with the Labor Code of the Russian Federation' establishes a procedure for controlling the past-date payables of the budget-funded institutions under the jurisdiction of the RF Ministry of Public Health and Social Development, and introduces the upper permissible value of the past-date payables of a budget-funded institution.

It is established that the upper permissible value of the past-date payables of a budget-funded institution should not exceed 2 % of the volume of the sources of financial provision which ensure the functioning of that budget-funded institution (or to ensure compliance with financial requirements regarding the incomes and volumes of financing calculated on the accrual basis) as of 1 January of the year following the reporting year. The sources of financial provision ensuring the functioning of a budget-funded institution that are to be taken into account are as follows:

- a) subsidies allocated to the implementation of a state assignment;
- b) targeted subsidies;
- c) budget investments;
- d) other sources of financial provision in accordance with the legislation of the Russian Federation.

The volume of the maximum permissible value of the past-date payables of a budget-funded institution should be estimated separately for each of the sources of financial provision.

The procedure for controlling the past-date payables of the federal budget-funded institutions under the jurisdiction of the RF Ministry of Public Health and Social Development is regulated as follows.

By the results of a financial year, a budget-funded institution carries out an inventory of its debts as of 1 January of the year following the reporting year.

For each of the state contracts (or agreements) associated with past-date payables, the budget-funded institution composes, in accordance with a special recommended form, a document reflecting the results of auditing, and prepares a set of documents which clarifies the causes of past-date payables.

The aforesaid documents are to be submitted, within the time limits established for submission of annual budget reports, to the Department of Accounting Policy and Control of the RF Ministry of Public Health and Social Development.

Then the submitted information on past-date payables and the relevant set of documents will pass through the procedure for checking the justifiability of the past-date payables at the Department of Auditing Policy and Control of the RF Ministry of Public Health and Social Development. The duration of the checking should not exceed ten business days from the moment of the documents' submission.

By the results of the performed check of the past-date payables, The Department of Accounting Policy and Control of the RF Ministry of Public Health and Social Development prepares a report for the RF Minister of Public Health and Social Development or for a person authorized by the Minister, which is to contain an assessment of the actions taken by the head of the budget-funded enterprise and either a proposal to terminate the labor contract with him or her, or recommendations as to how to settle the past-date payables.

On the basis of the proposals made by the Department of Accounting Policy and Control of the Ministry of Public Health and Social Development, the Minister of Public Health and Social Development or the person authorized by the Minister takes a decision to terminate the labor contract with the head of the budget-funded enterprise in accordance with Item 3 of Article 278 of the RF Labor Code.

The Order is to come in force from 1 January 2011. ●