



RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES 12'2011

MONTHLY BULLETIN:

RUSSIAN ECONOMY IN DECEMBER 2011: PRELIMINARY DATA AND MAJOR TRENDS	2
THE POLITICAL AND ECONOMIC RESULTS OF DECEMBER 2011 (S.Zhavoronkov)	4
INFLATION AND MONETARY POLICY (N.Luksha)	9
FINANCIAL MARKETS (N.Burkova, E.Khudko)	12
REAL ECONOMY: TRENDS AND FACTORS (O.Izryadnova)	19
RUSSIAN INDUSTRY IN NOVEMBER 2011 (S.Tsukhlo)	23
INVESTMENT IN FIXED ASSETS (O.Izryadnova)	26
FOREIGN INVESTMENTS (E.Ilukhina)	32
FOREIGN TRADE (N.Volovik, K.Kharina)	36
STATE BUDGET (T.Tishchenko)	40
THE RUSSIAN BANKING SECTOR (S.Borisov)	43
THE REAL ESTATE MARKET IN THE RUSSIAN FEDERATION (G.Zadonsky)	47
THE REVIEW OF THE MEETINGS OF THE GOVERNMENT OF THE RUSSIAN FEDERATION IN DECEMBER 2011 (M.Goldin)	51
THE REVIEW OF THE ECONOMIC LEGISLATION (I.Tolmacheva)	52
AN OVERVIEW OF NORMATIVE DOCUMENTS ON TAXATION ISSUES IN NOVEMBER–DECEMBER 2011 (L.Anisimova)	54
CHANGES IN THE NORMATIVE BASE OF BUDGETING (M.Goldin)	61
ANALYSIS OF UNIFIED TAX ON IMPUTED INCOME IMPLEMENTED FOR CERTAIN ACTIVITIES (UTII) (M.Esipova)	64

RUSSIAN ECONOMY IN DECEMBER 2011: PRELIMINARY DATA AND MAJOR TRENDS

The Political Background: An Undermined Legitimacy

The announcement of the results of the State Duma election has triggered a rapidly deepening political crisis. The election has certainly demonstrated a loss of confidence by the public not only in the United Russia party but in Russia's current political system as a whole. Apart from the gross election law violations in the course of the election campaign and the subsequent voting, the information fed into the national computerized 'Elections' system (GAS "Vybory") at many polling stations in Moscow turned out to be different from the data contained in the protocols of district electoral commissions. The massive scale differences between the official results of voting and the results obtained at the election districts where voting was monitored by election observers, and also with the data of exit-polls, were the last straw for many disenchanted voters who took to the streets of Moscow in their thousands. A number of mass rallies were held in Moscow. The first rally, at Patriarshie Prudy, was attended by 6 to 8 thousand protesters; the next rally, on Bolotnaya Square, by approximately 60 thousand; while the rally in Sakharov Avenue – by 70 to 90 thousand.

The rallies forced the authorities to make a number of hasty reshuffles in the Government and the RF President's Administration, with the most notable casualty being Vladislav Surkov, one of the principal architects of Russia's current political system, who thus lost his post in the Administration. RF President Dmitry Medvedev announced the beginning of major political reforms and introduced into the State Duma several draft laws drastically simplifying the rules for party registration and radically cutting the number of signatures required for a candidate to register for parliamentary or presidential election. However, the new norms will come into force only in 2013. Moreover, the authorities have categorically refused to meet the protesters' demand that the State Duma election results be revised. At present, the Kremlin's main goal is to legitimize the forthcoming Presidential Election, where Vladimir Putin will not be confronted by any strong challengers. And that it is exactly why the authorities have chosen to calm down protesters without offering them any major concessions. The issue of resuming direct elections of regional governors also remains very vague. The proposals in this respect that have been made so far by Dmitry Medvedev are intentionally hazy, so that the authorities may later disavow the idea of direct gubernatorial elections.

It is absolutely clear that even if mass rallies subside, the authorities manage to preserve the current composition of the State Duma, and Vladimir Putins becomes President in March 2012, the legitimacy of both the President and the State Duma will anyway be significantly dented. As a result, the State Duma will not be able to make any crucially important legislative decisions, while the President will be powerless to conduct a coherent and firm economic policy commensurate with the various risks engendered by the current global crisis. If the market situation takes a turn to the worse – a development warned against by former Minister of Finance Aleksey Kudrin last autumn – a complete collapse of Russia's political system cannot be ruled out.

Russia's Macro-Economy and Finance: An Unreliable Stability

Despite the storm in Russia's domestic politics, her economic situation remained relatively stable throughout November and December. Oil prices hovered at a comfortable level of \$ 103-110 per barrel (ICE. Brent). The belief in the stability of the Russian economy was contributed to by record-low inflation. Thus, the last two months of 2011 witnessed no traditional jump in prices ahead of New Year's Eve; in November prices rose by 0.4% on October, while the annual inflation rate climbed to 6.8%. In December, the weekly rise in prices remained at 0.1% – that is, at the same level as in November. Thus, Russia's annual rate of inflation will not exceed the forecast of 6.2%. However, one of the factors contributing to keeping Russia's inflation low is the rapid capital outflow of the recent months. It is expected that net capital outflow from Russia in 2011 will amount to \$ 85bn.

In November, the liquidity situation at Russian banks slightly improved. The reduction in their redundant reserves observed throughout October gave way to growth: by the end of November they had

climbed by 18.9%, to Rb 955.6bn. The major source of growth in liquidity was the RF Central Bank. At the same time the Ministry of Finance also lent a hand to the banking sector through the placement of deposits with domestic banks and by increasing budget expenditures.

In November, the ruble stopped weakening; by the end of that month, the real effective exchange rate of the ruble had risen by 3.6%. In November the volume of the Bank of Russia's foreign exchange interventions was two to three times smaller than in October: in the course of those interventions, the Bank of Russia sold in the domestic market \$ 1,386.7m and € 130.64m. In December, the Bank of Russia cut its refinancing rate to 8% per annum, effective from 26 December 2011.

In December, the international reserves of the RF Central Bank continued their downward trend. The major contributors to that trend were the euro's weakening against the dollar and the corresponding revaluation of the euro-denominated reserves of the RF Central Bank. In the course of December, the volume of Russia's international reserves dropped by 2.7%. As of 16 December, it amounted to \$ 501.3bn. From mid-August, when Russia's international reserves were at their peak, to mid-December they dwindled by 7.85%.

December saw a decline in Russian stock exchange indices brought about by the results of the State Duma election: the MICEX index, which had climbed to 1,500 points by 5 December, dwindled to 1,350 points in the course of the first post-election week. In the second half of December it stabilized in the 1,375 to 1,385 point range.

Thus, December continued the trend set during the autumn months, which can be characterized as follows: high oil prices ensure Russia's macro-economic stability, but the combined effect of the existing negative trends in overseas markets and in the domestic institutional sphere cools down investor attitude towards the prospects of the Russian economy.

The Real Sector of the Economy: A Non-Festive Mood

Against the background of a stubborn decline in the industrial growth rate, the dynamics of output growth registered in August through September was positively affected by developments in agriculture and the construction industry. Due to the ongoing steady drop in inflation, the downward trend in the real disposable incomes of the population had disappeared by the end of the year: in November, the dynamics of these incomes became positive, and figures for January-November 2011 indicate that the real disposable incomes of the population grew by 0.2% on the corresponding period of 2010. The sufficiently high rates of turnover in retail trade were achieved due to a reduction in the savings rate and a robust growth in consumer lending. In October 2011, credits granted to physical persons amounted to Rb 5,065.1bn, representing a 1.3 times growth on October 2010, while in the course of the first ten months of 2011 the proportion of savings in the incomes of the population dropped to 8.9% vs. 13.8% in January-October 2010.

In January-November 2011, investments in fixed assets climbed by 5.6% on the corresponding period of 2010. However, this trend turned out to be multi-directional: thus, according to preliminary estimates, in 2011 the volume of investments in the fixed assets of small businesses stood at 92% of their volume in 2010 and at approximately 85% of that in 2008. In 2011, small businesses' share of the total investment volume dropped to 27.9% vs. 29.9% in 2010. By contrast, big businesses showed a robust 12.1% year-on-year growth of investments in their fixed assets. There was a continuation of the trend towards changes in the structure of sources of investment finance: the share of credits granted by banks (especially by foreign banks) and the share of loans attracted by organizations were on the decline.

Business opinion surveys indicated a rather rapidly growing pessimism about the current state of and prospects for consumer and business demand in Russia. The November 2011 assessments of consumer demand eerily resembled those typical of the post-New Year's doldrums in January. Equally pessimistic assessments were made with regard to stocks of finished products: on the one hand, the volumes of those stocks were declining, while on the other hand, a growing number of entrepreneurs considered them to be 'above the norm'. The surveyed enterprises assessed their industrial production rates as hovering around zero. According to their assessments, their production plans were also on a downward trend: in November, the number of enterprises planning to cut output exceeded the number of those planning to increase it.

Although the ongoing decline in demand prevented industrial enterprises from increasing prices in November, industrial price forecasts were significantly adjusted upwards: while one month ago their plans envisaged only a minimum rise in prices, industrial enterprises are currently planning to resume robust price growth: in the course of one month, the balance of forecasts rose by 9 points. ●

THE POLITICAL AND ECONOMIC RESULTS OF DECEMBER 2011

S.Zhavoronkov

The main political results of December 2011 were three consecutive events: the outcome of the Duma election that revealed a sharp drop in United Russia's popularity; the mass anti-electoral fraud rallies on a scale unprecedented since the early 1990s; and the political reforms promised by the Russian authorities. Even according to the official results, United Russia bagged only 49.32% of the votes cast, or 15% less than in the 2007 parliamentary election. The Duma election was marred by widespread irregularities, including (most notably) those registered in Moscow. Enraged by the outcome of the election, protesters held massive rallies that numbered, by the most modest estimates, no less than 70 thousand participants. As a result, the hard-pressed Russian authorities announced the resumption of elections for Russia's regional governors and a dramatic reduction in the hurdles to the registration of political parties and RF presidential candidates. As far as the March 2012 Presidential Election is concerned, the events of December 2011 have considerably heightened the level of uncertainty regarding both its outcome and the effect of the ongoing mass protests.

According to the official results, *United Russia* took 49.32% of the votes cast, the CPRF – 19.9%, *Fair Russia* – 13.24%, the LDPR – 11.67%, *Yabloko* – 3.43%, *Patriots of Russia* – 0.97%, and *Right Cause* – 0.6% of the total votes cast. Thus, as it has been widely expected, only four parties won entry to the State Duma: *United Russia* (238 seats), the CPRF (92 seats), *Fair Russia* (64 seats), and the LDPR (56 seats). By comparison with the electoral results of 2007, *United Russia*, even according to official data, lost 15% of votes, while its actual losses were much higher. Even the official electoral results make it impossible for the authorities to persist with their claims that Vladimir Putin's political regime enjoys support of a majority of Russia's population. The election results also differed widely from one Russian region to another (for example, *United Russia's* worst official result was 29% – in Yaroslavl Oblast), notwithstanding the fact that sometimes those regions strongly resembled each other from the point of view of their economic geography, the level of GDP, and the (former) patterns of voting (for example, 61% in Tula Oblast and 40% in Orel Oblast). However, such a distribution of the votes cast could be explained by the success or failure of the electoral campaign in each individual region, or by the rating of one or other appointed governor, etc.

But some of the most scandalous official results were produced in Moscow. In fact, the logic of electoral geography simply did not work in Russia's capital: two adjacent electoral districts, with their polling stations situated on different floors of one and the same school building, demonstrated election results that differed two times, or even more, from one another (for example, in Moscow's Basmany District, *United Russia* took 32% and 61% of the vote in the two adjacent electoral districts – No 10 and No 11 – that had approximately the same number of registered voters and in every respect closely resembled each other). The regional pattern was exactly the same: for example, in the Central Electoral District that combines the Center of Moscow and the districts around it, *United Russia* got 27% of the votes cast in *Mar'ina Roshcha* and 63% of the vote in the Arbat area. This mystery can be explained quite simply by the fact that the territorial structure of the executive branch of Moscow Government does not follow the territorial structure of the capital's electoral districts, and that its Central Electoral District combines districts that simultaneously belong to the Central Administrative Okrug of Moscow and to the North-Eastern Administrative Okrug of Moscow. For example, *United Russia* took 27% of the vote in the Alekseevsky District of the North Eastern Administrative Okrug physically adjacent to the Krasnosel'sky District of the Central Administrative Okrug of Moscow, where it got 56% of the votes cast. As a result, *United Russia's* official result in Moscow was announced to be at the level of 46% – much higher than, for example, in Moscow Oblast, always known for its high support for the party of power, even the official election results of *United Russia* did not exceed 33% of the votes cast. The only possible explanation is

fraud committed by election officials. In Moscow (as in St Petersburg), electoral fraud was perpetrated blatantly and openly: thousands of *Nashists* (members of the pro-Putin youth group *Nashi*) with absentee voting certificates were bussed to polling stations¹, while in a number of Moscow districts election observers were removed from polling stations on a massive scale. Apparently, these removals were centrally organized and coordinated (for example, observers were removed at one and the same time – at the close of voting at 19.30 – 20.00, and always before the counting of votes was to begin). At hundreds of polling stations, the protocols issued to observers differed from the data published on the website of the Central Electoral Commission.

So far as the 2011 electoral results of the other parliamentary parties are concerned, we should note the minimization of their geographical differences by comparison with the previous periods (both the 2007 State Duma election and the regional elections of 2008-11): as a rule, the regions where *United Russia* performs poorly are the ones where all the other parliamentary parties show good results. Thus, for example, the CPRF took more than 25% of the votes cast in its traditional strongholds of Altai Krai and Orel, Volgograd and Omsk Oblasts, and turned out to have a strong showing in Irkutsk, Moscow, Kostroma and Nizhny Novgorod Oblasts where *United Russia* poorly performed. *Fair Russia* had its best results in Leningrad Oblast (more than 25%) due to the active electoral campaign conducted by the leader of its St Petersburg branch, Olga Dmitrieva, in St Petersburg and Leningrad Oblast (where she suffered less from electoral fraud than in St Petersburg), and also Sverdlovsk Oblast where it took almost 25% of the votes cast, while in Sverdlovsk Oblast's capital, Yekaterinburg, *Fair Russia* surpassed *United Russia* even according to official data – in Sverdlovsk Oblast the poor showing of the party of power coincided with the active and expensive electoral campaign carried out by the leader of *Fair Russia's* local branch, Alexander Burkov. The LDPR repeated its recent regional electoral success of spring 2011 in Khanty-Mansi Autonomous Okrug, where it once again finished with 22% of the votes cast, and also, traditionally, had a stronger than average showing in the Far East and Siberia. As expected, *Fair Russia* became the main beneficiary of the non-systemic opposition's campaign under the slogan 'vote for any party but *United Russia*' due to its relatively low negative ratings at the federal level, while the LDPR took part of the nationalist votes because of its being the only party permitted to openly use ultra-nationalist slogans.

The electoral results of *Patriots of Russia* and *Right Cause* that had conducted no electoral campaigns worth mentioning were statistically non-significant throughout the whole of Russia, while *Yabloko*, whose results across Russia were good neither in the December 4 election nor in any other recent elections, unexpectedly had a very strong showing both in Moscow and St Petersburg. In Moscow, *United Russia* came first, while the CPRF was in the second place with 19% of the votes cast, trailed by the CPRF with 19%, *Fair Russia* with 12%, the LDPR with 9.5%, and *Yabloko* with 8.5%. In St Petersburg, where the State Duma election was held simultaneously with that of the local legislative assembly carried out exclusively on the basis of party lists, *United Russia*, according to official data, took 32.3% of the votes cast, trailed by *Fair Russia* with 25.3%, the CPRF with 16%, and *Yabloko* with 12%, thus outstripping its very strong rival – the LDPR, which received 10.5%. For the first time ever, state funding will be granted to the *Yabloko* party which has managed to take more than 3% of the votes (in the previous election, *Yabloko* had even failed to get its election deposit back). All of a sudden, *Yabloko's* successful and expensive electoral campaigning in Moscow that carried a clearly positive tone, its traditionally strong organization in St Petersburg, and the discontinuation of its habitual indiscriminate vituperation of all the other opponents of the regime gave this almost moribund party a second lease of life in both Moscow and St Petersburg, and thus made some of its traditional electorate, who had previously voted for 'electable' parties, return to its fold.

From the very beginning, *United Russia's* election campaign was beset by a number of inherent weaknesses. For example, that campaign was badly harmed by the decision made by Russia's outgoing president, Dmitry Medvedev, to top *United Russia's* election list despite his being

¹ Although one-stop absentee voting is legal, the case in point is the "merry-go-round" fraud when absentee voting certificates are not withdrawn at the moment of voting, as prescribed by law, but instead are repeatedly used at many polling stations. In order to promote electoral fraud, this type of electoral violations on the part of election officials is punishable by a small fine.

disrespected by many voters and even not feared by government officials. Another debilitating factor was the absence on that election list of Prime Minister Vladimir Putin, the real leader of the ruling group. It should be said that initially the relative failure of *United Russia's* election campaign did not produce any considerable change in Russia's political situation. Everything seemed hunky-dory. Moreover, *United Russia's* drop in fortunes was even presented as a sign of democracy. The tandem's response to the electoral events was lackadaisical. Dmitry Medvedev merely called to restore the ballot option "None of the Above" (or 'Against All') (in the event of voting by party lists this option makes no difference at all) and single-member districts (it is exactly due to such districts that *United Russia* has managed to preserve its majority, for example, in the legislative assembly of Sverdlovsk Oblast, while in St Petersburg, where there were no single-member districts, it was forced to enter into an informal coalition with two other political parties). Vladimir Putin promised that video surveillance cameras would be installed at all polling stations¹ (this measure will be of no principal importance in a situation when the Central Electoral Commission and courts of justice pay no attention even to such documents as protocols endorsed with the seals of district electoral commissions).

Soon afterwards, however, Moscow and a number of Russian regions became the scene of events that had not taken place in Moscow and St Petersburg since the mass rallies of Boris Yeltsin's supporters and opponents in the early 1990s, and in the regions – since the 2005 mass protests against monetization of benefits and the outbursts of social unrest in 2008-2010, that were similarly rooted in economic causes (Primorskii (Maritime) Krai, Kaliningrad, Abakan, etc.). The first salvo was the Moscow rally on 5 December. It was followed by the 10 December mass rally on Bolotnaya Square, which assembled no less than 70 thousand protesters, and by the 24 December rally on Sakharov Avenue attended by roughly the same number of people. It should be noted that the role of any specific political driving forces was purely secondary, while the "systemic political parties" practically abstained from participating in the rallies². As a result, the "podiums" were spontaneously occupied by the leaders of a vast array of liberal, leftist and nationalist forces, who had decided to bring thousands of their supporters together at the same time and at the same place. The proposals put forward by them were varied and sometimes at odds with one other. At the mass rally held by the opposition on 24 December, the speakers called for resignation of Vladimir Putin and for a rerun of the State Duma election. The traditional team of veteran opposition word slingers such as Boris Nemtsov and Michael Kasianov were now joined, for once, by *Yabloko's* leader Grigory Yavlinsky and former First Deputy Prime Minister Alexei Kudrin. Although the self-nominated presidential candidate, billionaire Michael Prokhorov, kept silent at the rally, his presence there was duly appreciated by all concerned. It should be said that, judging by international experience and by Russia's own experience of 1991–1993, even the relatively modest number of people that assembled on Moscow squares in December 2011 is quite sufficient for staging an uprising with some chances of success. With the exception of the attempt of a group of only a few hundred of protesters to approach, without official sanction, the premises of the Central Electoral Commission on 5 December (the group was eventually dispersed by the police), the mass rallies were ostentatiously peaceful. However, in such events it is the presence of forces that counts, even if the opposition's aims are still far from anything radical.

The response by the Russian authorities was mixed, sending contradictory signals – from insults hurled at protesters (Vladimir Putin called them "Banderlog" after the lawless monkeys in *The Jungle Book*, and a frankly obscene message to the Opposition was sent from Dmitry Medvedev's official Twitter account) to compliments coming from exactly the same source as the insults, as well as from Vladislav Surkov, First Deputy Head of RF Presidential Administration, then in charge of Russia's domestic policy.

On 23 December, on the eve of yet another mass rally, outgoing RF President Dmitry Medvedev announced, in his annual address before the Federal Assembly, that a number of major reforms

1 Despite all the tales of "modernization", Russia's polling stations underwent drastic technical de-modernization in the course of Dmitry Medvedev's nominal rule, with the number of electronic scanners being sharply reduced.

2 The same can be said of the unrest caused by "monetization of benefits". It is remarkable that the organizers of the first rally held on 5 December – a group of leftists – one day earlier, on the 4th of December (the Election Day), had applied for a rally that was eventually attended by just a few dozens of people.

would be introduced in Russia. These reforms had long – and futilely – been awaited by his supporters within the Russian ruling elite. In particular, the President announced that the rules for party registration should be simplified, so that an application from 500 people (currently the requirement is 40 thousand signatures) would be sufficient to register a party. Medvedev also proposed a sharp cut in the number of signatures required for a candidate to register for parliamentary or presidential election (down to 300,000 in the latter case). He also promised the resumption of direct elections of regional governors (however, it should be said that the corresponding draft law has not been prepared as yet, and that Vladimir Putin, just days before Medvedev's speech, also proposed restoring direct gubernatorial elections on condition that candidates should go to a popular vote only after having been approved by "presidential filter", as he put it). However, all those promises are to be fulfilled in the future, while the term of the current Parliament, controlled by Vladimir Putin, is five years, and he himself aspires to be elected president for at least one six-year term. Moreover, even bearing in mind that under the proposed simplified party registration procedure it will still be possible to arbitrarily deny registration to political parties and presidential candidates, as it has been happening for the past seven years, since all the main components of Russia's current political system were put in place in September 2005¹. Therefore it is very likely that, unless the opposition manages to keep enough people protesting in the streets, the authorities will essentially renege on all their promises, because it is clear that these were given under duress. It should also be noted that, for the first time in many years, Russia's authorities are confronted with two possible courses of action: either to make an attempt at evolutionary liberalization from above, or to smash their opponents with brutal force – and then to switch over from 'pinpointed' to mass repressions. Under the latter scenario, the stakes will be very high and the outcome rather unpredictable. On the other hand, judging by Russia's experience of 1990–1991 and Serbia's experience of the late 1990s, such a 'truce' between the authorities and the opposition could sometimes be relatively long.

Already burdened by the issue of adopting and implementing the promised laws on political reforms, the authorities are confronted with the problem of choosing a course of action with regard to the presidential election that will take place on 4 March 2012. The non-systemic opposition is barred from taking part in that election – partly by Russia's electoral legislation that obligates a presidential candidate to collect 2 million signatures without giving him or her any guarantee of being registered, and partly by the opposition's own failure to fruitfully use the precious time span from late November – mid-December 2011. Unlike them, Vladimir Putin, an absolutely 'systemic' candidate, will definitely run for president. And the same is true of the other three 'systemic' candidates, also nominated by parliamentary parties: Gennady Ziuganov, Vladimir Zhirinovskiy and Sergey Mironov. Also, there are two possible candidates – Grigory Yavlinsky and Michael Prokhorov, who are promising to submit the required signatures in due time. The current dynamics of public opinion apparently indicates that there will be a second round of voting. It goes without saying that one of its participants will be Vladimir Putin, but much less clear who will be his challenger. Will it be Gennady Ziuganov? Not necessarily, because the gap between him and his competitors is small, and some of his electorate are mere protest voters and not his personal supporters. In a second round, Putin's chances of winning become very real even in the event of an honest election (especially if his rival is Gennady Ziuganov). And the very essence of the political regime that will be established in Russia will also depend on what strategy for achieving victory will be chosen by the authorities: either to further increase fraud or to try to outperform their opponents in the course of the forthcoming election campaign.

It can be added that, like many similar events in the European transition countries, the current civil unrest in Russia totally lacks any economic component. Nobody loots shops, nobody overturns cars, etc. Moreover, protesters, in fact, do not have any economic program at all, except for a rather abstract idea of a democratically elected government distributing social benefits on a more fair basis.

¹ For example, the current gubernatorial appointment system envisages that the RF President nominates a candidate for governor to be approved by the regional legislature. If the legislature rejects the President's proposed candidate, then the legislature is dissolved and new elections are called. Incredibly, this procedure is officially and legally called 'gubernatorial elections' (!)

December also witnessed a number of staff reshuffles in the top echelons of power, none of them really important. As a matter of fact, these reshuffles involved some grandly named posts that do not play any definitive role in Russia's current system of power. Boris Gryzlov, who is famous for the phrase "*Parliament is no place for discussions*", quitted his post as parliament speaker and retired from Parliament for good. In fact, he was made the scapegoat for the lamentable outcome of the State Duma election. His former post passed to the Head of the RF President's Administration, Sergey Naryshkin. Once known as a very influential deputy prime minister, Naryshkin has been politically lackluster in recent years and always remained in the shadow of his first deputy, Vladislav Surkov. Actually, his work was confined to solving diplomatic issues in the post-Soviet space. As far as the balance of forces within the ruling group is concerned, there is only one thing in Gryzlov's future career that really matters: whether or not he will preserve his post as Chairman of the Supreme Council of *United Russia*, because it is mainly due to this post that he could influence the personnel policy at the state level and had at his disposal considerable leverage to manipulate governors, members of the State Duma, etc. As for Gryzlov's prerogative to supervise parliamentary sessions where the results of voting were known in advance, it was relatively irrelevant.

The post of Head of the RF President's Administration will pass to Deputy Prime Minister Sergey Ivanov, who has shed much of his administrative weight in the government in the course of the past few years and has not distinguished himself with any bold political initiatives or ideas. If Vladislav Surkov remains in the RF President's Administration, it is highly possible that the current *status quo* will be sustained, with Surkov lingering as the *de facto* head of that agency. The post of Vice Prime Minister Responsible for the Defense-Industrial Complex was given to Russia's Permanent Representative to NATO, Dmitry Rogozin. In the mid-naughties this firebrand politician was the leader of a leftist populist faction in the State Duma, but then his fortunes changed drastically and he was deprived of his party and expelled from politics. Pardoned for his *faux pas*, he was subsequently returned to state service. It is still unclear whether Rogozin will become the formal head of the Defense Industry Commission, currently chaired by Sergey Ivanov. Even if he gets this post, it is highly unlikely that he will become as influential as Minister of Defense Anatoly Serdiukov or First Deputy Chairman of the Defense Industry Commission Yury Borisov. While all the other appointments have the character of a mere rearrangement of one and the same team, Dmitry Rogozin's appointment has a political tinge: by giving him an important job the authorities are clearly expecting to calm down leftist populist voters. But it is rather doubtful if Rogozin still preserves his influence on that section of Russia's electorate. Most likely, he has already lost it, partly because of his failure to clearly explain why he abandoned politics in favor of becoming an official and, even more importantly, what he has gained by doing so. He has had five long years to offer his explanation, maybe now it is too late for him to try to mend fences. ●

INFLATION AND MONETARY POLICY

N.Luksha

In November 2011 the consumer price index decreased by 0.1 p.p. as compared with October and amounted to 0.4% for the month. In December, a weekly inflation was growing at the rate of 0.1%. As a result, within three weeks of the month it reached 0.3%. Thus, the cumulative inflation since the beginning of the year made 6% (against 8.4% in 2010). In November, the situation with bank liquidity has somewhat improved: excessive reserves of the banks have reached a nearly comfortable level of Rb 1 trillion. Net capital outflow continued in November, having reached, according to preliminary estimates of the Bank of Russia, \$10bn, slightly lower than in October. As a result, capital outflow over 11 months of 2011 reached \$74bn. In November ruble has stopped to weaken: the real effective exchange rate has increased over the month by 3.6%. From December 26, 2011 the Bank of Russia has lowered the refinancing rate to 8% per annum.

In November, inflation slowed down by 0.1 p.p. as compared with October and amounted to 0.4% as per the month result.

The growth rate in prices for foodstuffs in November, like in October was 0.5% (against – 1.4% in November 2010). In November, there was continued a decrease in prices for fruit and vegetables (-1%). Prices for cereals and beans continued to decrease (-2.3%), as well as granulated sugar (-4.5%). The list of cheapening goods was extended with sunflower oil and pasta (both by 0.2%). Like a month before, the utmost growth among the foodstuffs was noted for eggs (+2.4%).

In November the growth rate of prices for industrial goods has decreased to 0.6% from 0.7% in October. The largest growth in prices was still observed in tobacco, although the growth rate of its prices dropped by half to 0.9%. As a result, since the beginning of the year prices for tobacco products increased by 20.2%. Among other types of non-food goods were medicines, which prices were growing nearly as fast (+0.8%), clothing and underwear (+0.7%). Like in October, there was no reduction in any type of non-food items.

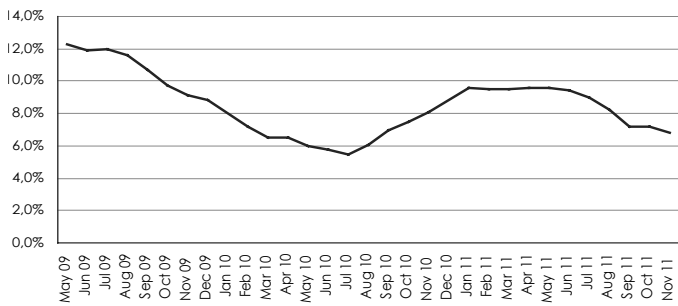
The growth rate of prices for commercial services in November remained unchanged at the rate of 0.1%. The utmost increase in prices was observed for heating (+0.8%). Similar growth rates were noted in prices for housing utilities (+0.6%) and healthcare services (+0.5%). At the same time, a number of commercial services in November have been decreased. In particular, the decrease in prices for health-improving recreational services and foreign tourism, respectively, by 2.5% and 0.9%, as well as for passenger transport and communications (-0.1%).

In November, inflation in annual terms (November 2011 against November 2010) has slowed down and made 6.8%, or 1.3 p.p. lower as compared with the same period of the last year (*Fig. 1*). The basic consumer price index¹ in November 2011 has remained unchanged – 0.5% (0.7% in 2010).

In December, on the basis of incomplete three weeks there was no acceleration of inflation: on Dec. 19 the increase in consumer prices made 0.3%. Thus, the cumulative inflation since the beginning of the year reached 6%, which is by 2.4 p.p. lower than in the same period of 2010. It is obvious that the annual inflation rate matches the official forecast, and its level will be a historic minimum.

In the first half of 2012 the slowdown of inflation is likely to continue. The main inflation curbing factors will be: firstly, the transfer of indexation of tariffs for natural monopolies from January 1 to July 1; secondly, the effect of high base, started in 2011, when food prices due to summer drought in 2010 were significantly increased; thirdly, restrained growth of monetary supply, and fourthly, a slowdown in the global food prices.

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



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

The October decline of excessive reserves¹ of commercial banks in November was replaced with their growth. As of the month results, they increased by 18.9% to Rb 955.6bn. The main source of liquidity was the central bank. At the same time, support to the banking sector has been provided also by the Ministry of Finance through the allocation of federal funds in the bank deposits and an increase in budget spending.

In December, the Bank of Russia continued to refinance the banking sector. Herewith, the demand for the RF CB funds remained high. At the same time, the Bank of Russia has reduced the limit for a one-day repo as compared with November up to RB 500–600bn to Rb 120–200bn in order to reduce the likelihood of bank speculations in the foreign exchange market, as well as in anticipation of high expenditures of the federal budget. As a result, in the second half of the month the one day repo rate reached the highest value since the end of 2009, i.e., 6.5%.

Due to the difficult situation in the banking sector, on December 9, the Bank of Russia has issued instructions to extend implementation of the federal law provisions “On additional measures to improve the stability of the banking system in the period up to December 31, 2011” for another three years. This law was adopted during the acute period of 2008 crisis and is aimed at preventing bankruptcies of troubled banks.

The volume of monetary base in narrow definition (cash plus mandatory reserves)² has grown: within the month it has increased by 0.8% and made Rb 509.3bn (*Fig. 2*). In December, international reserves of the RF CB continued to decline. Such dynamics of reserves was primarily urged by the

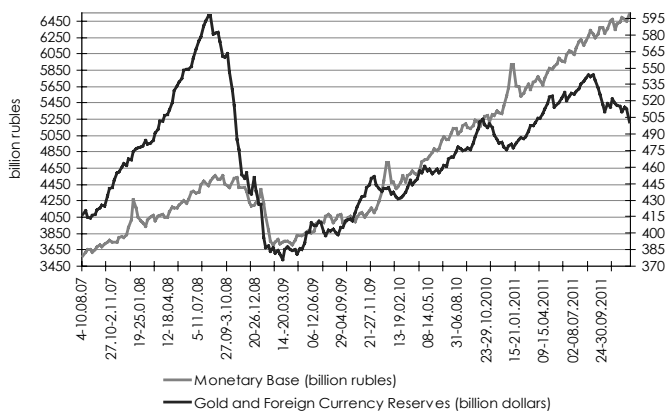


Fig. 2. Changes in the Monetary Base and in the Gold and Foreign Currency Reserves in 2007–2011

In November, the monetary base in broad definition increased to Rb 7,464.8bn: the growth compared to October was 2.8%. All components of the monetary base were growing in November. The greatest growth was demonstrated in the volume of funds deposited by banks on the accounts with the Central Bank (1.8 times) and correspondent accounts (+7.9%). As a result, the October reduction of banks’ deposits with the RF CB has been fully compensated.

In November, the liquidity situation in the banking sector has somewhat improved.

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The volume of monetary base in narrow definition (cash plus mandatory reserves)² has grown: within the month it has increased by 0.8% and made Rb 509.3bn (*Fig. 2*). In December, international reserves of the RF CB continued to decline. Such dynamics of reserves was primarily urged by the decline of Euro against the U.S. dollar and the corresponding revaluation of reserves denominated in Euro. In addition, due to the cheapening of gold, its dollar value in the reserves has dropped. Within the month, the volume of international reserves decreased by 2.7% and on December 16 made \$501.3bn. This was the lowest indicator since March of the current year.

Foreign exchange interventions of the Bank of Russia in November were 3–4 times lower than in October: in the framework of foreign exchange intervention the Bank of Russia has sold \$1,386 7m dollars and Euro in the domestic market (*Fig. 3*³).

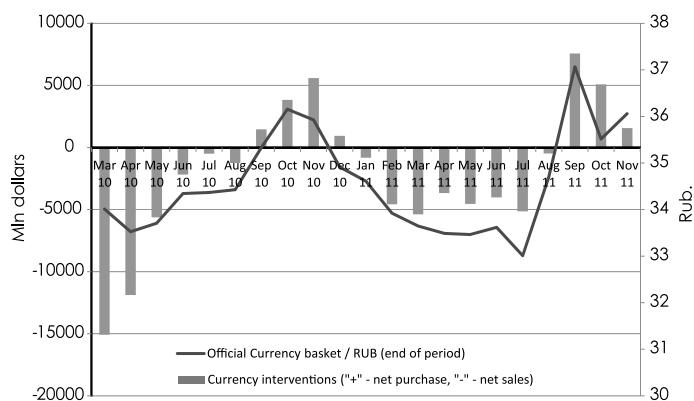
1 Under the excessive reserves of commercial banks in the Central Bank rating is understood the sum of correspondent accounts of commercial banks, their deposits with the CB and the CB bonds from commercial banks.
 2 We would like to remind, that the monetary base in the broad definition is not a monetary instrument, it reflects the obligations of the Bank of Russia in national currency. The monetary base in narrow definition is a monetary instrument (one of indicators of the volume of monetary supply), which is under total control of the RF Central Bank.
 3 The level of January 2002 is accepted as 100%.

In November, the ruble depreciation, which began in August, has ceased: within the month the growth in real effective exchange rate was 3.6%. As a result, the real effective exchange rate returned to the summer levels. During the period from January to November, the ruble rate has strengthened by 3.7% in real terms (*Fig. 4*).

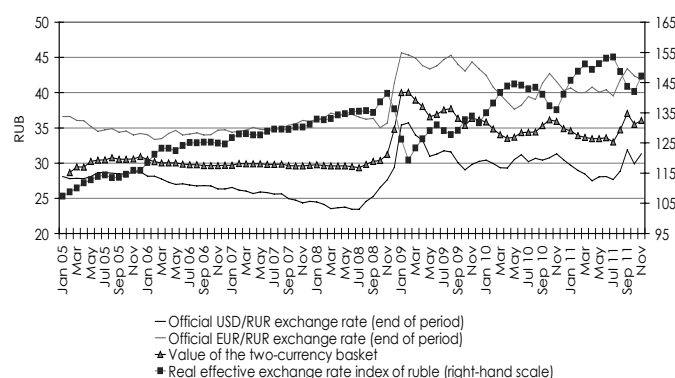
The influence by external factors over the dynamics of the exchange rate is sustained. Against the background of instability in the global markets dollar is strengthening as the most reliable currency. Growing oil prices in the second half of December and some reduction of capital outflows from Russia have led to an upgrading of the Russian currency.

On December 23 The Bank of Russia announced a decrease of the refinancing rate from December 26 by 0.25 p.p. from 8.25% to 8% per annum, as well as reduced by the same amount interest rates on some operations to provide liquidity and increase the rates for deposit operations at fixed rates. But actually only the interest rates on Lombard loans and repo transactions for a period of one day at a fixed rate have been reduced. Reduced rates on direct REPO transactions at fixed rates for a period of 7 days, and loans secured by non-marketable assets or guarantees for a period exceeding six months will have no impact on financial markets, as those operations are suspended. Thus, the rate on direct REPO auctions and loans secured by non-marketable assets and guarantees for a period of less than six months have not been reduced, whereas it is through these operations that the RF CB provides the bulk of liquidity to commercial banks.

Therefore, in our opinion, the Central Bank measures are aimed primarily at improving the efficiency of its interest rate policy by narrowing the interest rate corridor, through which the Bank of Russia has an impact on financial markets. Recall that in the periods of excessive liquidity an important role in determining the interest rates in the interbank market play the rates on deposit operations of the Central Bank of Russia, and in the periods of liquidity shortage – the rates of the Central Bank Operations to provide liquidity to the banks. Gradual reduction of the spread between interest rates on liquidity provision and absorption allows the Bank of Russia to manage market interest rates more effectively. ●



Source: RF Central Bank, author's estimates.
 Fig. 3. Central Bank Currency Interventions and Dynamics of Ruble Exchange Rate in March 2010 – October



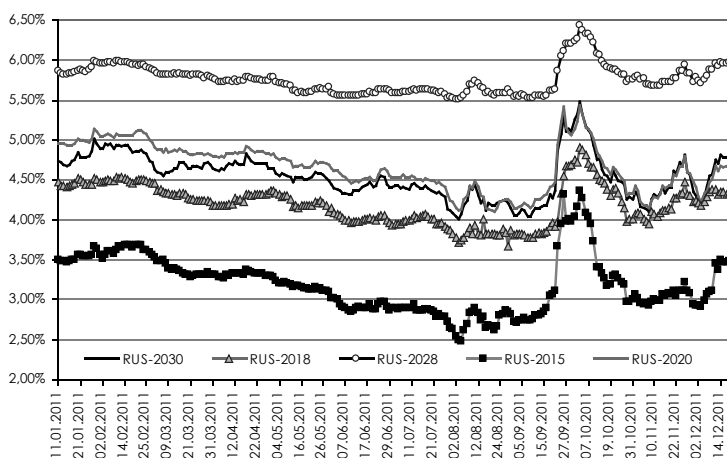
Source: RF Central Bank, author's estimates.
 Fig. 4. Indicators of ruble exchange rate dynamics in January 2005 – November 2011

FINANCIAL MARKETS

N.Burkova, E.Khudko

In December, the situation on the Russian financial market became highly volatile, largely in response to substantial fluctuations of prices on world financial markets. Lack of any serious measures aimed at supporting the Eurozone's financial system coupled with warnings of international rating agencies that most of the European countries might lower their credit ratings brought down the indices of Russia's government debt market and share market.

The Government Securities Market



Source: Data released by the *Finmarket* information agency.

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

In December, the high volatility of world markets resulted in a drop of activity and a rise in the yield to maturity on the RF government securities market. Thus, the yield to maturity of the majority of Russian Eurobonds rose, on average, by 1-3%. At the same time, the yield of RUS-15, which belong to the category of the 'shortest' securities tradable on that market, displayed a record-high rise of 12.9% (*Fig. 1*).

Over the period from 23 November to 20 December 2011, the combined turnover of the secondary market of OFZ bonds amounted to Rb 64.94bn, while the average daily turnover amounted to about Rb 3.25bn, which corresponds to the 2.7% drop of the average daily

turnover over than month by comparison with the previous period. Between 23 November and 20 December, one primary placement auction of OFZ bonds was held in Russia (vs. 3 auctions one month earlier). The placement auction of OFZ 25079 planned for 23 November was cancelled because of its failure to attract even a single bid. On 7 December, there was a placement auction of OFZ 26202. The volume of the bond issue put for auction was Rb 10bn, the actual volume of placement was Rb 9.25bn, while the weighted average yield amounted to about 8% per annum. Thus, over the period under consideration, the actual placement volume amounted to 92.5% of the planned figure (vs. 51.3% one month earlier). No auctions for additional placement of OFZ on the secondary market were held over that period.

The Stock Market

In December, the top news story regarding the Russian stock market was the discontinuation, from 19 December, of trading on the RTS stock exchange caused by the merger of Russia's two major stock exchanges, RTS and MICEX, into one trading floor, which started operating on the same day. The stock market of the new integrated stock exchange consists of three sectors: the main market that includes all the trading regimes of MICEX; the Standard sector which represents the former RTS Standard market transferred to MICEX; and the Classica sector which represents the former RTS Classica market transferred to MICEX. Trading in futures and options is conducted in two markets: the MICEX short-term market (foreign exchange and interest rates) and the FORTS short-term market (stock derivatives, foreign exchange derivatives and commodity derivatives).

Factors in the Dynamics of the Russian Stock Market

Russia's stock market was on the rise during the last ten days of November and the first few days of December. The main factors contributing to its growth were the news of a drop in the number of unemployed in the USA; the approval, by the world's six leading central banks, of new coordinated measures designed to prop up the world financial system; the Eurozone's decision to release the sixth tranche of loans to Greece; the adoption, by the governments of Italy and Greece, of a package of rigid belt-tightening measures; and China's decision to relax its monetary policy (by cutting the required reserve ratio). At the same time, the RF stock market's growth was restrained by the following factors: warnings from international rating agencies about a possible downgrade of the USA's and France's credit ratings; Fitch Ratings' revision of the outlook on U.S. credit rating from stable to negative and its downgrading of Portugal's sovereign credit rating from BBB- to BB+ with a negative outlook; the downward revision of the UK economy's growth forecast for 2011 and 2012; and the OECD's downgrading of its global economic growth forecast for 2012 (from 4.6 to 3.4%) and of its forecasts of Russia's GDP growth in 2011 (from 4.9 to 4%) and 2012 (from 4.5 to 4.1%).

On 6 December, world markets were collapsed by the decision of the Standard & Poor's international rating agency to put the sovereign credit ratings of 15 Eurozone countries (including Germany) and the long-term credit rating of the European Financial Stability Fund on negative watch. On 13 December, Russian stock market indices began to rise once again as the result of a number of successful placement auctions of Spain's government bonds and a growth of the index of investor expectations in Germany. Also, the stock market was buoyed by the decision of the U.S. Federal Reserve System to keep the target range for the discount rate, one of the two key interest rates in the USA, at 0 to 0.25% per annum, by the ongoing reduction in the number of first-time applications for unemployment benefits in the USA, and by the decreasing yield on Italy's and Spain's government bonds.

On the whole, over the period under consideration world markets rose by 1–6%, with the exception of several Asian markets, and had fallen by 1–26% since the year's beginning (*Table 1* and *Fig. 2*).

Table 1

THE DYNAMICS OF WORLD STOCK EXCHANGE INDICES

Индекс	Value (as of 12.20.2011)	Change over month (%)*	Change since year's beginning (%)
MICEX (Russia)	1,409.84	0.57	-16.48
RTS (Russia)	1,395.79	-2.47	-21.15
Dow Jones Industrial Average (USA)	12,103.58	5.31	4.54
NASDAQ Composite (USA)	2,603.73	3.27	-1.85
S&P 500 (USA)	1,241.30	4.48	-1.30
FTSE 100 (UK)	5,419.60	4.09	-8.14
DAX-30 (Germany)	5,847.03	5.59	-15.43
CAC-40 (France)	3,055.39	6.43	-19.70
Swiss Market (Switzerland)	5,804.31	6.55	-9.82
Nikkei-225 (Japan)	8,336.48	0.26	-18.50
Bovespa (Brazil)	56,864.85	1.77	-17.95
IPC (Mexico)	36,239.39	0.75	-6.00
IPSA (Chile)	4,179.20	1.26	-15.19
Straits Times (Singapore)	2,614.45	-3.78	-18.04
Seoul Composite (South Korea)	1,793.06	-1.82	-12.58
ISE National-100 (Turkey)	52,126.94	0.27	-21.03
BSE 30 (India)	15,175.08	-5.54	-26.01
Shanghai Composite (China)	2,215.93	-8.15	-21.09
Morgan Stanley Emerging & Frontier Markets Index	713.10	-0.96	-21.79

*- As a percentage of an index's value on 22 November 2011.

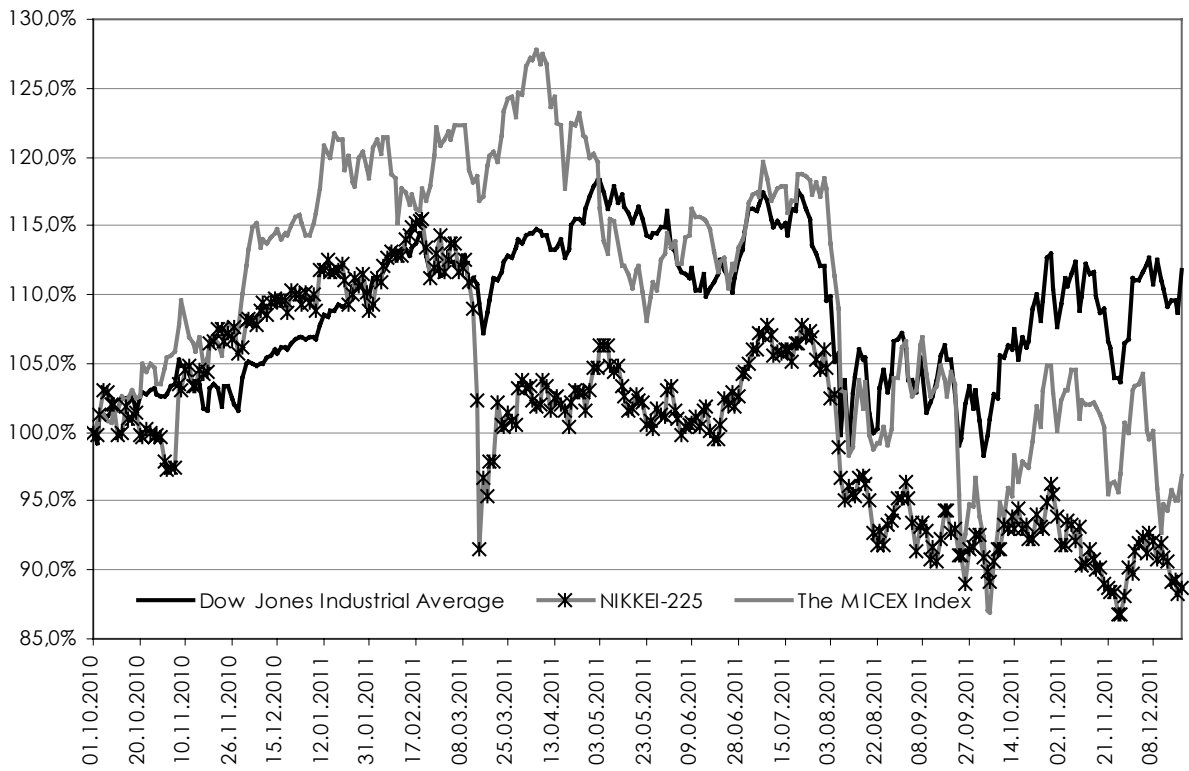


Fig. 2. Dynamics of the Main USA, Japanese and Russian Stock Indexes (As a Percentage of Their Values on 1 October 2010)

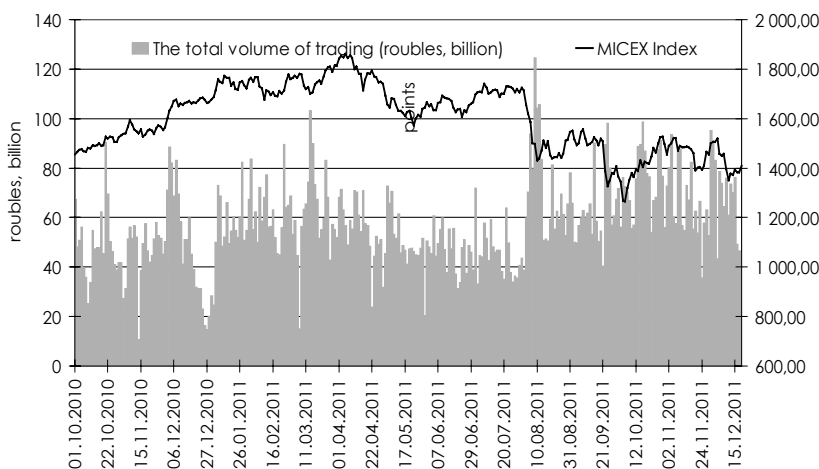
Among the domestic negative factors in the dynamics of the Russian stock market, we should note the negative financial reports for Q3 2011 submitted by a number of biggest Russian companies, and the mass rallies against the results of the State Duma election.

The Situation on the Share Market

The MICEX Index reached its December 2011 peak on 5 December when it hit 1,517.89 points (vs. 1,521.01 points one month earlier). The MICEX Index dropped to its December 2011 lowest level of 1,349.96 points (vs. 1,390.56 points one month earlier) on 12 December (Fig. 3).

On the whole, over the period between 23 November and 20 December 2011, the MICEX Index rose by 0.57%, or by 7.93 points in absolute terms (between 21 December 2010 and 20 December 2011, the MICEX Index dropped by 15.77%), while the trading volume of the shares included in the MICEX Index climbed to Rb 1,327.03bn. By comparison with the previous period, in December 2011 the average daily level of investor activity on the stock market declined by 5.86%.

In the period from 1 January to 20 December 2011, the biggest price losers among the blue chips were shares in *Mosenergo* and *VTB Bank*, which shed 40.66% and 37.33% of their value respectively (Fig. 4).



Source: MICEX.

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

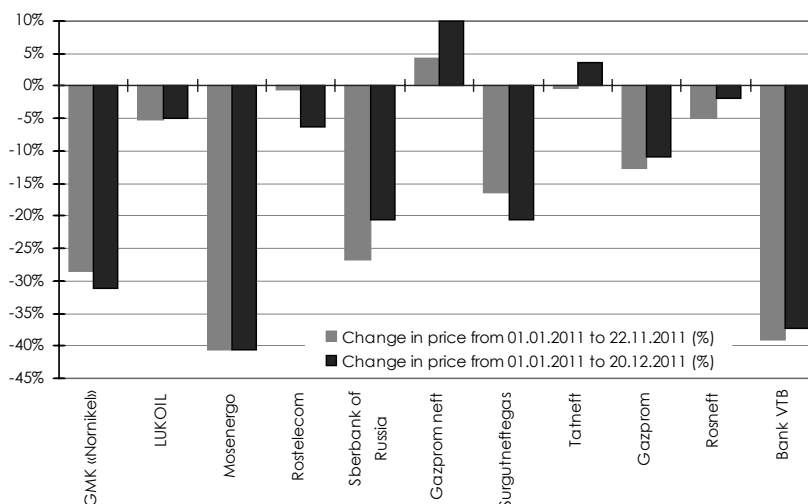
The Futures Market

In December 2011 (from 23 November to 20 December), the volume of trading in the MICEX

futures market amounted to Rb 7.9bn. In December, the highest trading volume was recorded by transactions with foreign exchange futures (Rb 4.03bn, 480 transactions) and funds futures (Rb 3.72bn, 11,850 transactions). By the trading volume in the foreign exchange instruments section of the MICEX short term futures market, the first place belonged to cash-settled US dollar futures contracts, while the second and third places belonged to euro-ruble currency pair futures contracts and euro-US dollar currency pair futures contracts, respectively. The prices of the ruble-US dollar currency pair futures contracts with the date of execution set for

15 March 2012 concluded in the MICEX and FORTS futures markets in December 2011 were, on average, within the limits of 31.2 to 32.4 rubles per US dollar, which means that some of the market participants expected that the ruble would become stronger by 0 to 2.6% by comparison with its value as of 20 December 2011 (32.03 rubles per US dollar), while other market participants expected that it would become weaker by 0 to 1.2%. The prices of the ruble-euro currency pair futures contracts with the date of execution set for 15 March 2012 concluded in the MICEX and FORTS futures markets were, on average, within the limits of 42 to 42.7 rubles per euro, which means that participants of these markets expected that the ruble would become weaker by 0.7 to 2.4% by comparison with its value as of 20 December 2011 (41.69 rubles per euro). By the trading volume in the funds futures section of the MICEX futures market, the first place belonged to cash-settled futures contracts on the MICEX Index, while the second place was taken by delivery futures contracts on shares in *Gazprom*, *LUKoil*, the Savings Bank of the Russian Federation and *NorNickel*. It should be noted that the value of the MICEX Index (the price of the concluded transactions) for March 2012 was, on average, within the limits of 1,370 to 1,530 points, which means that some of the market participants expected that the MICEX index would decrease by up to 2.8% by comparison with its value as of 20 December 2011, while other market participants expected that it would increase by up to 8.5%. The third place by the trading volume (Rb 100m) belonged to interest instruments futures. The trading volume of commodity futures was Rb 48m.

In December, the FORTS futures market saw a decline in average daily investor activity by 7% on the previous month. The first place in the volume of futures trading belonged to futures contracts on the RTS Index, followed far behind by ruble-US dollar currency pair futures contracts, futures contracts on shares in the Savings Bank of the Russian Federation (*Sberbank*) and *Gazprom*, and euro-US dollar currency pair futures contracts. The prices of the latest transactions concluded under ruble-US dollar currency pair futures contracts with the date of execution set for 15 June 2012 were, as a rule, within the limits of 31.6 to 32.9 rubles per US dollar, which means that market participants expected that the ruble would rise by 0 to 3% by comparison with its value as of 22 November 2011, and those with the date of execution set for 15 March 2012 – within the limits of 30.3 to 31.6 rubles per US dollar. Judging by the prices of the latest transactions, the value of a futures contract on the RTS Index with the date of execution set for 15 March 2012 was, on average, within the limits of 1,340 to 1,540 points, which means that some of the market participants expected that the RTS Index would decline by up to 4% by comparison with its value as of 20 December 2011, and other market participants expected that it would increase by up to 10%; while the value of a contract with the date of execution set for 15 June 2012 was, on average, within the limits of 1,320 to 1,530 points. Options were in much less demand, with the



Source: MICEX.

Fig. 4. The Dynamics of Russian Blue Chip Stocks from January through December 2011

options turnover amounting to approximately Rb 248.57bn (while the futures turnover was Rb 4,614.82bn). The first place in the volume of options trading belonged to marginable options on the RTS Index futures contract.

The Corporate Bond Market

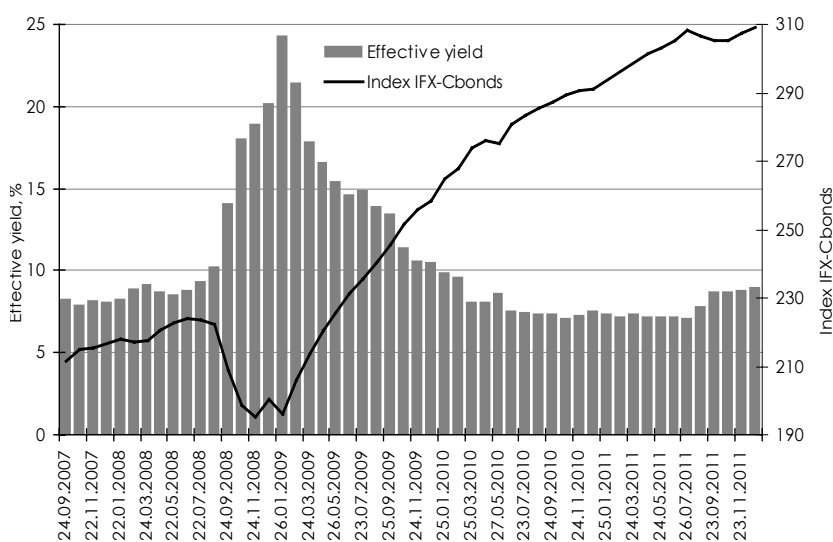
In December 2011, the volume of Russia's domestic corporate bond market (by the nominal value of ruble-denominated securities in circulation) continued to grow. In late December, it amounted to Rb 3,363.8bn, which represented an almost 1.8% rise on late November¹. Thus, in the last month of 2011 this index reached its new historic high. This occurred due to an increased number of bond loans and a rise in the number of the emitters represented in the debt market. Of all the issues denominated in foreign currencies, only one, yen-denominated, issue of bonds still remained in circulation.

In December, the secondary corporate bond market's trading indicators went up: the combined volume of transactions carried out on the MICEX stock exchange from 23 November to 20 December amounted to Rb 94.7bn (for reference: in October-November, the trade turnover in each of the two months hovered around Rb 70bn), and the number of transactions was 20.8 thousand (vs. 18.5 thousand in October)². Although the rise in investor activity at the end of a year is a seasonal phenomenon, it should be noted that the trading indicators of December 2011 failed to reach their high values registered in Q3 2011, when the trading volume exceeded Rb 100bn.

By the end of December, the IFX-Cbonds index of the Russian corporate bond market rose by 1.7 point (or 0.6%) from the end of November. At the same time, the weighted average effective yield also rose on the previous month, to 8.97% as of the end of December vs. 8.75% as of the end of November (Fig. 5). Thus, in the past four months, the level of yield in the corporate debt market was higher than the refinancing rate.

The corporate bond portfolio duration index once again slightly decreased – to 767 days by the end of the month (a 42-day drop on the end of November). Despite this drop, it has remained high enough, which proves that the corporate bond market has a sufficiently high proportion of long-term bonds.

In December, the interest rates on the most liquid bond issues were highly volatile. The leaders with regard to yield growth (by more than 1 p.p.) were OJSC *Rostelekom* (06 series bonds), OJSC *Magnitogorskii Metallurgicheskii Kombinat* [Magnitogorsk Integrated Iron-and-Steel



Source: According to data released by the Cbonds company.

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

Works] (BO-02 and BO-03 series bonds), *Vneshekonombank* [Bank for Development and Foreign Economic Affairs] (08 series bonds), CJSC *Raiffeisenbank* (04 series bonds), OJSC *Gazprom Neft* (10 series bonds) and OJSC *AKB Ak Bars* [Joint-Stock Commercial Bank] (05 series bonds). The greatest losers (by more than 1 p.p.) were CJSC *Kommercheskii Bank Glabeks* [Commercial Bank] (BO-01 series bonds), CJSC *AKB Globeks* [Joint-Stock Commercial Bank] (BO-01 series bonds), CJSC *AKB Promsviazbank* [Joint-Stock Commercial Bank], and JSC *AK Transneft* (01 series bonds)³.

In December, the yields on securities issued by financial

1 According to data released by the Rusbonds company.

2 According to data released by the Finmarket information agency.

3 According to data released by the Finmarket information agency.

sector emitters were generally on the rise: the yields on bonds issued by Russia's biggest banks (*Alpha Bank, Bank VTB, Bank Zenit, MDM Bank, Rossiiskii Selskokhoziaistvennyi Bank* [Russian Agricultural Bank] and *Rosbank*) and the RF Agency for Housing Mortgage Lending rose by 0.3 to 0.7 p.p. The only exceptions to this trend were bonds issued by CJSC *AKB Globeks*, CJSC *AKB Promsviazbank*, and OJSC *KB Renaissance Capital* [Commercial Bank]. It should be noted that the yields on some of the most liquid issues of securities floated by those banks have been on a downward trend for the second month in a row.

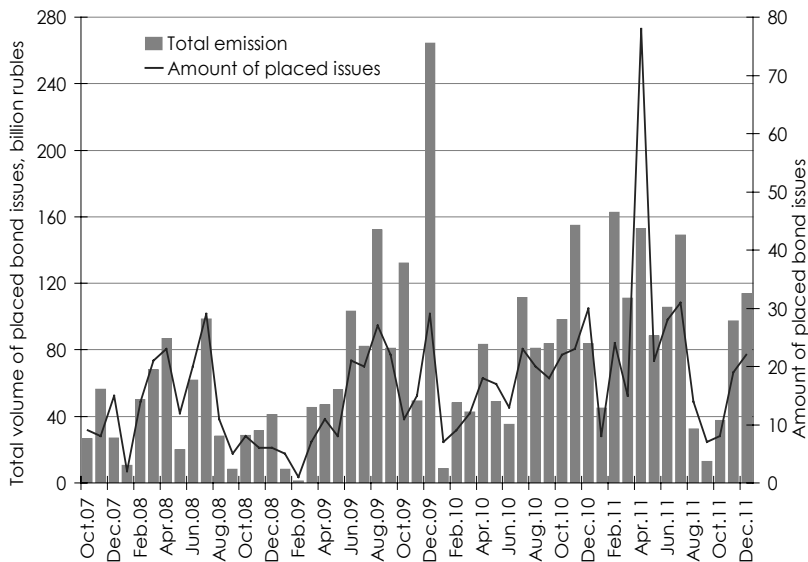
Industrial companies displayed different trends in the yields on their loans. In the gas, mining and metallurgical industries, the rates went up, but this rise, on average, amounted to no more than 0.4 to 0.6 p.p. At the same time, the yields on securities issued by some oil and chemical companies declined. A small upward trend was shown by securities issued by power-generating companies (although in November the yields on the most liquid issues of their bonds were characterized by a downward trend) and high-tech companies (*AFK Sistema, MTS, VympelKom-Invest* and *Sitroniks*).

It should also be mentioned that *Fitch Ratings* expects higher volatility risks for CIS metals and mining companies in 2012 after their strong performance in 2011. According to *Fitch Ratings*, this rise in volatility risks will result from weaker market conditions coupled with excess industry production capacity in the global steel sector. On the other hand, Russia's major steel companies like *Euras SA, Severstal, Magnitogorsk Integrated Iron-and Steel Works* and *Novolipetsk Integrated Steel-and Iron Works*, with control over raw materials supply, are better prepared for potential economic downturns than their global peers. The seasonal rebound in financial markets spurred issuer activity with regard to registration of new bond issues. Thus, between 24 November and 22 December state registration was granted to 60 corporate bond issues with a total face amount of Rb 199.6bn, the highest such amount on record in the last several months (for reference: between 26 October and 23 November – 18 corporate bond issues with a total face amount of Rb 125.7bn). Nearly half of the registered bond issues were issues of exchange bonds – the type of securities that are registered in a simplified procedure by big emitters long represented on Russia's stock market. Besides, state registration was granted to several inaugural bond issues with small face amounts of Rb 100m to Rb200m. The biggest issues over the period under consideration were registered by OJSC *Novolipetskii Metallurgicheskii Kombinat* [Novolipetsk Integrated Iron-and-Steel Works] (5 series of bonds with a combined face amount of Rb 50bn), OJSC *Mobil'nye TeleSistemy* [Mobile TeleSystems] (4 series of bonds with a combined face amount of Rb 30bn), OJSC *GAZ* [Gorky Automobile Plant] (4 series of bonds with a combined face amount of Rb 22bn), LLJSC *UTair-Finance* (11 series of exchange bonds with a face amount of Rb 16bn), and CJSC *Bank Inteza* (4 series of exchange bonds with a combined face amount of Rb 16bn)¹.

Investor activity in the primary bond market also increased although, just as it happened in the previous months, it considerably lagged behind the registration indices. From 24 November to 22 December, 18 emitters placed 22 bond issues with a combined face value of Rb 113.8bn (vs. 19 bond issues with a combined face value of Rb 97.4bn placed from 26 October to 23 November) (*Fig. 6*). The biggest bond loans were placed by real sector companies including OJSC *Federal'naiia Setevaia Kompaniia EES* [Federal Grid Company of the Unified Energy System] (one series of bonds with a face value of Rb 15bn), OJSC *Novolipetskii Metallurgicheskii Kombinat* (2 series of exchange bonds with a combined face value of Rb 10bn), OJSC *Bashneft* [Bashkirian Oil] (one series of exchange bonds with a face value of Rb 10bn), and the RF Agency for Housing Mortgage Lending (one series of bonds with a face value of Rb 14bn)². Big emitters managed to place their bond issues for a very long term. Thus, the circulation period of the securities issued by CJSC *Ipotechnyi Agent AIZhK* [Mortgage Agent of the RF Federal Agency for Housing Mortgage Lending] is 33 years, while the circulation periods of the securities issued by the RF Federal Agency for Housing Mortgage Lending, CJSC *Primam* and OJSC *Federal'naiia Setevaia Kompaniia EES* are 18, 15 and 12 years, respectively. Special mention should be made of the first foreign emitter represented on the Russian bond market, *Uranium One Inc* (it is noteworthy that the controlling block of shares in *Uranium One Inc.* belongs to the Russian company OJSC *Atomredmetzoloto*, whose parent entity

1 According to data released by the Rusbonds information agency.

2 According to data released by the Rusbonds information agency.



Source: According to data released by the Rusbonds company.

Fig. 6. The Dynamics of the Primary Placements of Corporate Bond Issues Denominated in Foreign Exchange

During the period from 24 November to 22 December, each of the eleven emitters who had to redeem their bond loans fulfilled its obligations in due time (in November, one emitter failed to fulfill its obligations and declared a technical default on the redemption of a securities issue). It is expected that January 2012 will see the redemption of 4 corporate bond issues in the amount of Rb 8bn².

In December, the state of affairs with respect to actual defaults (a situation when the emitter is incapable of paying the coupon to the securities holders even within the next few days after the record date) slightly deteriorated. In the period from 24 November to 22 December, 2 emitters failed to fulfilled their current obligations with regard to bond loans in due time or within the framework of a technical default (in the period from 26 October to 23 November none of the emitters declared a technical default due to missing a coupon payment to the securities holders)³. In December, one emitter failed to redeem the face value of the placed securities even within the framework of a technical default (no actual defaults on redeeming the face value of securities were registered in November). And only one of the emitters failed to redeem the bonds before their maturity by means of a buyback offer to their current holders and to achieve an agreement with them concerning debt restructuring.

Similarly to the previous month, one emitter failed to redeem the bonds before their maturity by means of a buyback offer to their current holders and to achieve an agreement with them concerning debt restructuring. ●

is OJSC *Rosatom*). In December, that company successfully placed a Rb 16.5bn bond issue with a circulation period of 10 years.

In December, it was a very positive piece of news that none of the bond issues offered in the Russian bond market was annulled by the Federal Financial Markets Service of Russia due to failure to place even a single security. It should be said that the worst misfortune that befell the bond market in the previous months was the large number of bond issues being annulled for that reason (15 to 20 annulments per month)¹. The absence of such annulments in December is indicative of the existence of high investor demand for bonds issued by Russian companies.

1 According to data released by the Federal Financial Markets Service of Russia.

2 According to data released by the Rusbonds company.

3 According to data released by the Cbonds company.

REAL ECONOMY: TRENDS AND FACTORS

O.Izryadnova

Industry growth rates slowing down, it was agriculture and construction that made a positive contribution into the production dynamics in August–November. In January–November 2011 the investments in fixed assets went up by 5.6% as compared with the corresponding period of the previous year, while agriculture production – by 21.7%. Overcoming the trend for the decrease of the real incomes of the population was the positive feature of January–November. Slowing-down of the inflation rates to 105.6%, which is 2% below the level of the preceding year, had a favorable impact on the consumer consumption.

In January–November 2011 the dynamics of the internal market was determined by the simultaneous growth of both the consumer and investment demand. The retail trade turnover growth rate reached 106.9% versus January–November 2010.

In November the trend towards the decrease of the real incomes of the population ceased. On the whole over January–November real incomes made 100.2% and real wages – 103.2% versus the corresponding period of the previous year.

The growth of the retail trade turnover is still based on the decrease of the savings rate and on the increase in consumer crediting. Credits issued for natural persons made RB 2065.1bn, having increased by 1.3 times as compared with the corresponding month of 2010. The savings ratio in the incomes of the population decreased to 8.9% over the first ten months of the year as compared with 13.8% in January–October 2010, savings in the form of deposits and securities – to 3.5% as compared with 6.6%.

The situation in the investment sphere worsened a bit. On the whole over January–November 2011 the growth of the investments in fixed assets made 5.6% versus the level of the previous year. The recovery of the investment demand proceeds very slowly, and it is expected that the pre-crisis level of the investments is achieved by 2013 on condition of their average annual growth of 6%.

It should be noted that while the internal market is expanding, the structure of the demand both for the domestically produced and for the imported goods is changing. The shifts in the aggregated structure of the demand are determined by the intensification of the trend to the contraction of the proportion of consumption goods import and reorientation to the import of goods of investment and intermediate demand. In the 3rd quarter 2011 the proportion of investment goods import in the total of import made 22.7% exceeding the corresponding figure of the 3rd quarter 2010 by 1.2%. The proportion of supplies of the goods of intermediate demand went up to 42.2% versus 39.4% a year ago.

The proportion of the import on the retail trade resources decreased by 2% as a result of the 3rd quarter and was at the level of 43%. This is accounted for by the recovery of the domestic production of household appliances, passenger cars, furniture, sewing production, footwear and leather goods production. Since the beginning of the year consumer prices index made 105.6% (107.6% over the corresponding period of 2010), foodstuffs process index – 103.2% (110.6%), non-food goods prices index – 106.3% (104.5%),

In 2010–2011 industrial production index is of recovery nature approaching the pre-crisis development trajectory, and the specific features of the dynamics are determined to a considerable extent by the effect of the base. In January–November 2011 industrial production index made 105.0% versus the corresponding period of 2010, in November 2011 – 103.9% versus November 2010. It was manufacturing industries that had a prevailing impact on the industry's dynamics and structure. Index of the manufacturing industry reached 106.8% versus January–November 2010 and 104.9% versus November 2010, extractive industries – 101.9% and 101.3%.

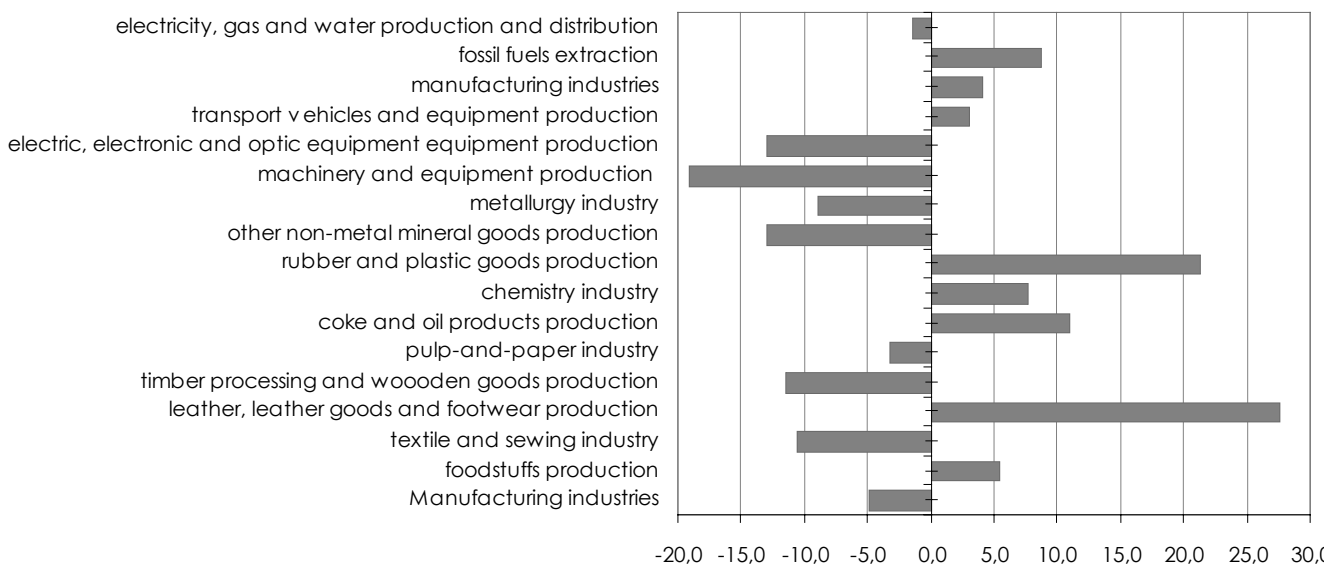
Dynamics of manufacturing industries development was considerably differentiated by types of economic activities and depends on such factors as the level of production facilities use, structure and dy-

namics of the internal solvent demand, degree of export orientation, expenses and prices dynamics. It is the complex of machine-building industry, chemistry industry, rubber and plastics goods production, timber processing, leather, leather goods and footwear production makes the main contribution into the manufacturing industries output. On the whole the structure of the recovery growth of 2009–2011 reproduces the scheme of post-crisis development of 1998–2000, when the growth trajectory started with the development of foodstuffs production and minerals extraction, as well as with the manufacturing industries connected with hydrocarbons and other raw and mineral resources.

The rates of the chemistry industry, wood processing, pulp-and-paper industry and metallurgy recovery are strongly dependent on the changes in the foreign economic situation, since the proportion of export in the production of some goods in these types of economic activities is in the range of 45–80%. The rates and structure of machine building recovery and adjacent production of rubber and plastic goods and the complex of consumer goods oriented primarily on the internal market are defined by the level of the solvent demand and competitive ability of their production versus the import goods.

Over 11 months of 2011 the index of machinery and equipment production made 111.2% versus the corresponding period of the previous year while the volumes of the production expanded for the majority of goods subclasses of this group. Thus, the growth of electric, electronic and optical equipment production in January–November 2011 made 104.9% versus 123.7% in January–November 2010. In this group the production dynamics was considerably influenced by the contraction of the demand for components and final goods in the sector-consumers. Transport vehicle and equipment production index made 126.3% in January–November 2011 versus the level of the corresponding period of 2010, cars, trailers and semitrailers – 158.4%. Production of passenger cars increased by 46.9%, of trucks – by 35.8%.

Dynamics of the industrial growth to a considerable extent is accounted for by the changes of prices and production expenses. As compared with the beginning of the year the prices for the producers of the industrial goods in November 2011 were 14.4% higher – compared to 15.6% increase in the corresponding period of the previous year. In minerals extraction the prices index in November versus last December was 134.2% (115.0% in November 2010). In January–November 2011 the prices growth rates in the manufacturing industries were observed to slow down to 109.2% versus 115.5% in the corresponding period of 2010. This is due to the reserved dynamics of freight transportation tariffs growth rates – 109.6% in January–November 2011 versus 131.3% in the corresponding period of 2010 and producers’ prices in electricity, gas and water production and distribution – 104.9% versus 114.0%.



Source: Federal State Statistics Service.

Fig. 1. Growth Rates of Manufacturing Industries by Types of Economic Activities in January-November 2011, as percentage 2008

Favorable situation at the world market of energy carriers allowed the enterprises in minerals extraction sector getting positive balanced financial result of Rb1516bn as a result of January–September 2011, which is 64.5% above the index of the previous year. Financial situation at the manufacturing enterprises has somewhat improved: over January–September 2011 their balances financial result made Rb1382.8bn exceeding by 19.7% the level of the previous year over the same year.

Table 1

PROFITABILITY OF SOLD GOODS, PRODUCTION, WORKS, SERVICES AND ASSETS BY ORGANIZATION AS BROKEN BY TYPES OF ECONOMIC ACTIVITY IN 2008-2011, AS PERCENTAGE

	Profitability of sold goods, works, services				Profitability of assets				For reference		
	2008	2009	2010	January–September 2011	2008	2009	2010	January–September 2011	January–September 2011 versus January–September 2010		September 2011 versus December 2010
									Financial result growth rates	Physical volume index	
Total	13.0	11.5	11.1	11.2	5.4	5.7	5.1	5.5	120.6		
Including: agriculture, hunting, forestry	10	8.4	10.3	11.8	4.8	3.1	3.4	3.4	148.6	115.9	96.1
fishing, fish breeding	7.4	21.4	20.8	22.9	1.0	14.5	13.9	14.1	122.9	116.1	
minerals extraction	25.4	29.2	35.5	36.4	10.5	11.3	14.5	14.4	164.5	102.4	121.8
manufacturing industries	17.1	12.5	14.4	13.4	8.6	5.6	7.8	6.3	119.7	107.2	108.2
electricity, gas and water production and distribution	4.9	7.6	7.2	6.9	2.3	3.6	4.9	2.9	98.7	100.6	103.4
construction	5.6	6.6	5.7	3.4	3.1	2.9	1.2	1.0	80.0	107.9	106.8
wholesale and retail trade; motor vehicles and motorcycles servicing; repair of household appliances and items of private use	10.8	8.3	7.6	9.4	5.3	7.9	7.4	7.5	149.7	106.2	
transportation and communication	14.2	14.1	13.7	13.4	5.4	4.5	5.0	3.6	112.7		117.7

Source: Federal State Statistics Service.

Changes in the dynamics of the financial results of the enterprises trading goods at the external market were mainly defined by the increase of the exchange prices for oil, nonferrous and ferrous metals, and chemistry industry products. As a result of January–September 2011 financial results of the oil products production made Rb558.0bn, which is 24.9% above the figure of the correspond-

ing period of the previous year – this is accounted for by the increase in both the expansion of production and growth of price level. In January–November 2011 oil products output went up by 3.6% as compared with the corresponding period of the previous year, while producers' prices increased by 19.8% since the beginning of the year.

Improvement of the financial indices of the chemistry industry has been registered since 2010. In January–September 2011 the balanced financial result of the enterprises of chemistry industry made Rb189.8bn, having increased by 72.4% as compared with the corresponding period of the previous year. It should be noted that the growth of producers' prices in chemistry industry reached 122.5% in January–November 2011, while the production volumes reached 105.6% versus the corresponding period of the previous year. The profitability of chemistry industry in January–September 2011 made 24.1%, exceeding by 5.0% the figure of 2010 due to the intensive contraction of production expenses. The efficiency of chemistry industry enterprises operation was negatively affected by the high degree of machinery and equipment wear and tear as well as the narrow assortment and low quality of the produced goods supplied to the internal market as compared with the external supplies.

In January–September 2011 the balanced financial result of the metallurgy complex made Rb338.6bn and remained practically at the level of the corresponding period of the previous year. Starting with the 2nd half of 2011 the metallurgy complex was registered to have a decrease in financial results due to the contraction of the external demand. As compared with January–September 2011 the profitability of the complex decreased by 3.1%, making 16.7%. As a result of January–November 2011 the level of the output in the metallurgy and production of finished metal goods went up by only 2.9% versus the growth of 11.5% in the corresponding period of the previous year while the producers' prices growth has slowed down to 114.4% versus 122.3%.

The operation of the organization producing goods that are not traded at the external markets remains ineffective in most cases. It should be noted that despite the growth of the financial result in the types of economic activities oriented towards the internal investments demand saturation the situation in these types of activities is still disadvantaged.

In January–September 2011 profitability index in construction materials production made 12.2% having increased by 3.9% as compared with the corresponding period of the previous year, remaining however considerably below the pre-crisis level (18.9% in the 1st quarter 2008).

In January–September 2011 the balanced financial result in the complex of machine-building industries exceeded by nearly two times the level of the preceding year being though considerably diversified by the types of activity. In January–November 2011 transportation vehicles and equipment production retained the leading position, characterized by anticipating production growth rates as compared with other machine-building complex industries as well as with the aggregated indices of the manufacturing industries. As a result of January–September 2011 the balanced financial result in transportation vehicles and equipment production made Rb39.5bn, while the sales profitability nearly returned to the pre-crisis level making 6.1% having increased by 1.9% as compared with the index of the corresponding period of the previous year. The pricing policy being reserved, which is characteristic for the machine-building complex, the level of profitability was prevalently influenced by the output dynamics and expenses level.

Textile and sewing industry profitability in January–September 2011 went up to 7.3% versus 5.3% a year ago, profitability of leather, leather goods and footwear production – to 7.7% versus 6.9%. Profitability of foodstuffs production made 8.3% decreasing by 4.3% as compared with January–September 2010. It was the slowdown of foodstuffs production growth rates to 100.6% over January–November 2011 versus the corresponding period of the previous year while producers' prices went up by 1.4% that acted as one of the main factors defining the decrease of economy efficiency. Financial result of foodstuffs production made Rb89.4bn in January–September 2011, which is by 31.4% below the level of the corresponding period of the previous year.

On the whole one can say that nearly all the sectors of economic activity are gradually expanding the production volumes with the simultaneous growth of producers' prices, which defines step-by-step improvement of the financial results as compared with the previous year. ●

RUSSIAN INDUSTRY IN NOVEMBER 2011

S.Tsukhlo

According to the surveys conducted by the Gaidar Institute¹, the continuing and progressively more rapid decline of effective demand and its forecasted values has resulted in worsened estimations of stocks of finished products and in a slow down in the revival of industrial growth. Enterprises continue to cut down their personnel and are not prepared to begin recruiting new cadres in the next few months.

Demand for Industrial Products

In November 2011 our surveys registered an increase of the intensity of decline in the demand for industrial products. The initial balance (growth rate) of sales dropped another 6 points (to -16) and thus became comparable with the typical January values recorded over the pre-crisis years and in January 2011. When cleared of seasonality, the adjusted balance value becomes equal to -9 points, which is the worst result since September 2009 (*Fig. 1*).

Following its 22-point decline in September 2011, the forecasted demand dropped by further 15 points in November. As a result, at present the balance of forecasts (before clearing of seasonality) amounts to -20 points. Over the nearly 20-year history of our surveys, worse values of that index were previously registered only three times: in 1998, 2008 and 2009.

So, it appears that industry is currently characterized by very low hopes for demand revival. However, the formal methods of seasonal adjustment have so far improved the pessimistic outlook of enterprises and placed demand forecasts on the plus side; but its values represent this year's historic low and are evidently below the forecasts recorded in late 2010.

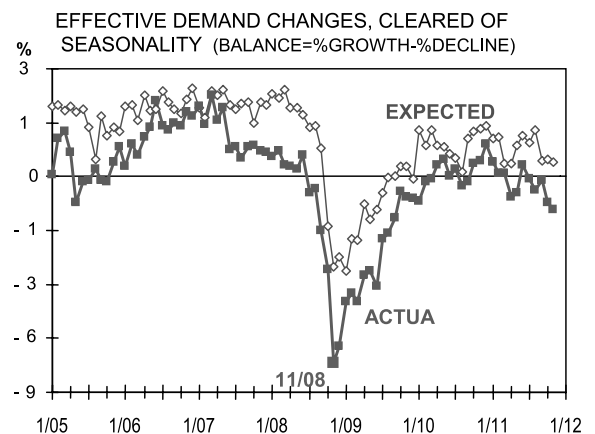


Fig. 1

Stocks of Finished Products

One more consequence of the continuing demand shrinkage has become a worsened balance of estimates of finished products stocks. This index increased by 4 points (i.e. worsened, because the number of the answers "above the norm" became even higher). The deterioration of estimates of finished products stocks occurred alongside shrinkage of their physical volumes. In this connection, the rate of decline displayed by stocks of finished products in November reached the level of -8 points, i.e. a historic high for the last five quarters. This intensity of stocks decline in Russian industry is highest since July 2010.

Output

The rate of industrial production growth in November displayed no changes in terms of either initial data or data cleared of seasonality (*Fig. 2*). The initial balance for November (similarly to the situation observed over a few recent months) is close to zero and remains the worst one since early 2010 (of course, if the nation-wide idle period in January is excluded). The seasonal

1 Monthly business opinion surveys of directors of industrial enterprises have been conducted by the Gaidar Institute on the basis of European harmonized methodology since September 1992 across the entire territory of the Russian Federation. The panel consists of approximately 1,100 enterprises employing more than 15% of the total number of industrial employees. The panel is skewed towards big enterprises in each selected subsector. Of the questionnaires posted, 65 to 70% were returned.

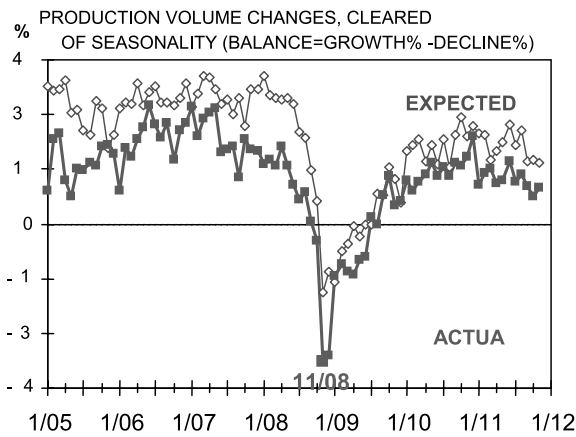


Fig. 2

level in September–November; this level, however, is the historic low for 2011 and 9 balance points below the plans for September–November 2010.

Producer Prices

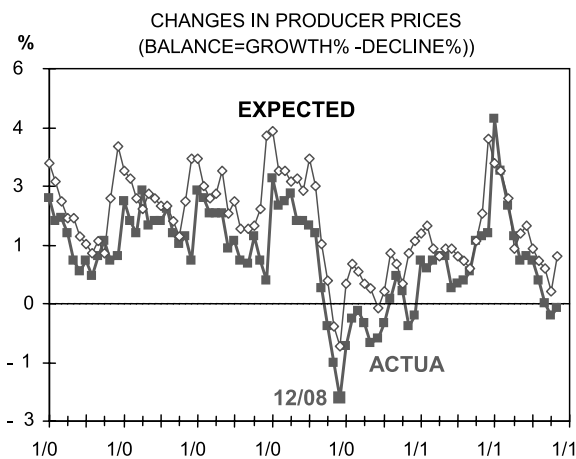


Fig. 3

the zero zone when prices were neither increasing nor declining. But the situation in each sector when taken separately did change. Decline of prices continued in ferrous metallurgy, while in non-ferrous metallurgy prices began to grow. Growth of prices also began in the chemical industry and became more intense in the food industry. The timber industry began to bring down its prices. Machine-building did not alter its pricing policy, maintaining growth at a negligible rate.

In November, forecasts of prices in industry were subject to more serious adjustments. While one month ago only minimum growth of prices was planned, now industry intends to return to their significant growth: over the past month the balance of pricing plans increased by 9 points. The most intense growth rates are planned to take place in the chemical and food industries and machine-building. Light industry is also prepared to begin to increase producer prices. A decline of producer prices, just as one month before, is planned only in metallurgy.

Actual and Planned Job Cuts

Industrial enterprises continue to dismiss their personnel (*Fig. 4*). In November the intensity of that process did not change and remained at its October level – the highest since 2010. The seasonal adjustments brought similar results. The highest rates of job cuts were registered in ferrous metallurgy, the food and construction industries. A significant rate of recruiting was

adjustment has increased the initial balance value in absolute terms, but it still remains at its lowest level since March 2010. Enterprises have noted no revival in industry.

Neither do they expect it in the next few months. The production plans of enterprises (before clearing of seasonality) in November declined by further 16 points and became negative (i.e., the number of enterprises planning output reduction) and thus continued the downward trend that had emerged as early as the beginning of the first half-year 2011. As a result, over the last five months the plans of enterprises have “lost” 45 points, whereas the losses recorded over the same period of last year amount to 25 points. So far, clearing of seasonality have been improving the situation and thus stabilizes output plans at the same

In November, industry for the second time this year attempted to overcome the downward trend in price growth (*Fig. 3*). The first attempt was recorded in May-June. Then the rate of price growth became stabilized at the level of 11 points after a four-month-long decline from its post-default historic high of 47 points. However, in August the slowdown of the rate of price growth continued, and then in October came to a complete halt. The balance even became negative (-3), but that value was not significant enough to provide sufficient grounds for a confident conclusion as to decline in absolute term across entire industry. Decline of producer prices in October was registered only in metallurgy, while the prices in all the other sectors (except the food industry) remained practically unchanged. In November the overall balance changed only slightly and thus remained in

registered only the chemical industry. The plans for November envisage a slight increase in the intensity of job cuts as compared to the October plans. Personnel dismissals are going to prevail in all the sectors. The highest rates are expected in ferrous metallurgy, the food industry and light industry, as well as in the construction industry.

Crediting of Industry

In November 2011, industry did not experience any changes in crediting conditions (Fig. 5). The share of enterprises with normal credit availability in recent months became stabilized at the level of 68%, while the mean rate on credits offered by banks to enterprises remained unchanged (11.8%). Only excessive (“above the norm”) banks’ offers have decreased (but only negligibly). The share of such “imposition of loans” dropped to 3% after having been 6% in June. The most comfortable crediting conditions in Q4 2011 are offered to ferrous metallurgy (82% – ‘normal’ credit availability, 10% – “above the norm”); the chemical industry (68% and 7% respectively), machine-building (75% and 1% respectively); and the construction industry (68% and 1% respectively). In the food industry, normal credit availability is reported by 58% of enterprises, excessive credit availability – by 4% of enterprises.

It is unlikely that bankers’ hopes that ferrous metallurgy will increase its demand for credits can be realized in the near future. The majority of enterprises are not planning to increase the volume of their borrowings in the next few months, while any potential changes will be negative. In ferrous metallurgy the number of enterprises intending to decrease the rate of their borrowing is higher than the number of those that plan to increase it. The most active demand for loans is possible in light industry (the balance of crediting plans is +29 points), the timber industry (+25) and the construction industry (+25). ●

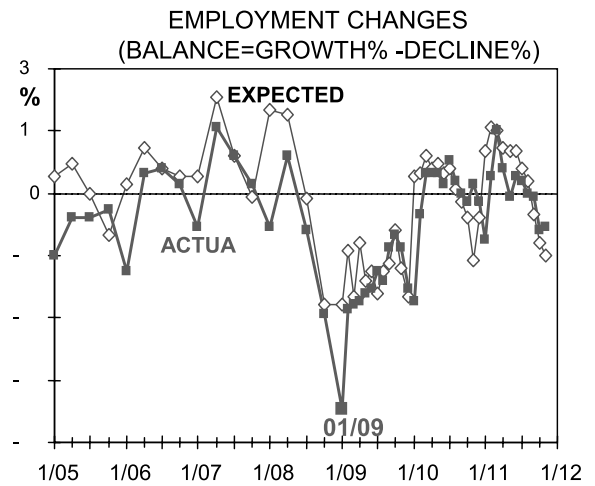


Fig. 4

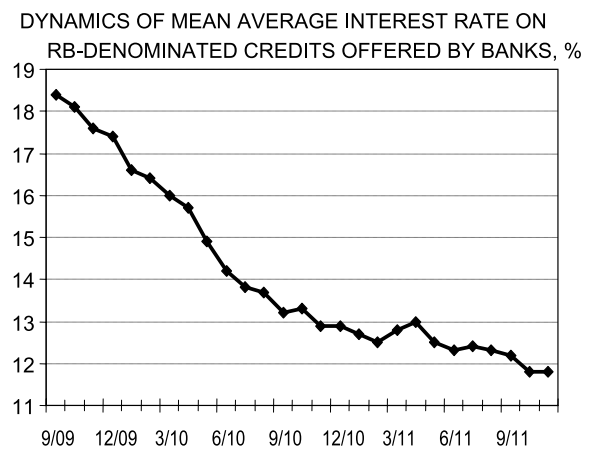


Fig. 5

INVESTMENT IN FIXED ASSETS

O.Izryadnova

In January–November 2011 investments in fixed assets made Rb8950.55bn or 105.6% versus the level of the corresponding period of the previous year. The steady growth of the investments in the fixed assets had been observed since July 2011, which resulted in the growth of the workload of construction by 4.8% in January–November. In the 2nd half of 2011 the trend towards the contraction of the residential area implementation was overcome, and in January–November 2011 the index demonstrated the growth of 4.4% versus the corresponding period of the previous year. The structure of the investments financing sources was characterized by the intensification of the trend for the contraction of banking credits and organizations' borrowed funds. The simultaneous contraction in banking credits and the growth of capital withdrawal testifies the necessity of fundamental changes in the investment climate.

In the 2nd quarter 2011 the increase in the investments in fixed assets volumes by 5.0% versus the corresponding period of the previous year compensated for the negative impact of investments recession in the 1st quarter 2011 by 0.8%. In October–November 2011 the trend towards the expansion of investment activity has sustained. As a result in January–November 2011 the increase in investments made 5.6% versus the level of the corresponding period of the previous year.

The behavior of different economic entities had a considerable impact on the nature of crisis overcoming.

The positive dynamics of the increase of the investment activity in the segment of small- and medium-scale business characteristic for 2010 was not maintained in 2011, which aggravated the situation in the investment sector. Thus, according to the preliminary estimation, investments in fixed assets in the segment of small business in 2011 were estimated at the level of 92% of the previous year and approximately at 85% of 2008. The proportion of investments in small business segment in the total volume of the investments in the economy in 2011 made 27.9% according to the preliminary situation decreasing by 2% versus the previous year.

In contrast, the forecast investments in fixed assets growth rates on the whole throughout the economy at the level of 5.3% in 2011 is connected with the acceleration of investments in fixed assets at large enterprises up to 12.1% versus the previous year. Despite the positive dynamics of 2011 the investment demand made 93.5% of the level of 2008 on the whole throughout the economy, and 97.2% in the segment of large enterprises.

It was the shift from financing of the investments in fixed assets from enterprises' own funds to expansion of the borrowed funds participation was a fundamentally new feature of the economic development in the last decade. However, in the environment of the slow post-crisis recovery of the internal market and the economy's earnings in January–September 2011 the orientation towards the use of enterprises' own funds for investment programs financing intensified. As a result of January–September 2011 the proportion of own funds of organizations in the structure of investments in fixed assets went up to 45.3% exceeding by 3.3% the figure of the corresponding period of the previous year.

Table 1

STRUCTURE OF INVESTMENTS IN FIXED ASSETS AS BROKEN BY SOURCES OF FINANCING
(EXCLUDING THE SUBJECTS OF SMALL-SCALE ENTREPRENEURSHIP NOT OBSERVED BY
STATISTICAL METHODS), AS PERCENTAGE TO THE TOTAL

	2008	2009	2010	January–September		
				2009	2010	2011
Investments in fixed assets – total	100	100	100	100	100	100
Including as broken by sources of financing:						

Table 1, cont'd

	2008	2009	2010	January–September		
				2009	2010	2011
own funds	39.5	37.1	41.2	38.3	43.0	45.3
profit remaining available to organizations (accumulation fund)	18.5	16.0	14.7	15.5	16.0	17.6
borrowed funds	60.5	62.9	58.8	61.7	57.0	54.7
of which:						
bank credits	11.8	10.3	8.7	11.1	9.1	8.6
of which foreign banks' credits	3.0	3.2	2.0	3.4	2.7	1.8
borrowed funds of other organizations	6.2	7.4	5.6	8.9	6.6	5.5
budget funds	20.9	21.9	19.4	18.7	17.4	16.2
of which:						
federal budget funds	8.0	11.5	10.0	8.6	8.5	8.8
funds of subjects of the Russian Federation	11.3	9.2	8.2	9.1	7.8	7.4
off-budget funds	0.4	0.3	0.3	0.2	0.3	0.2
other	21.2	23.0	24.86	22.8	23.6	24.2
of which:						
funds of superior bodies	13.8	15.9	18.0	16.2	16.7	18.0
funds received for share participation in construction (from organization and population)	3.5	2.6	1.9	2.6	2.0	1.8
of which funds of population	1.9	1.3	1.1	1.0	1.1	1.1
funds from corporate bonds issue	0.1	0.1	0.01	0.1	0.02	1.0
funds from stocks emission	0.8	1.0	1.4	0.8	1.4	1.0
Foreign investments in the total volume of investments in fixed assets	4.3	4.3	3.8	5.4	4.8	3.7

Source: Federal State Statistics Service.

The changes in the volume and proportion of the borrowed funds in the sources of financing were accompanied by the change in their structure. The state demand for the produce and services of the Russian enterprises is supported by the fulfillment of the planned investment projects in the sector of transportation, telecommunications etc. within the framework of FTP and FTIP as well as large investment projects of the Investment Fund. The period of 2010-2011 was characterized by the decrease in the proportion of the budget funds used for these investments in fixed assets. Thus, in 2010 it made 2.79% of the GDP, decrease according to our estimations to 1.95% of the GDP in 2011, the funds of the federal budget making, correspondingly, 1.44% and 0.96%.

As of November 2011 the total volume of budget allotments envisaged for FTIP fulfillment in 2011 made Rb920.9bn, of which budget investments made Rb784.7bn, subsidies – Rb136.2bn.

The funds of Rb572.3bn (62.1% of the total FTIP volume) were envisaged to finance the objects included in the federal target programs, of which budget investments made Rb472.6bn, subsidies – 99.7bn. The funds for fulfillment of special works included in the state defense order made Rb64.5bn.

In 2011 Rb348.6bn was envisaged for construction of objects not included in federal target programs, which makes 37.9% of the total volume of FTIP, of which Rb312.1bn comprise budget investments and Rb35.5bn – subsidies. The share of special works included in the state defense order in it makes Rb89.5bn.

In concordance with FTIP for 2011 taking into account corrections as on November 1, 2011 the budget allotments for construction and purchase of 3756 objects was envisaged and commissioning of 2218 objects was planned.

In January–November 2011 94 objects were put into commission, 69 of which – to full extent, 25 – partially. As on November 1, 2011 1517 objects were financed, 819 objects were characterized by technical readiness in the range from 51.0% to 99.9%.

In January–October 2010 Rb391.9bn of the annual limit (55.2% of the total volume of the funds envisaged for the year) was financed from the federal budget and Rb20.6bn – from the budgets of the subjects of the Russian Federation (69.4% of the total volume of budgets of Russian Federation

subjects). The state customers used Rb325.9bn at the expense of all the sources of financing or 41.6% of the annual limit.

Table 2

OBJECTS ENVISAGED BY TARGETED INVESTMENT PROGRAM AND VOLUMES OF PUBLIC INVESTMENTS IN 2011 (EXCLUDING CONSTRUCTION SIGHTS AND OBJECTS INCLUDED IN STATE DEFENSE ORDER)

	Number of objects for 2011		Commissioned in January–October 2011		Limit of public investments in 2011		Financed from the federal budget in January–October 2011	Investments used from all financing sources in January–October 2011
	total	with the commissioning deadline in 2009	to full extent	partially	total	of which from the federal budget		
	Units				Rb billion			
Total	3756	2218	69	25	783.1	709.6	391.9	325.9
of which:								
transportation complex	1046	539	27	4	305.2	273.6	197.7	163.2
agriculture complex	191	107	6	7	9.1	8.7	5.9	3.8
special complex	757	559	14	4	54.3	49.9	21.9	15.3
social complex	1586	940	22	10	363.0	333.2	144.0	127.5
other objects	176	73	-	-	515	44.2	22.4	16.0

Source: Federal State Statistics Service.

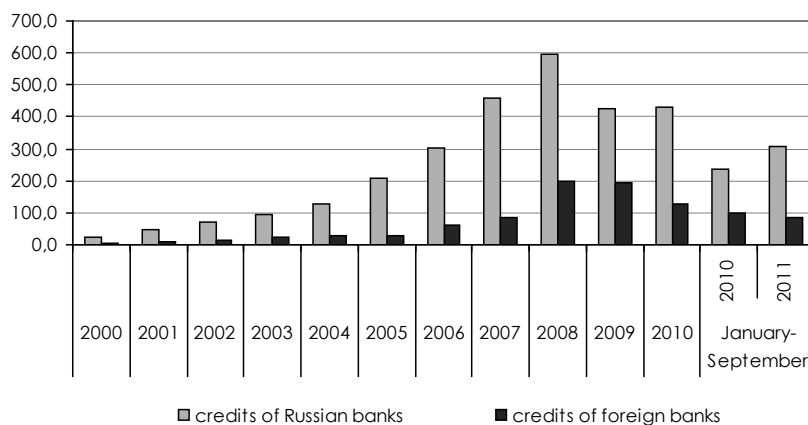
The annual limit of the public investments in transportation (72.2%) and agriculture (67.8%) complexes was financed to a considerably higher extent than the limit for construction sights and objects on the whole. Budget allotments for special complex were financed by 43.9%, for social complex – by 43.2%.

In 2010 the structure of the funds borrowed for investments in fixed assets financing was characterized by the intensification of the trend towards the contraction of banks' and borrowed funds participation. It should be noted that while the credits of the Russian banks issued for investment purposes had a trend for stabilization, the foreign banks' credits decreased, which defined the total contraction of the banks' credits in the sources of investments in fixed assets financing.

In January–September 2011 the situation changed: the growth of crediting from the Russian banks fully compensated for the contraction of the foreign banks' credits. The increase in the credits of the Russian banks issued for financing of the investments in fixed assets made Rb71.5vb

as compared with January–September 2010.

The proportion of the foreign investments in the total volume of the investments in fixed assets in January–September 2011 decreased to 3.7% versus 4.8% in the corresponding period of 2010. In 2009–2011 the structure of the foreign investments was transformed due to a sharp drop of the volumes and proportion of the direct investments and the expansion of other investments. In January–September 2011 the proportion of the direct



Source: Federal State Statistics Service.

Fig. 1. Bank Credits for Financing of Investments in Fixed Assets in 2000–2011, Rb billion

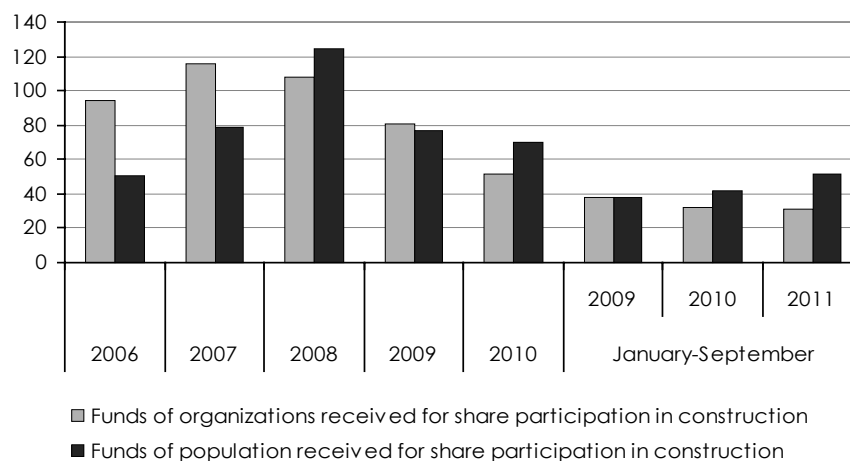
investments accounted for 8.8% of the total volume of the foreign investments versus 17.3% a year ago.

In the 1st half of 2011 the housing complex was subject to inertial trends of two previous years and the contraction of the housing commissioning made 3.7% versus the corresponding period of the previous year. In the 3rd quarter 2011 the situation changed: the housing commissioning increased by 15% versus the corresponding period of the previous year, as a result of which the increase in January–September versus January–September 2010

made 2.8%. At the same time the proportion of individual housing construction in the volume of housing commissioning in January–September 2011 made 50.4% versus 54.9% in 2009. The volumes of unfinished individual construction growing, the main proportion of housing commissioning was made at the expense of the organizations' funds.

While the absolute volumes of the investments in housing construction decreased, in 2010–2011 in contrast to 2009 the population's funds volume and proportion was observed to expand, the organizations' funds contracting at the same time. In January–September 2011 the increase in the funds of population directed to share participation in construction made Rb9.9bn. Investment activity of the population aimed at solving their own housing problems was supported by the growth of the demand for the credits. In January–September 2011 the volume of issued housing credits made Rb386.1bn versus Rb223.0bn in the corresponding period of 2010.

The growth of investments in fixed assets in 2010–2011 is to a considerable extent determined by the low base of 2009, when the decrease in investments made 16.2%. Comparative analysis of the structure of investments in fixed assets in January–September 2009–2011 allows to dingle out both general and specific features of the changes in the investment demand by types of economic activities. In 2009–2011 the structural shifts in the investments in the fixed assets were determined by the increase in the proportion of the industry in the total volume of the investments in fixed assets (not taking into account the subjects of small-scale entrepreneurship). Quite a considerable diversification of the rates by the types of economic activity was observed. The drop of the investments in fixed assets in the extraction sector of the economy and electricity, gas and water production and distribution was less dramatic than in the manufacturing industry. Crisis overcoming was determined both by the high growth rates of the fuel and energy sector and extraction complex of the industry and by higher dynamics of the investments demand in these types of activity. In 2010 investments in fixed assets in the extraction industries went up by 8.9%, in electricity, gas and water production and distribution – by 24.1%, in manufacturing industries – by 3.3%. In January–September 2011 the growth of investments in fixed assets was observed in the majority of the types of economic activities, but the investments in fixed assets of the manufacturing industries remained by 13.4% and the extractive industries by 2.2% below the figure of January–September 2008. Among manufacturing industries one should note the increase of the investments in the coke and oil products production by 2 times in January–September 2011, in the electricity, gas and water production and distribution – by 1.3 times, in the pipelines transportation – by 1.6 times versus the corresponding period of 2008. The period of 2009–2011 was characterized by the upsurge of the investment activity in textile production and leather production, which is accounted for by the change in the customs regime for equipment and raw materials import.



Source: Federal State Statistics Service.
Fig. 2. Funds Received for Share Participation in Construction in 2007–2011, Rb billion

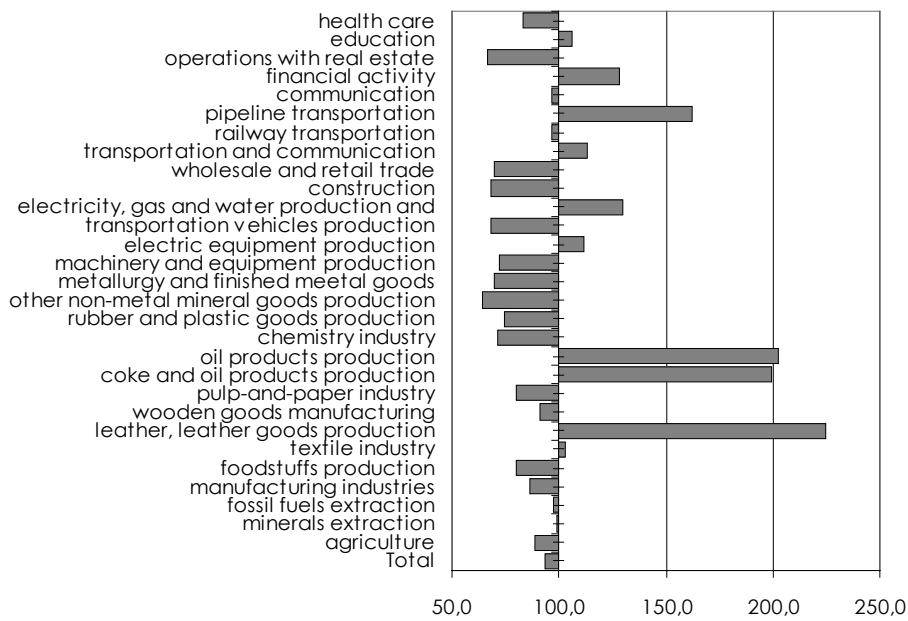


Fig. 3. Investment in Fixed Assets in January-September 2011, as Percentage to January-September 2008

Slow recovery of the demand for investment goods and construction material resulted in the contraction of the investments in January–September 2011 as compared with the corresponding period of 2008: by 30.1% in metallurgy, by 3.8% in construction materials production, by 27.9% in machinery and equipment production and by 27.9% in transportation vehicles production.

According to the data of the selective survey on the investments activity of organizations of minerals extraction sector, manufacturing industries, electricity, gas and water production and distribution,

which was carried out by the Federal State Statistics Service, it was the substitution of the outdated technology an equipment that was the main aim of the investments in 2010–2011 – the same as in the previous year. The main proportion of the investments in the fixed assets in 2010–2011 is directed for the purchase of the new machinery and equipment.

The main factor that restrained the investments activity of organizations of minerals extraction sector, manufacturing industries, electricity, gas and water production and distribution in 2010–2011 was the shortage of own financial funds.

Table 3
 VOLUME AND DYNAMICS OF INVESTMENTS IN FIXED ASSETS AS BROKEN BY TYPES OF ECONOMIC ACTIVITY IN 2008–2011 (EXCLUDING THE SUBJECTS OF SMALL BUSINESS AND PARAMETERS OF INFORMAL ACTIVITY)

	2008	2009	2010	January–September		2008	2009	2010	January–September	
				2010	2011				2010	2011
	Rb billion									
	As percentage to the previous year									
Total	6272.1	5769.8	6413.7	3512.7	4581.7	105.6	82.5	105.1	96.2	112.1
of which:										
agriculture, hunting and forestry	243.0	192.6	190.9	121.4	158.4	95.7	75.2	88.9	97.2	120.9
minerals extraction	1040.9	967.8	1109.8	694.6	893.5	103.9	88.3	108.9	95.7	116.9
of which:										
fossil fuels extraction	950	893.5	1021.5	641.3	808.1	104.8	89.1	108.7	96.2	114.0
manufacturing industries	1034.0	881.9	993.7	617.8	742.1	107.8	78.2	103.3	95.9	108.4
electricity, gas and water production and distribution	558.2	585.6	786.3	442.1	527.9	111.3	99.8	124.1	116.3	106.0
construction	91.7	162.7	194.1	96.5	106.5	91.7	66.1	117.3	101.5	92.4
wholesale and retail trade	168.7	138.4	158.4	90.5	103.1	95.6	75.7	108.9	2.4	100.6
transportation and communication	1628.0	1624.6	1696.1	957.6	1258.9	112.4	99.1	109.0	97.3	119.0
of which communication	257.4	180.6	207.3	115.8	161.5	95.1	66.6	108.6	109.3	137.9
financial activity	74.7	74.6	77.2	42.9	61	95.6	99.4	107.1	86.2	133.9
operations with real estate, rent and services rendering	733.8	558.2	658.3	340.4	358.1	100.9	70.8	92.8	96.6	99.4
of which research and development	31.9	48.9	62.8	23.7	30.6	101.9	131.9	114.4	95.7	116.8
state management and military security; compulsory social insurance	128.2	133.0	120.5	52.9	53.0	109.7	89.5	87.0	78.1	106.3
education	162.9	117.4	142.9	67.0	84.5	96.9	78.7	113.7	105.7	121.2
health care and social services rendering	188.0	145.7	161.3	73.0	75.8	116.0	82.1	105.6	107.2	97.4
other utilities, personal and social services rendering	128.8	168.6	185.8	98.8	137.4	127.9	85.1	102.8	104.9	125.8

Source: Federal State Statistics Service.

FOREIGN INVESTMENTS

E.Ilukhina

January–September 2011 is characterized by high activity of foreign investors in the Russian Federation as compared with the previous year. It was other investments made on the reverse basis that were characterized by the highest growth rates, their proportion in the aggregated structure of foreign investments reached 90.8%. The proportion of direct investments is estimated to be 8.8%. Financial activity is still the most attractive sector for the foreign investors. In January–September 2011 investments from Russia in foreign countries continued to grow, making 72.3% of the volume of foreign investments received over the period.

As of the end of September 2011 the accumulated foreign capital in the Russian Federation not taking into account the bodies of monetary and crediting regulation, commercial and saving banks, including investments in rubles recalculated into US dollars, made \$323.2bn, exceeding by 7.7% the figure of the January 1st, 2011, and by 21.5% – the figure of October 1st, 2010.

Table 1

STRUCTURE OF FOREIGN INVESTMENTS IN THE RUSSIAN ECONOMY IN JANUARY–SEPTEMBER 2007–2011

	As USD million				As percentage to the previous year			
	Total	Direct	Portfolio	Other	Total	Direct	Portfolio	Other
2007	87 936	19 644	1 547	66 745	248.9	191.3	232.6	273.7
2008	75 792	19 201	1 296	55 259	86.2	97.7	83.8	82.8
2009	54 738	9 975	1 019	43 744	72.2	51.9	78.6	79.1
2010	47 488	8 196	866	38 426	86.8	82.2	85.0	87.8
2011	133 784	11 736	535	121 513	281.7	143.2	61.8	316.2

Source: Federal State Statistics Service.

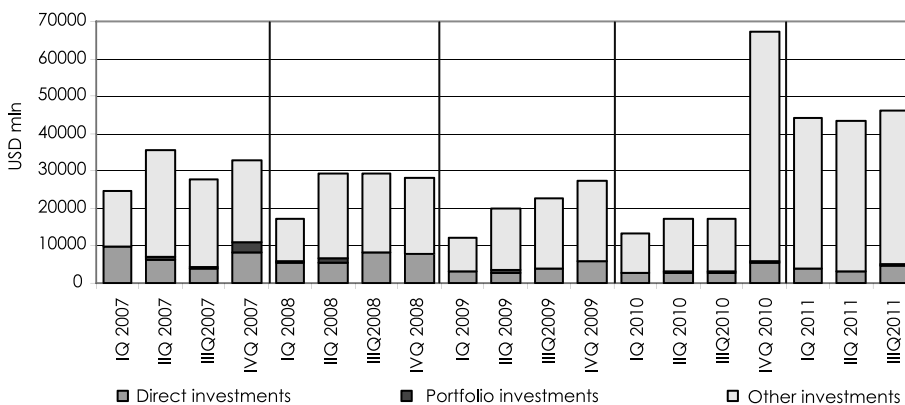
Total volume of the foreign investments received by the Russian economy in 2011 went up due to the increase in the direct and other investments.

In 2011 quarterly volumes of other foreign investments made about \$40bn, demonstrating a considerable increase versus the corresponding periods of the previous year.

The growth of the direct foreign investments in the Russian economy as compared with the corresponding periods of the previous year has also been observed for three quarters of the current year. In contrast to other and direct foreign investments, the segment of portfolio investments

in the 1st and the 2nd quarter 2011 was characterized by the contraction as compared with the corresponding periods of the previous year. In the 3rd quarter the portfolio investments were observed to grow by 77.1%.

Diversified dynamics of the directions of foreign investments in the Russian economy demonstrates the following changes of quarter-by-quarter structure of foreign investments: as a result of 9 months 2011 the



Source: Federal State Statistics Service.

Fig. 3. Quarter-by-quarter dynamics of foreign investments inflow in the Russian Federation in 2007–2011

proportions of direct and portfolio foreign investments contracted to 8.8% and 0.4% (17.3% and 1.8% in 9 months of 2010), proportion of other investments went up to 90.8% (80.9% in 9 months of 2010).

In the 3rd quarter 2011 foreign investments remained concentrated in the financial sphere, industry and trade, where 93.3% of the total volume of foreign investments in the Russian Federation was directed (87.5% and 93.6% in the 1st and 2nd quarter 2011).

As a result of 9 months 2011 foreign investments in financial activity went up by 37.5% as compared with January–September 2010, in industry – by 58.1%, in trade – by 42.3%, correspondingly.

A considerable increase in the investments in the financial activity against the background of a more moderate growth of the investments in other segments of the economy resulted in the changes in the structure of foreign investments as broken by the segments of the economy as compared with the previous year.

Table 2

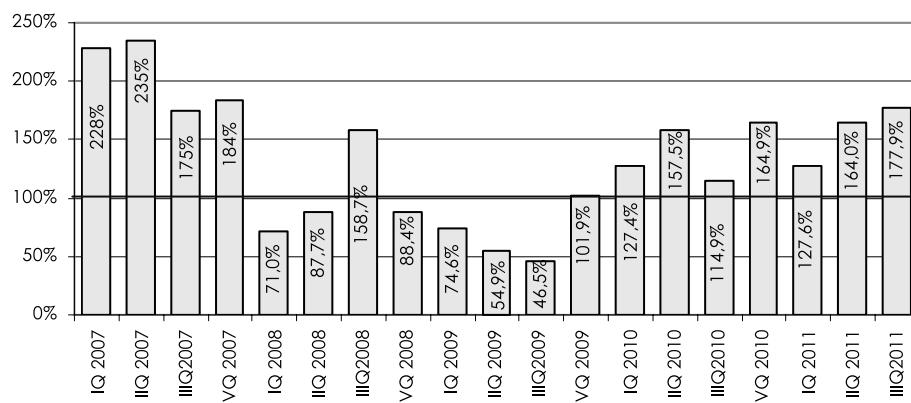
STRUCTURE OF FOREIGN INVESTMENTS IN THE RUSSIAN ECONOMY AS BROKEN BY BRANCHES IN JANUARY-SEPTEMBER 2009–2011

	As USD million			Change, as percentage to the previous year			As percentage to the total		
	2009	2010	2011	2009	2010	2011	2009	2010	2011
Industry	21 130	28 022	44 291	55.5	132.6	158.1	38.6	59.0	33.1
Transportation and communication	8 512	3 952	5 494	380.5	46.4	139.0	15.6	8.3	4.1
Wholesale and retail trade; motor vehicles and motorcycles servicing; repair of household appliances and items of private use	16 277	8 688	12 363	90.8	53.4	142.3	29.7	18.3	9.2
Operations with real estate, rent and services rendering	5 593	3 843	4 782	51.9	68.7	124.4	10.2	8.1	3.6
Financial activity	1 971	1 764	65 711	60.7	89.5	3725.1	3.6	3.7	49.1
Other segments	1 255	1 219	1 143	35.4	97.1	93.8	2.3	2.6	0.9

Source: Federal State Statistics Service.

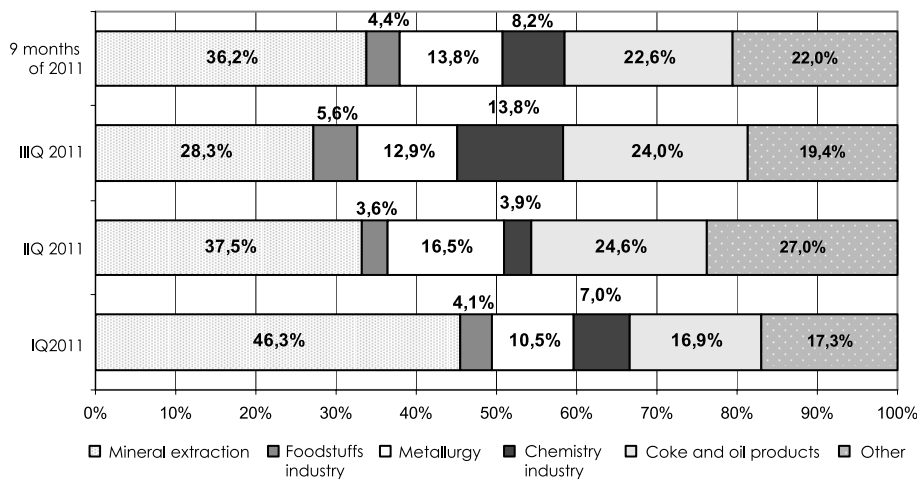
As a result of 9 months of 2011 it was the minerals extraction that was the leader off the growth: as compared with January–September 2010 the investments in this segment went up by 85.5% (51.3% growth in 2010). As to the manufacturing industries, 46.4% more investments was directed in the segment compared with January-September 2010 (26.0% growth in 2010).

In the manufacturing sector investments in coke and oil products production increased by 2times, investments in chemistry industry – in 2.2 times, making \$10.0bn and \$3.6bn, correspondingly (in January–September 2010 investments in coke and oil products production went up by 63.1%, in chemistry industry – 69.8%). Foreign investments in metallurgy in 2011 as compared with 2010 increased by 20.3%



Source: Federal State Statistics Service.

Fig. 2. Foreign Investments in Industry in 2007–2011, Change as Percentage versus the Corresponding Period of the Previous Year



Source: Federal State Statistics Service.

Fig. 3. Structure of Foreign Investments in 2011 by Sectors of Industry

investments in the metallurgy went up by 69.9% versus the corresponding quarter 2010, while in the 1st and the 3rd quarters they decreased by 10.7% and 2.7%, correspondingly. Investments in minerals extraction grew by 81.5% and 63.2% correspondingly in the 1st and the 2nd quarters, in the 3rd quarter 2011 investments in the extraction went up by 2.4 times. Foreign investments in foodstuffs production in the 1st quarter 2011 contracted as compared with the level of the corresponding period of 2010 by 42.7%, while in the 2nd and the 3rd quarter they went up by 50.6% and 27.6%. The growth of investments in the chemistry industry made: 88.2% in the 1st quarter, 2.1 times in the 2nd quarter and 2.3 times in the 3rd quarter.

The differences in the dynamics in the sectors of industry are reflected in quarter-by-quarter dynamics of the structure of foreign investments in industry as broken by sectors of industry.

The proportion of the direct investments in the industry as a result of 9 months of 2011 remained at the level of the previous year – 16.2%, the proportion of other investments over the same period increased from 82.5% to 83.2%.

The structure of foreign investments in the industry as broken by types of economic activities was subject to considerable changes as compared with the previous year. In the sector of minerals extraction in January–September 2011 direct foreign investments went up by 2.8 times up to \$3.8bn, which resulted in the expansion of their proportion in the aggregated investments into the sector from 15.9% in January–September 2010 to 23.7%. The proportion of other investments in extraction, which growth as a result of 9 months of 2011 made 68.4% (\$12.2bn), decreased from 83.8% in January–September 2010 to 76.0%.

As a result of 9 months of 2011 the main proportion of foreign investments in the manufacturing industries was also accounted for other investments, which, as compared with January–September 2010, went up by 56.0%, making 88.4% in the resulting indices of the investments in manufacturing industries. Lower growth rates of the direct foreign investments in the manufacturing industries (increase of 2.3%) resulted in the contraction of their proportion in the manufacturing industry as a result of 9 months of 2011 down to 11.3% (16.2% in 9 months of 2010).

As to the geographical structure of the foreign investments received by the Russian economy in 9 months of 2011, it is Switzerland that holds the leading position, accounting for in \$67.6bn, Netherlands is in the second place – \$13.2bn (\$7.5bn in 9 months of 2010), Cyprus – the third – \$13.0bn (\$5.6bn in 9 months of 2010).

The differences in the investments dynamics resulted in the changes of the geographical structure of foreign investments. The proportion of Switzerland in the aggregated volume of the foreign investments received by the Russian economy made 51.1%. The share of Germany contracted from 15.8% in January–September 2010 to 6.1% as a result of 9 months of 2011, share of Cyprus – from 11.9% to 9.7%, of the UK – from 8.9% to 4.7%, of France – from 4.4% to 1.8%, of Luxemburg – from 2.6% to 1.5%.

up to \$6.1bn (the growth of 50.5% of the investments in this sector was observed in January–September 2010).

The analysis of the quarter-by-quarter dynamics of foreign investments in the industry this year testifies the growing interest of foreign investors in the Russian industry.

Foreign Investments in Industry in 2007–2011, Change as Percentage versus the Corresponding Period of the Previous Year

In the 2nd quarter if the current year the foreign

INFLOW OF FOREIGN INVESTMENTS IN THE RUSSIAN FEDERATION
FROM MAIN INVESTOR-COUNTRIES IN 2011

	Received, USD m			As percentage to the corresponding period of 2010			As percentage to the total		
	1 st qu.	2 nd qu.	3 rd qu.	1 st qu.	2 nd qu.	3 rd qu.	1 st qu.	2 nd qu.	3 rd qu.
Switzerland	25789	20598	22021	No data			58.2	47.5	47.8
Germany	1763	3859	2547	83.7	104.4	148.3	4.0	8.9	5.5
UK	2236	1690	2410	210.9	129.2	128.7	5.0	3.9	5.2
Cyprus	2711	4824	5437	188.9	286.8	215.9	6.1	11.1	11.8
Netherlands	4027	3801	5390	159.5	230.2	161.8	9.1	8.8	11.7
Luxemburg	726	657	568	87.2	161.0	3341.2	1.6	1.5	1.2
Other countries	7097	7920	7713	136.8	93.3	100.9	16.0	18.3	16.7

Source: Federal State Statistics Service.

As a result of 9 months of 2011 it was the financial activity that was the most attractive for Swiss investors. 92.3% of the total investments from Switzerland into the Russian Federation was directed into the sector making 96.1% of the total foreign investments in the sector.

In the structure of investments in the Russian Federation from the Netherlands the proportion of fossil fuels extraction expanded from 29.1% in January–September 2010 to 50.5% in January–September 2011. 19.8% of the investments directed from the Netherlands into the Russian Federation was directed into the trade (34.2% in January–September 2010), 12.1% – into transportation and communication (16.3% in January–September 2010).

In January–September 2011 investors from Cyprus demonstrated the interest towards the manufacturing industry of the Russian Federation, having invested 41.6% of the total investments in these types of the industry (39.8% in January–September 2010). The proportion of operations with the real estate in the investments from Cyprus lowered from 23.0% in January–September 2010 to 13.5% as a result of 9 months of 2011. The proportion of Cyprus investments in trade made 23.7%.

For the investors from Germany the priorities lied in the manufacturing industry, fossil fuels extraction and trade sector, where they invested 50.5%, 25.0% and 16.1% of the total investment from Germany in the Russian Federation in January–September 2011. As a result of the corresponding period of 2010 the manufacturing industries received 31.3%, fossil fuels extraction – 43.2%, trade – 19.7% of the investments from Germany.

As a result of January–September 2011 Cyprus, the Netherlands, Luxemburg, Germany and China are leading countries-investors, which proportion makes 64.2% (as a result of 9 months of 2010 the leading five countries-investors in the Russian Federation, which included the UK instead of China, accounted for 66.0%). The proportion of five leading countries-investors in the Russian Federation in the segment of direct investments contracted to 66.4% (68.6% in January–September 2010), in the segment of portfolio and other investments their share was 20.4% and 64.7% (78.9% and 63.1% in January–September 2010).

The volume of profits of foreign investors transferred abroad and interest payment for the use of credits and credits repayment as a result of 9 months of 2011 went up by 2.3 times as compared with the corresponding period of 2010 and made \$120.4bn or 90.0% of foreign investments received in 9 months of 2011 (112.3% in 9 months of 2010). It should be noted that whereas in the 1st and 2nd quarters 2011 92.5% and 93.9% of the volume of foreign investments received over the period, in the 3rd quarter this figure made 83.9%.

Besides, as a result of 9 months of 2011 investments from Russia in foreign countries made 72.3% of the volume of foreign investments in the Russian economy (117.7% in 9 months of 2010). In the 1st and 2nd quarters 2011 the ratio of investments from Russia to foreign investments in the Russian economy was estimated to be 66.2% and 87.4%. In the 3rd quarter 2011 investments from Russia in foreign countries made 64.2% of the foreign investments received over the period. ●

FOREIGN TRADE

N.Volovik, K.Kharina

In October 2011, the growth rate of imports in the Russian Federation continued to decline against the backdrop of an unchanged per annum rate of growth of exports. This happened due to a more rapid growth of Russia's balance of trade. The Eighth WTO Ministerial Conference approved the package of documents concerning the accession to the WTO of the Russian Federation.

In October 2011, Russia's foreign trade turnover, calculated in accordance with the balance of payments methodology, amounted to \$ 75bn, representing a 26.3 percent increase on the same index for 2010. Exports amounted to \$ 45.9bn, representing a 32.3 percent increase on the same period of last year. Imports rose by 17.8% – to \$ 29.1bn.

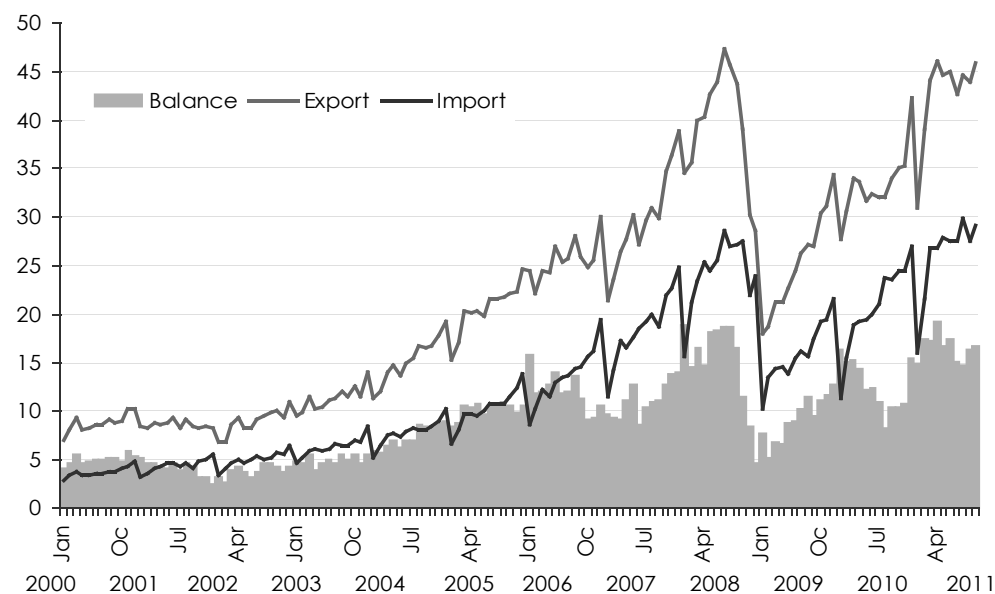
Like before, the continuing rise in the value of exports was caused by the favorable situation on the world market. Although the world economy's lack of stability somewhat pushed down the prices on the global raw materials market, these still remain on a rather high level.

While in January 2011 the average price of Brent amounted to \$ 93.8 per barrel, its average price in July 2011 hit \$ 111.7. As a result, in the first half year of 2011, the price of Urals amounted to \$ 108.3 per barrel, representing a 42.7 rise on the same period of 2010.

In early October the price of Brent reached its historic low since February 2011: on 1 October it amounted to \$ 100.2 per barrel. However, as early as 14 October the price of Brent increased once again – to \$ 114.68.

The average price of Urals in October 2011 was \$ 108.39 per barrel, having climbed on last year's October by 33% (\$ 81.53 per barrel). However, by comparison with September 2011 it dropped by 2.8% (\$ 111.5 per barrel).

During the period from 15 November 2011 through 14 December 2011, the average price of Urals was \$ 109.09 per barrel. Thus, the margin for the rate of export duty on oil from 1 January 2012 onwards will be brought down from its December level of \$ 406.6 to \$ 397.5 per ton. The single rate of the export duty on white and dark petroleum products (except benzenes) calculated in accordance with the new methodology 60/66/90, from 1 January 2012 onwards will amount to \$ 262.3 per ton against \$ 268.3 per ton in December 2011.



Source: RF Central Bank.

Fig. 1. Major Indicators of Russian Foreign Trade (bn US dollars)

In this connection, the duty on gasoline remaining at the level of 90% of the duty on oil will amount to \$ 357.7 per ton (against \$ 365.9 per ton in December 2011). The preferential duty on crude oil from the eastern Siberian oil fields and two LUKoil's Caspian oil fields from 1 January 2012 onwards will be \$ 194.1 per ton (against \$ 200.9 per ton in December 2011).

In October 2011, non-ferrous metals

became cheaper due to the expected decline in demand on the part of their major consumers in China. Thus, the price of copper dropped on September 2011 by 12.45%; and the prices of aluminum and nickel – by 5.31% and 7.11% respectively.

Table 1

MONTHLY AVERAGE WORLD PRICES FOR OCTOBER (2001–2011)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Oil (Brent). \$/barrel	21.45	27.2	29.6	49.8	58.2	57.9	81.4	79.63	73.21	83.56	108.8
Natural gas*. \$/mln BTU	3.52	3.28	3.88	4.83	7.28	8.97	9.16	15.93	7.6	8.28	11.42
Gasoline. \$/gallon	0.603	0.801	0.841	1.43	2.056	1.484	2.13	4.195	1.903	2.09	
Copper. \$/ton	1,405.1	1,519.0	1,916.4	3,012.0	4,060	7,500	8,008	4,925.7	6,286.8	8,292.4	7,347.5
Aluminum. \$/ton	1,280.8	1,313.2	1,474.8	1,822.8	1,929	2,659	2,442	2,121.4	1,877.8	2,447.0	2,172.0
Nickel. \$/ton	4,836.8	6,840.9	11,030	14,483	12,403	32,348	30,999	12,140	18,514	22,167	18,886

* European market, average contract price at franco frontier.

Source: Calculations are based on data from the London Metal Exchange (London, UK) and the International Petroleum Exchange (London).

In October 2011, global food commodity markets also displayed a downward trend in prices: the mean value of FAO Food Price Index was 216 p.p., which is 9 p.p. below its September value and 22 p.p. lower than its historic high of 238 p.p. recorded in February 2011.

In January–October 2011, Russia's foreign trade turnover, calculated in accordance with the balance of payments methodology, amounted to \$ 685.2bn (132.0% of the level recorded in January–October 2010), including exports – \$ 423.7bn (131.6%) and imports – \$ 261.6bn (132.8%).

The Russian Federation's revenues from oil exports in January–October 2011 rose on the same period of 2010 by 34.6% – to \$ 141.2bn. In this connection, the cost volume of exports to the countries of the far abroad increased by 38.9% – to \$138.2bn, and that of exports to the CIS countries dropped by 24.2% – to \$ 2.9bn. Export of oil in terms of physical volume declined by 6.8% and amounted to 180.6 m tons; in this connection, the decline of exports to the countries of the far abroad amounted to 4.2%, and that of exports to the CIS countries – by 2.4 times.

The Russian Federation's revenues from natural gas exports in January–October 2011 rose on the same period of 2010 by 34.3% – from \$ 34.2bn to \$ 45.9bn. In terms of physical volume, natural gas exports from Russia rose over the first 10 months of 2011 rose on the same period of 2010 by 8.6%, thus amounting to 131.9 bn m³. This figure includes natural gas exports to the countries of the far abroad, which increased by 8.7% – to 93.2 bn m³, and its exports to the CIS countries, which increased by 8.4% – to 38.7 bn m³.

Over the first 10 months of 2011, Russia exported 12,617,000 tons of cereals. Of these, 10,847,000 tons was constituted by wheat and *meslin* (a 2:1 mixture of rye and wheat), and 1,354,000 tons – by barley. Besides, this country exported 122,000 tons of rice and 541,000 ton of flour. Considering the fact that Russia imposed a ban on export of all grains from 1 August 2010 through 1 July 2011, this entire volume of grain exports falls on July, August, September and October 2011.

Thus, as far as cereals are concerned (as part of Russia's vegetable cultivation), this country has fully satisfied its domestic demand, and in addition to that, it exports a substantial part of its grain crops. However, as far as vegetables and subtropical fruits are concerned, Russia needs to import these in large quantities. The same is true with regard to animal husbandry products. In 2011, Russia's average monthly exports of fresh and frozen meat amounted to 119,800 tons, including 59,700 tons of pork, and 37,100 tons of fish. No decline in the import of milk and dairies was observed, either – its October values are quite compatible with the average monthly values.

Beginning from June 2011, the per annum growth rate of commodity imports has been demonstrating a stable decline. One of the contributing factors is the slowdown of overall economic

growth. This triggered growth of the balance of trade. If in June 2011 it rose on June 2010 by 32.7%, its rise in October 2011 on October 2010 amounted already to 67.9%. Over the first 10 months of 2011 the balance of trade amounted to \$ 162.1bn, which is by 29.7% higher than the index for the same period of last year.

On 16 December 2011, the Ministerial Conference held by the World Trade Organization (WTO) in Geneva approved the package of documents concerning the accession of the Russian Federation. As follows from the information posted to the WTO's official website, Russia has agreed to ensure a free trade regime and speed up its integration in the world economy, as well as to create transparent and predictable conditions for trade and foreign investments.

In the framework of its accession in the WTO, Russia concluded 57 bilateral agreements concerning access to commodity markets and 30 bilateral agreements concerning access to services markets.

As far as trade in commodities is concerned, the average weighted rate of bound¹ import duties will amount to 7.8% against the average weighted rate of 10% applied in 2011. The average bound tariff on agricultural commodities will be set at 10.8% (the current average weighted tariff is 13.2%), and that on industrial commodities – at 7.3% (the current average weighted tariff is 9.5%).

In this connection, import duties will be decreased gradually over a period of eight years and differentiated between different commodity groups. From the moment of accession in the WTO, more than one-third of all import tariffs will be brought down; another one-quarter will be decreased three years later. The longest transition period is envisaged for pork – 8 years; for motor cars, helicopters and civil aircraft – 7 years.

In 2012, the total amount of trade-distorting support to agriculture will not exceed \$ 9bn, and then will be gradually declining to \$ 4.4bn by 2018. Russia has agreed not to introduce agricultural export subsidies. Once acceding to the WTO, Russia is going to abolish exemptions from VAT previously granted to some types of domestic agricultural products.

Besides, the Russian government intends to conclude an agreement with the European Union that will regulate Russian timber exports (a regulation to this effect has been published in the databank of federal normative and regulatory documents on 28 November 2011). The volume of tariff quotas on timber export into the EU will be regularly determined on an annual basis, and the parties will exchange information on the use of the quotas every three months. The administrative procedures will be prepared by the time of Russia's accession in the WTO.

Russia is going to lower its rates of duties within the quota established for fir timber to 13% (one-half of the existing level), for pine timber – to 15% (a drop by 40%), while retaining the possibility to increase the duties on exports outside of the established quotas. The duty on aspen timber will be cut by half and thus amount to 5%, and that on birch timber will be increased from 0 to 7%. It is expected that growth of exports will be sustained mostly through sale of soft types of timber which are not subject to any quotas.

It should be reminded that the issue as to the level of export duties on Russian timber has been a stopgap during the negotiations on Russia's accession in the WTO. In accordance with its policy of promoting the domestic timber processing industry, the Russian government set up a schedule for gradually increasing the export duties up to a "forbidding" level. In 2007 their rates were raised from 6.5% to 20%. Under pressure exerted by the EU and the domestic industry's unpreparedness to adequately process the produced timber, in 2008 Russia imposed a moratorium on any further growth of export duties, freezing them at the level of 25% of their customs value (two exceptions being birch and aspen timber).

From 2007 through 2010, the volume of unprocessed timber products exported from Russia was continually declining: from 50 mln m³ to 21 mln m³. The moratorium on further increase of the duties was to expire as of 1 January 2011, but at the Russia – EU summit meeting in early December 2010 the parties agreed to extend it until the end of 2011 and to lower the duties after Russia's accession in the WTO.

In the sphere of services, Russia assumed certain responsibilities with regard to 11 sectors and 116 subsectors. In four years, the restriction on the participation of foreign capital in the sphere

¹ The rates of duties that cannot be raised unilaterally under the General Agreement on Tariffs and Trade (GATT). The principle of binding import customs duties represents one of the most typical instruments applied by the WTO in order to liberalize customs tariffs.

of telecommunications will be lifted (at present it is set at 49%). Foreign insurance companies will be allowed to establish their affiliations in this country nine years after Russia's accession in the WTO. Foreign banks will be able to operate here through their affiliated structures. On the whole, the quota for foreign capital's participation in Russia's banking system cannot exceed 50%.

The producers and distributors of natural gas in Russia will be operating on the basis of ordinary commercial principles – covering their costs and deriving profits. The tariffs on supply of natural gas to households and other non-commercial users will be regulated on the basis of national social policy principles – just as it happens at present.

All sanitary and phytosanitary measures in Russia and across the Customs Union will be elaborated and applied in accordance with the WTO Agreement on Sanitary and Phytosanitary Measures (SPS Agreement). In order to ensure the international SPS standards, Russia will actively participate in the activity of the World Organization for Animal Health (OIE) and the International Plant Protection Convention (IPPC). With the exception of cases when serious risks may arise to animal or human health, Rosselkhoznadzor (the Federal Service for Veterinary and Phytosanitary Surveillance, will not suspend import of commodities before providing the exporter country with an opportunity to suggest some correctional measures.

Russia has assumed the obligation to publish information on legislation of the Customs Union prior to its adoption and to establish a reasonable period of time for the WTO members and all other related parties to offer their comments. ●

STATE BUDGET

T.Tishchenko

Despite the traditional outpacing growth of budget expenditures over the revenue in the last months of the year, the volume of the federal budget surplus for the first 11 months still looks very impressive – 2.8% of GDP. It is now clear that the year-end balance of the federal budget remains positive. At the same time, non-obvious trends in the leading countries of the world economy in 2012 and the pre-election promises of leadership, generating unplanned expenditure commitments, highlight the relevance of the issue of fiscal system sustainability.

Analysis of the key indicators of the federal budget execution over January–November 2011

Federal budget revenues, according to the tentative estimates of the Russian Ministry of Finance, for 11 months of this year totaled to Rb 10,165.1bn, or 20.9% of GDP, which by 2.6 p.p. of GDP exceeds their value over the relevant period of 2010 (*Table 1*). Expenditures within January–November have decreased against the same period of 2010 by 2.4 p.p. of GDP and amounted to Rb 8,821.9bn.

Table 1

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

	January–November 2011		January–November 2010		Change, p.p. of GDP
	Rb, bn	GDP %	Rb, bn	GDP %	
Revenues, including taxes :	10 165.1	20.9	7432.3	18,3	+2,6
Corporate profit tax	311.7	0.6	217.8	0.5	+0,1
VAT on goods sold in the RF territory	1547.3	3.2	1196.0	2,9	+0.3
Excise duties on goods manufactured in the RF territory	211.5	0.4	103.9	0,3	+0,1
Individual income tax	1825.5	3.8	1246.2	3,1	+0,7
Expenditures, including:	8 821.9	18.2	8337.8	20,6	+2,4
Surplus/Deficit of the federal budget	1 343.1	2.8	- 905.5	2,2	+5,0
GDP estimates ¹	48541.0		40566.0		

Source: Ministry of Finance of Russia, Gaidar Institute estimates.

The lack of data of the Federal Treasury on the federal budget as of December 1, 2011 does not allow to assess oil and gas revenues and the scope of non-oil deficit of the federal budget, but according to preliminary estimates of the Ministry of Finance, the share of oil and gas revenues in total revenues of the federal budget in the current year increased as compared with the previous year, amounting to Rb 5,579.3bn, which is equivalent to a half of the total budget revenues (based on 2010 results, oil and gas revenues amounted to Rb 3,830.7bn or 46.1% of budget revenues). Growth of oil and gas revenues by 2 p.p. of GDP in 2011 was in principle quite predictable, taking into account favorable foreign economic situation. At the same time, non-oil revenue forecast is an issue of concern because their rate of growth in 2011 (0.6 percent of GDP or 25.9% compared to the non-oil income received in 2010) is significantly lower than the growth in federal revenues in general (+2.5 p.p. or 35.0% of GDP as a share of FB in 2010).

Dynamics of revenue from the main taxes to the federal budget within 11 months of this year shows an increase in revenues from all major taxes administered by the Federal Tax Service of Russia. The largest increase was observed in MET revenue – by 0.7 p.p. of GDP compared to the same period of the last year. The growth of federal revenues from corporate income tax, VAT and

¹ Assessment of the Economic Expert Group.

excise taxes on products sold and manufactured in the territory of Russia, varied in the range of 0.1-0.3 p.p. of GDP.

As per 11 months of 2011 results, budget surplus amounted to Rb 1,343.1bn, which is by 5.0 p.p. of GDP higher than in the same period of the last year. Experts have different estimates of the annual surplus, which depends on an assessment of the GDP in 2011, as well as on the level of cash execution of budget expenditures planned for the following 12 months. Budget expenditures for January–November this year were executed at the level of 79.3% against to adjusted budget estimates, while the proceeds for the same period amounted to 91.4% of the expected annual amount of federal budget revenues. This situation with the cash execution of the federal budget could result, in the opinion of the Ministry of Finance, in the twofold increase in the average monthly expenditures of the budget in December – up to Rb 2 trillion, while the amount of federal revenues for the December was estimated at \$1 trillion. In case of this scenario implementation the budget surplus for the year can drop to Rb 200bn (0.4% of GDP). Despite the fact that the savings are planned to be spent in full on the reduction of the next year budget borrowing, it is expected that in 2012, the volume of domestic borrowing will still grow to Rb 1.6 trillion (Rb 1.4 trillion in 2011), which will undoubtedly lead to increased costs of servicing domestic public debt in the coming years.

Analysis of the main indicators

of the RF Subjects consolidated budget execution in January-October 2010–2011

In January-October 2011 consolidated budget of the RF Subjects have increased in absolute value to Rb 6.2763 trillion (12.9% of GDP), but declined against GDP by 0.4 p.p. as compared with the same period of 2010 (see Table 2.). Growth in proceeds has occurred only from profit tax by 0.3 p.p. of GDP, in other taxes there was an insignificant revenue reduction by 0.1-0.2 p.p. of GDP.

Table 2

MAIN INDICATORS OF THE RF SUBJECTS CONSOLIDATED BUDGET EXECUTION
IN JANUARY–OCTOBER 2010–2011

	January–October 2011		January–October 2010		Change, p.p. of GDP
	Rb, bn	GDP %	Rb, bn	GDP %	
Revenues, including taxes :	6276.3	12.9	5380.6	13.3	-0.4
Corporate profit tax	1678.6	3.5	1282.8	3.2	+0.3
VAT on goods sold in the RF territory	261.5	0.5	283.9	0.7	-0.2
Excise duties on goods manufactured in the RF territory	310.1	0.6	271.3	0.7	-0.1
Individual income tax	1534.9	3.2	1383.8	3.4	-0.2
Property tax	595.7	1.2	537.9	1.3	-0.1
Expenditures, including:	5458.2	11.3	4908.9	12.1	-0.8
Interest expenditures	53.0	0	51.7	0	0
Non-interest expenditures	5405.2	11.1	4857.2	12.0	-0.9
Surplus/Deficit of the federal budget	818.0	1.7	471.7	1.2	+0.5

Source: RF Federal Treasury, Gaidar Institute estimates.

Consolidated budget expenditures in the 10 months of this year have decreased by 0.8 p.p. of GDP, compared with January-October 2010 and amounted to Rb 5,458.2bn or 11.3% of GDP. Decrease is observed in nearly all sections of the functional classification of budget expenditures (Table 3). The greatest reduction occurred under the budget line “Social Policy” by 0.4 p.p. of GDP. In other areas there was a slight decline: under the budget line “Federal issues” – by 0.2 p.p. of GDP, and under the sections “National Security and Law Enforcement”, “National Economy”, “Housing and public utilities” and “Education” – by 0.1 p.p. of GDP. Under the budget line “Healthcare” there was observed growth in expenditures by 0.5 p.p. of GDP, which might be associated with an increase in the volume of funds allocated for payment of the executable, usually in the fourth quarter, government contracts in the framework of regional healthcare modernization programs.

Table 3

DYNAMICS OF EXPENDITURES OF THE RF SUBJECTS CONSOLIDATED BUDGET EXECUTION
IN JANUARY–OCTOBER 2010–2011

	January–October 2011		January–October 2010		Change, p.p. of GDP
	Rb, bn	% of GDP	Rb, bn	% of GDP	
Expenditures, total:	5458.2	11.3	4908.9	12.1	-0.8
Including					
Federal issues	349.6	0.7	359.2	0.9	-0.2
National defense	2.4	0	2.3	0	0
National defense and law enforcement	196.0	0.4	189.1	0.5	-0.1
National Economy	892.0	1.8	768.5	1.9	-0.1
Housing and public utilities	630.5	1.3	576.9	1.4	-0.1
Environmental protection	11.9	0	10.1	0	0
Education	1263.3	2.6	1095.9	2.7	-0.1
Culture, cinematography and mass media	190.8	0.4	167.1	0.4	0
Health care and sports	939.5	1.9	575.8	1.4	+0.5
Social policy	915.9	1.9	914.3	2.3	-0.4
Public and municipal debt servicing	53.0	0	51.7	0	0

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

In the flow of important political developments in Russia, the visit of the International Monetary Fund (IMF) in the first week of December has been unnoticed by the wide public. Meanwhile, in a press release issued after the visit, a number of recommendations to which should not be neglected by the leaders of the public financial sector, including those related to developing a preventive action plan for emergencies in the global financial system and restoring the temporarily suspended restrictions for non-oil deficit at the level of 4.7% of GDP. ●

THE RUSSIAN BANKING SECTOR

S.Borisov

The growth of the Russian banking sector's assets in October 2011 became much slower. The main cause of that slowdown was a dramatic drop in the growth rate of the credit portfolio of legal entities and physical persons, as well as shrinking volumes of interbank loans and investments in securities. Liabilities demonstrated a significant cash outflow from deposits and settlements accounts of non-financial organizations. Interest rates on credits continued to increase in the interbank market, thus pushing up banks' demand for monies attracted through direct REPO transactions with the RF Central Bank.

Table 1

THE MAIN INDICES OF THE RUSSIAN BANKING SYSTEM

	As of 01.11.2010, bn Rb	As of 01.01.2011, bn Rb	As of 01.11.2011		
			Nominal value, bn Rb	Growth since year's beginning, %	Year on growth, %
Assets	31, 907.0	33, 804.6	38, 464.4	13.8	20.6
Credits allotted to non-financial institutions	13, 691.0	14, 062.9	16, 883.2	20.1	23.3
Credits allotted to physical persons	3, 938.1	4, 084.8	5, 176.6	26.7	31.4
Credits allotted to banks	2, 954.9	2, 921.1	3, 560.0	21.9	20.5
Investments in bonds	4, 434.3	4, 419.9	4, 583.9	3.7	3.4
CB's deposits	330.0	325.7	971.0	198.1	194.2
Banks' deposits	3, 603.0	3, 754.9	4, 064.0	8.2	12.8
Deposits of legal entities	5, 594.6	6, 035.6	7, 819.1	29.5	39.8
Population's deposits	9, 080.7	9, 818.0	10, 876.1	10.8	19.8
Reserves against potential losses	2, 268.2	2, 192.0	2, 311.9	5.5	1.9
Profit (current year)	441.1	573.4	676.0		53.3

Source: Bank of Russia.

According to the RF Central Bank, the value of assets in the Russian banking system in October remained practically the same as in September, monthly growth amounting to only 0.1%. The historic low displayed by the growth rate of asset value was the result of a slowdown in the growth rate of all types of operations with assets in the banking system. After the significant increase in the non-financial organizations' credit portfolio registered in September (+Rb 795bn), the data for October appear to be quite modest: only +Rb 201bn over one month. Alongside a slower growth rate of the corporate credit portfolio, the growth rate of loans to physical persons also became lower: +Rb 112bn in October against + Rb 178bn in September.

The volume of loans received by banks, similarly to investments in securities, was also on the decline in October. As stated by the RF Central Bank, over that month the securities portfolio shrank by Rb 133bn, while the former index (loans to banks) decreased by further Rb 74bn.

Besides, October saw a drop in the volume of monies held by banks on their correspondent accounts with the RF Central Bank.

Liabilities also demonstrated some significant changes in October. The decline in the amount of non-financial organizations' monies attracted by banks on deposits and settlements accounts over that month was Rb 354bn. As an alternative source of resources, in October banks were actively resorting to direct REPO operations with the RF Central Bank. Due to the upward dynamics of rates in the interbank market (Fig. 1), demand for the RF Central Bank's resources continued to be

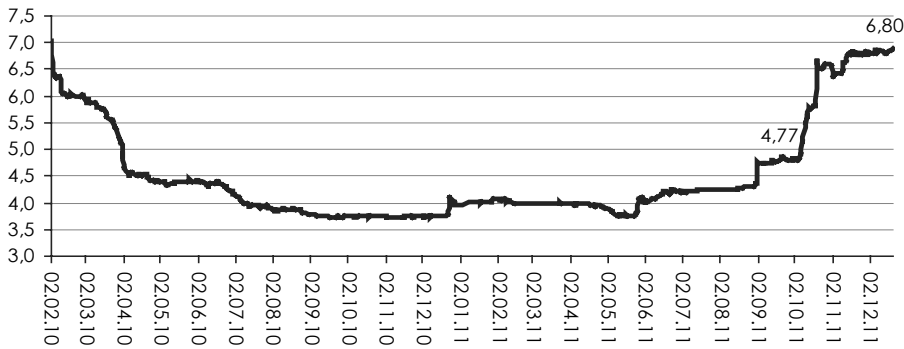


Fig 1. Behavior of Mosprime 3M

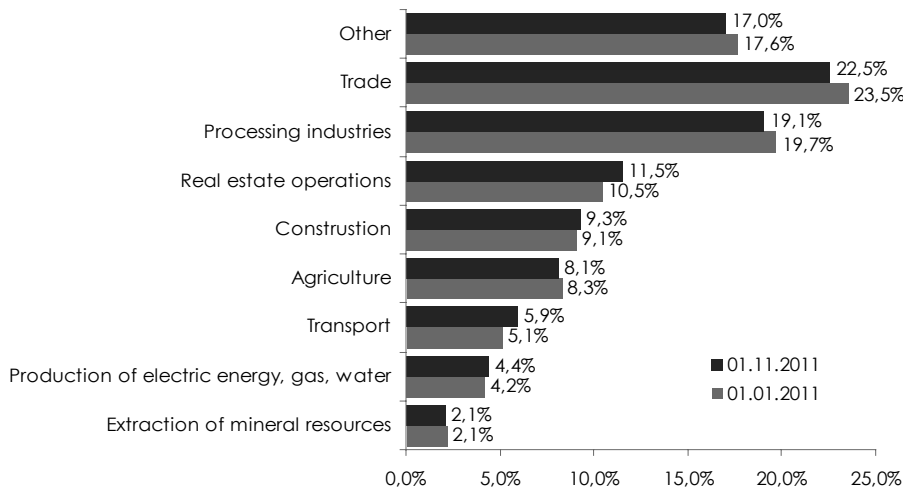


Fig. 2. The Structure of Ruble-denominated Credit Portfolio of Non-financial Organizations, %

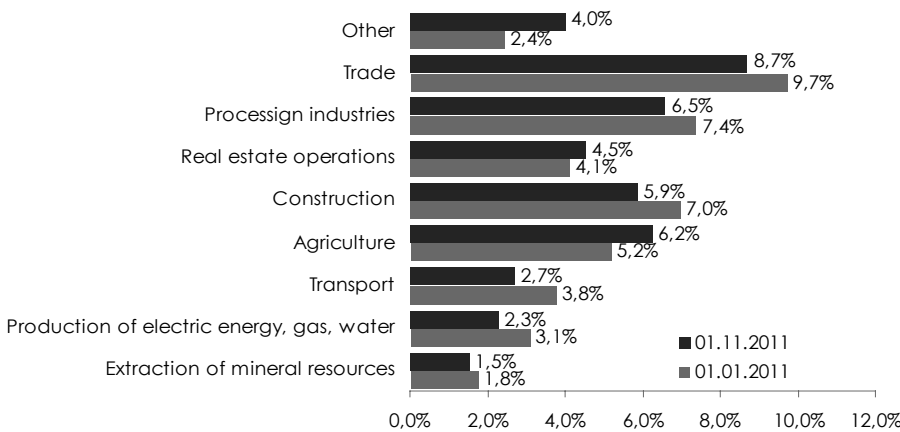


Fig. 3. The Share of Stale Debt in the Credit Portfolio of Non-financial Organizations, %

on the rise. In October, the volume of such monies increased by Rb 464bn to Rb 971bn – the level of early 2010.

In the by-branch structure of the credit portfolio as of 1 November, the highest share belongs to credits granted to trade companies (22.5%) (Fig. 2), followed by credits to the processing industry (19.1%) and to companies engaged in operations with real estate (11.5%). The most dynamic growth over the first 11 months of 2011 was displayed by the portfolio of transport companies (+0.8 p.p.) and the producers and distributors of gas, water and electric energy (+0.3 p.p.). An especially important factor is the growing share of credits granted to construction companies: its rise by 0.2 p.p. is indicative of their increasing demand for circulating assets due to expansion of construction projects. Since the beginning of 2011, the construction companies' credit portfolio has increased by Rb 254bn, while its growth over the entire year 2010 amounted to only Rb 86bn.

The highest by-branch share of stale debt against ruble-denominated credits as of 1 November is registered in the credit portfolio of trade companies (8.7%). These are followed, in terms of their share of stale debt, by companies operating in the processing industries (6.5%). The lowest stale debt index is

still displayed by mineral resources extraction companies (1.5%) (Fig. 3). The highest drop over the first 10 months of 2011 in the level of stale debt (by 1.1 p.p.) in their ruble-denominated credit portfolios is demonstrated by construction, transport and trade companies (Fig. 3).

As shown by the data for September (the statistics on average weighted interest rates is published with a substantial delay), the value of ruble-denominated assets attracted from physical persons

for periods up to one year was registered at the level of 4.0%. The average weighted interest rate on such assets attracted for periods over one year was 6%. It is noteworthy that the average weighted cost of credits, irrespective of their periods, remained at a stable level throughout the three reporting months (from July through September). In this connection, as of 01.11.2011, the share of the population's ruble-denominated deposits for periods over one year in the total amount of the population's assets was 52%.

The average weighted interest rate on ruble-denominated credits allotted to legal entities for periods over one year increased, from 01.01.2011 onwards, by 0.3 p.p (by +0.1 p.p over July–September 2011). In its turn, growth of the interest rate on credits coupled with a stable cost of assets attracted from physical persons had a positive effect on the broadening of the interest rate's margin and the growth of interest income in the banking sector.

Housing credits can be regarded as the locomotive of retail crediting in 2011. According to data released by the RF Central Bank as of 01.10.2011, growth of the housing credit portfolio since the year's beginning amounted to 37% (for reference: credits allotted to physical persons increased since the year's beginning by 27%), or Rb 405bn. At the same time, the average weighted interest rate on ruble-denominated housing credit continues to decline. Since early 2011, the interest rate dropped by 1.2 p.p. – from 13.3 to 12.1% (*Fig. 4*).

Accumulated profit in the banking sector since the year's beginning amounted, by late October, to Rb 676bn, which is by 53% higher than the index for the same period of 2010.

The most notable events that occurred in the banking sector in December are as follows:

The State Duma approved the draft law “On Pledge”, which is going to fundamentally change the approach to redeeming debts to banks. From now on, a bank will not be able to demand additional payment from a borrower who has stopped to pay back the loan and was forced to transfer his or her apartment to the credit institution in lieu of the remaining sum. In such a case, the debt will be considered to be redeemed irrespective of the apartment's actual value at that time.

The RF Central Bank announced that the refinance schemes for banks against their loans to strategic enterprises introduced in the crisis year 2009 could be reintroduced, and the list of such enterprises reinstated. Thus, the list of instruments applied in order to refinance banks in a situation of financial instability is increasingly acquiring a distinctly anti-crisis character.

The Council of the Federation approved the government's draft law on upgrading the requirements on credit institutions' minimum capital. The draft law is aimed at implementing the provisions stipulated in the strategy for developing the Russian the banking sector until 2015. It is proposed that the minimum capital size for banks should be increased from Rb 180m to Rb 300m. The owners of currently operating banks are granted a period of 3 years, until 1 January 2015, for taking all the necessary measures in order to increase the size of their own capital to the required level. For newly created banks it is suggested that the increased minimum capital size should be introduced as early as 1 January 2012.

The Bank of Russia published on its website a draft of its order whereby banks, from 1 January 2012, will be required to create reserves against their idle immovable property and land. The banking sector regulator thus urges banks to more actively dispose of their property received during the crisis period as debt redemption. The size of the reserve is to be determined depending on the length of period during which the assets are shown on a given credit institution's balance sheet. In particular, the size of the reserve against assets shown by a bank on its balance sheet for a period of one year or longer as of 1 January 2012, beginning from reports prepared as of 1 February 2012, must amount to at least 10%. If a bank attempts

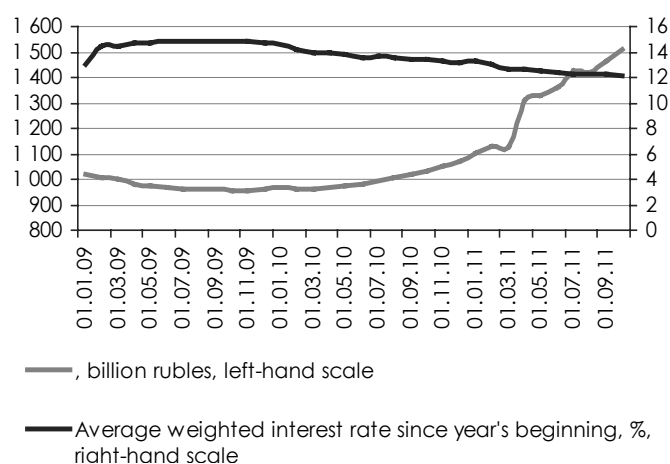


Fig. 4. The Dynamics of Housing Credits and the Average Weighted Interest Rate on Ruble-denominated Housing credits (Since the Year's Beginning)

to transfer that property to the balance sheet of its affiliation, it will still be required to create a reserve against the property until its sale.

In “Vestnik Banka Rossii” (“The Bank of Russia’s Herald”, or “Bulletin of Banking Statistics”), a list of insider information was published. The document is to come in force 10 days after its publication. The category of insider information includes information on State registration of an issue of securities or a refusal of State registration; information on suspension (or resumption) of issue of securities; information on State registration of the result of issue of securities or a refusal of State registration; information on recognizing an issue of securities as invalid or on annulling State registration of an issue of securities, or on decisions concerning obtaining a license when expanding the sphere of a bank’s activity, or a recall (annulment) of a license. Besides, the information concerning the Bank of Russia’s request that a petition should be submitted in order to recall the right to operate deposits in accordance with the law on deposit insurance, as well as information on recognizing to be null and void the RF Central Bank’s permission to attract physical persons’ monies as deposits is also placed in the category of insider information. ●

THE REAL ESTATE MARKET IN THE RUSSIAN FEDERATION

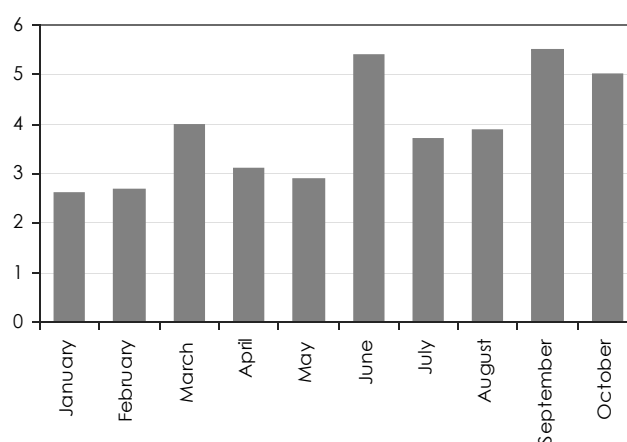
G.Zadonsky

In January–October 2011, the entities of all the forms of ownership built 461,000 apartments with the total floorspace of 38.8 million square meters which figure amounted to 103.3% of the respective period of 2010. The ratio between the price of housing and households' income in 2011 points to the growth in affordability of housing both on the primary and secondary markets. The average weighted rate on the extended mortgage housing loans in rubles fell from 13.1% in 2010 to 12.1% as of October 1, 2011. The share of the housing commissioned within the frameworks of the regional programs of mortgage lending of housing development in the total volume of housing commissioned in Russia in 2010 amounted to 1.2% or 728,800 square meters.

In January–October 2011, entities of all the forms of ownership built 461,000 apartments with the total floorspace of 38,8m square meters which figure amounted to 103.3% of the respective period in 2010. The above number of apartments includes 59,000 apartments with the total floorspace of 5.0m square meters built in October which figure is 9.1% lower than in September 2011 (*Fig. 1*). Individual developers built 19.5m square meters of housing which figure amounted to 103% of the respective period last year or 50.3% of the total volume of housing commissioned in January–October 2011.

In the January–October period of the current year, 273.1 sq. meters of housing per thousand persons were commissioned on average in the Russian Federation, while the highest index of 620.3 sq. meters of housing per thousand persons was registered in the Moscow Region. In 2009, as regards the index of the total floorspace of housing per thousand persons Russia (409 sq. meters) was behind Portugal (1,216 sq. meters), Turkey (836 sq. m), Norway (611 sq. meters), Belarus (602 sq. meters), Denmark (491 sq. meters) and Poland (418 sq. meters).

According to the Rosstat's data, in 2011 the average price of a square meter of housing was growing on the housing market both in respect of the standards apartments and the apartments of all the types ("all the apartments") (*Table 1*). The prices of the primary market of apartments of the all the apartments category were lower than those on the secondary market. In particular, in the 3rd quarter of 2011 they were 8.97% lower. On the contrary, the prices of the primary market of standard apartments were higher than those on the secondary market: in the 3rd quarter of 2011 they were 2.86% higher.



Source: Rosstat's data.

Fig. 1. Dynamics of commissioning of apartment houses by the month (million square meters of housing)

Table 1
THE AVERAGE PRICE OF A SQUARE METER OF FLOORSPACE OF APARTMENTS ON THE HOUSING MARKET IN 2011, RUBLES

	Housing market	1st quarter 2011	2nd quarter 2011	3rd quarter 2011
All the types of apartments	primary	41534	42201	42905
	secondary	46158	46666	47133
Standard apartments	primary	42797	43569	44074
	secondary	41654	42081	42848

Source : Rosstat's data.

According to the Rosstat's data, in January–September 2011 the average actual cost of building of a square meter of housing amounted to Rb 32,325. The average actual cost of building of a square meter of housing which was 50% and more higher than the national average level was observed in the Chukotka Autonomous Region (Rb 173,131), the Magadan Region (Rb 78,006), the Nenetsk Autonomous Region (Rb 55,159 рублей) and the Sakhalin Region (Rb 54,474), while in 54 constituent entities of the Russian Federation it was below the national average level. The lowest index was registered in the Republic of Karachaevo-Cherkessia (Rb 15,691), the Kursk Region (Rb 20,412) and the Republic of Kalmykia (Rb 22,636).

In 2011, the ratio between the price of housing and the households' income points to the growth in affordability of housing both on the primary and secondary markets. As of October 1, 2011, the coefficient of affordability of housing (CAH) as the ratio between the price of a standard apartment with floorspace of 54 sq. meters to the annual income of a family of three persons amounted to 3.45 years on the primary market and 3.36 years on the secondary market which figures are 8.8% and 28.6% lower than the respective indices of CAH as of January 1, 2011.

According to the data of the Central bank of Russia, in January–October 2011 392,752 mortgage housing loans for the total amount of Rb 539,919bn were extended which figure exceeds by 100% the volume of mortgage housing loans extended in the same period in 2010. In January–December 2010, 301,433 mortgage housing loans for the total amount of Rb 380,061bn were extended. As regards the number of mortgage housing loans, in 2011 it was higher than in 2008 when credit institutions extended 349,502 mortgage housing loans for the total amount of Rb 655.8bn, while the number of mortgage housing loans extended in the 3rd quarter of 2011 was almost equal to that of the 3rd quarter of 2008.

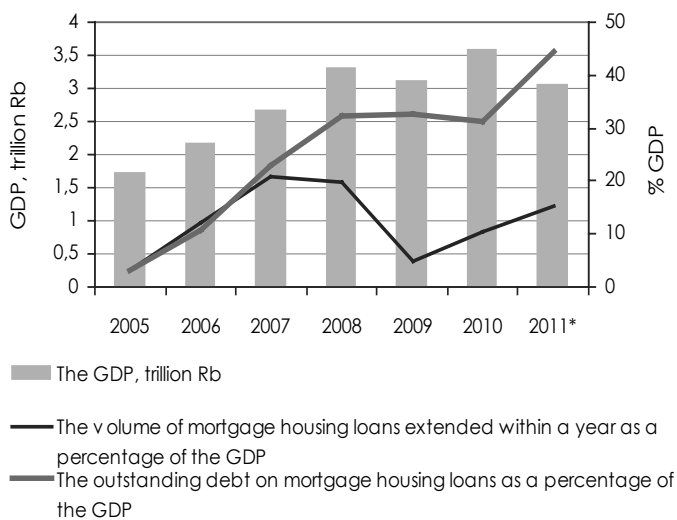
As of October 1, 2011, the volume of mortgage housing loans amounted to 1.22% of the respective value of the GDP against 0.85% in 2010 (*Fig. 2*). As of October 2011, the debt on mortgage housing loans amounted to 3.54% of the respective GDP which figure is 1.03% higher than the value in 2010.

In 2011, the growth of the outstanding debt on the extended mortgage housing loans in rubles continued while the share of the overdue debt in the outstanding debt kept decreasing. As of October 1, 2011, the debt on mortgage housing loans in rubles increased by 33.6% as compared to the 3rd quarter of 2010 and amounted to Rb 1181,594bn. The overdue debt decreased by 0.66% and amounted to 2.17% of the outstanding debt. Within the same period, the outstanding debt on mortgage housing loans in foreign currency decreased by 6,6% and amounted to Rb 173,252bn, while the overdue debt increased by 1.79% to 11.3%. As of October 1, 2011, the overdue debt on mortgage housing loans in rubles amounted to Rb 25,583bn, while that on mortgage housing loans in foreign currency, to Rb 19,581bn. According to the data of the Federal State Registration, Cadastre and

Cartography Service, as of October 1, 2011 683,032 mortgage encumbrances on housing were registered by individuals in the Unified State Register of Titles to Property.

In 2011, both the outstanding debt on mortgage housing loans without overdue payments and its share in the aggregate debt amount kept growing (*Table 2*). As of November 1, 2011, the share of that debt (Rb 1,272,913bn) in the total sum of the debt amounted to 92.47%, which figure is 4.64% lower than that as of January 1, 2011. As of November 1, 2011, the share of the debt on mortgage housing loans with payments overdue for over 180 days (the debt on the defaulted loans) in the total amount of the debt decreased by 0.46% against that as of January 1, 2011.

In 2011, both the share of the debt on mortgage housing loans with payments



Source: Data of the Central Bank of Russia.

Fig. 2. The dynamics of the mortgage housing lending as a share of the GDP

overdue for over 180 days in the total debt and the share of the overdue debt on mortgage housing loans in the total debt tend to decrease with narrowing of the difference between their values. As of January 1, 2011, the difference between the debt on mortgage housing loans with payments overdue for 180 days in the total sum of the debt and the overdue debt on mortgage housing loans in the total sum of the debt amounted to 1.42 %, while as of November 1, 2011 it was 0.67% (*Table 2*).

Table 2

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

2011	The total amount of the debt on mortgage housing loans	Including the debt						The overdue debt on mortgage housing loans	
		Without overdue payments		With payments overdue from 1 to 180 days		With payments overdue from 31 days to 90 days		Million Rb..	%*
		Million Rb.	%*	Million Rb.	%*	Million Rb.	%*		
Jan 01.	1 129 373	991 928	87.83	79 734	7.06	57 711	5.11	41632	3.69
Feb 01.	1 132 700	981 599	86.66	97 298	8.59	53 803	4.75	42321	3.74
Mar.01.	1 138 642	986 861	86.67	99 062	8.70	52 719	4.63	42075	3.70
Apr.01.	1 158 433	1 018 958	87.96	85 955	7.42	53 520	4.62	42195	3.64
May 01.	1 178 450	1 044 814	88.66	79 781	6.77	53 855	4.57	41964	3.56
Jun. 01.	1 208 952	1 096 277	90.68	61 778	5.11	50 897	4.21	42611	3.52
Jul. 01.	1 242 940	1 127 097	90.68	64 385	5.18	51 458	4.14	43247	3.48
Aug.01.	1 268 565	1 158 199	91.3	59 623	4.70	50 743	4	42758	3.37
Sept. 01.	1 311 238	1 213 945	92.58	45 499	3.47	51 794	3.95	43702	3.33
Oct.01.	1 354 846	1 251 608	92.38	49 180	3.63	54 058	3.99	45164	3.33
Nov.01.	1 376 568	1 272 913	92.47	50 107	3.64	53 548	3.89	44369	3.22

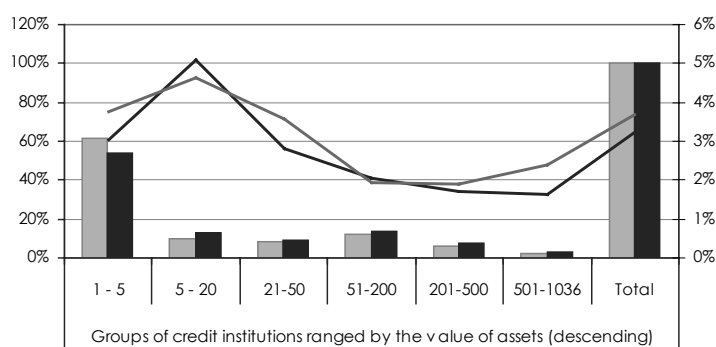
* % of the total amount of the debt.

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

According to the data of the Central Bank of Russia, the average weighted rate on mortgage housing loans extended in rubles from the beginning of the year fell from 13.1% in 2010 to 12.1% as of October 1, 2011. The average weighted rate on mortgage housing loans in foreign currency extended from the beginning of the year also fell from 11.0% in 2010 to 9.5% as of October 1, 2011.

The average weighted period of lending as regards mortgage housing loans in rubles extended from the beginning of the year fell from 16.36 years in 2010 to 15.33 years as of October 1, 2011, while that on mortgage housing loans in foreign currency amounted to 12.91 years as of the end of the 3rd quarter of 2011.

In 2010, a drop in the share of the five credit institutions with the largest assets in the total volume of the mortgage housing loans extended within a year to 54.02% was replaced in January–October 2011 by the growth in that share to 61.75% and redistribution of the volumes between other groups (*Fig. 3*). In 2010 and 2011, the highest risk (as regards the share of the overdue



- The volume of mortgage housing loans extended by the group to individuals in January–October 2011 as % of the total volume of loans granted.
- The volume of mortgage housing loans extended by the group to individuals in 2010 as % of the total volume of loans extended in the year
- The overdue debt of the group as % of the outstanding debt of the group as of November 1, 2011
- The overdue debt of the group as % of the outstanding debt of the group as of the end of 2010.

Source: Data of the Central Bank of the Russian Federation.
Fig. 3. Dynamics of the volumes of the extended mortgage housing loans and the overdue debt by the group of credit institutions ranged by the value of the assets

debt) portfolio of mortgage housing loans was with the second group (4.65% in 2010 and 5.1% in 2011). In 2011, as regards the volume of lending the second group and the fourth group happened to be almost similar, however, the portfolio of mortgage housing loans of the fourth group (2.06% of the overdue debt) was less risky than that of the second group (5.1% of the overdue debt).

In the 3rd quarter of 2011, the explicit trend towards a drop both in the share of the volume of mortgage housing loans in foreign currency extended within the quarter in the total volume and the share of the debt on mortgage housing loans in foreign currency in the total debt came to a halt. As compared to the 2nd quarter of 2011, the share of the mortgage housing loans in foreign currency in the total volume of mortgage housing loans increased by 0.35% and amounted to 3.2%, while the share of the outstanding debt on mortgage housing loans in foreign currency in the total debt increased by 0.02% to 12.79%. In 2010 and 2011, the share of the overdue debt on mortgage housing loans in foreign currency in the total debt in foreign currency varied from 39.06% to 43.4% and amounted to 43.36% as of November 1, 2011.

According to the data of the Central Bank of Russia, in the first six months of 2011 131 entities including 19 credit institutions refinanced mortgage housing loans with a sale of the pool (rights of claim in respect of mortgage housing loans) for the amount of Rb 25.9bn which figure amounted to 9.5% of the volume of mortgage housing loans extended in the first six months. 102 resident-specialized entities accounted for 86.4% of the volume of refinancing. According to the data of the AMHL, as of November 30, 2011 in the United States the share of the refinanced loans amounted to 73.9% against 9.5% of the volume of the loans extended in the first six months in Russia.

As of July 1, 2011 mortgage housing loans for the amount of Rb 100.3bn were repaid in advance which figure amounted to 36.75% of the volume of the loans extended in the first six months. With borrowers' own funds Rb 80,401bn was repaid. In the same period of 2010, Rb 67.6 bn was repaid or 50.67% of the volume of the extended mortgage housing loans.

In the three quarters of 2011, the OAO AMHL refinanced 27,385 mortgage loans for the sum of Rb 34.3bn which figure amounted to 8.1% in quantitative terms and 7.3% in money terms of all the mortgage loans extended within that period. In January-September 2011, the rate of repurchase by the Agency of mortgages amounted to 11.1%.

As of November 1, 2011, the AMHL refinanced 4119 mortgage loans extended under the *Military Mortgage* program for the total amount of about Rb 8bn, as well as 828 loans with use of the maternal capital for the total amount of over Rb 936m. Within the frameworks of the *Stimul* program, the Agency extended at the rate of 7% to 8.75% per annum 188 loans for the total amount of Rb 10.7bn for the purpose of financing banks which grant loans for building and purchasing of housing.

According to the data of Rosreestr, in January-October 2011 under agreements on purchase and sale of housing (exchange agreements) 2,535,001 titles were registered by individuals. In the same period, 715,851 housing mortgages were registered including 683,032 housing mortgages by individuals. Under some assumptions made, the share of mortgages of individuals in the volume of the registered assignment of the purchase and sale titles may amount to 27%.

According to the data of Rosreestr, the share of the housing commissioned within the frameworks of the regional programs of mortgage lending of housing development in the total volume of housing commissioned in Russia in 2010 amounted to 1.2%. As compared to 2009, the volume of floorspace built with use of mortgages in Russia in general increased by 11.5% and amounted to 728.800 square meters. ●

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

M.Goldin

In December 2011, at the meetings of the Government of the Russian Federation the following issues were considered: approval by the Sub-Commission of the Government of the Russian Federation on Customs Tariffs and Non-Tariff Regulation and Protective Measures in Foreign Trade of a decision on application from 2012 of reduced rates as regards both import and export duties on individual types of goods; approval of amendments to the Resolution of the Government of the Russian Federation on the Procedure for Notification of the Commencement of Individual Types of Entrepreneurial Activities.

On December 13, 2011, at the meeting of the Sub-Commission of the Government of the Russian Federation on Customs Tariffs and Non-Tariff Regulation and Protective Measures in Foreign Trade a decision was taken on the extension of the existing 5% import customs duties rates in respect of individual types of chalk-coated paper and paperboard till December 31, 2012, as well as another decision was supported as regards application of zero import customs duties rates in respect of individual types of components parts and parts needed for manufacturing of civilian airliners.

With taking into account the high yield of sugar beet in the current year, the sub-commission found no sufficient grounds for application of the institute of special exporters of white sugar from the Russian Federation.

The above decisions of the sub-commission have been recommended for consideration at the meeting of the Commission of the Customs Union.

Also, the participants in the meeting recognized that it would be expedient to apply preferential conditions for payment of the export customs duties in respect of crude oil which is produced at the continental shelf of the Arctic zone (the Prirazlomnoe oil deposit). A similar procedure is applied in respect of oil deposits in Eastern Siberia and the Caspian Sea.

On December 22, 2011, at the meeting of the Presidium of the Government of the Russian Federation the draft resolution of the Government of the Russian Federation on Introduction of Amendments into Some Acts of the Government of the Russian Federation as Regards the Issues of Provision of Notifications of Commencement of Individual Types of Entrepreneurial Activities was considered. The above draft resolution was proposed by the Ministry of Economic Development of the Russian Federation.

The need in such a resolution arose due to the fact that by Federal Law No. 242-FZ of July 18, 2011 on Introduction of Amendments into Individual Statutory Acts of the Legislation of the Russian Federation as Regards the Issues of Fulfillment of State Control (Supervision) and Municipal Control such amendments were made into Article 8 (2) of Federal Law No. 294-FZ of December 26, 2008 on Protection of the Rights of Entrepreneurs -Legal Entities and Entrepreneurs-Individuals in Fulfillment of State Control (Supervision) and Municipal Control as provide for extension of the list of the types of entrepreneurial activities of which commencement economic entities have to notify state supervision authorities (the above list was extended from 43 to 68 types of entrepreneurial activities).●

THE REVIEW OF THE ECONOMIC LEGISLATION

I.Tolmacheva

In December, the following amendments were introduced into the legislation: a new type of legal entities – the economic partnership – related to for-profit organizations have been introduced; instances of justified placement of orders with a sole supplier (performer, contractor) without an auction being held have been specified.

I. Federal Laws of the Russian Federation

1. Federal Law No. 393-FZ of December 6, 2011 ON INTRODUCTION OF AMENDMENTS INTO ARTICLE 50 OF PART TWO OF THE CIVIL CODE OF THE RUSSIAN FEDERATION DUE TO ADOPTION OF THE FEDERAL LAW ON THE ECONOMIC PARTNERSHIPS

The economic partnerships have been included in the list of legal entities which are for-profit institutions. The activities of the above type of legal entities is regulated by Federal Law No. 380-FZ of December 03, 2011 on the Economic Partnerships. The above federal law, as well as the Federal Law on Economic Partnerships will come into effect from July 1, 2012. .

2. Federal Law No. 380-FZ of December 03, 2012 ON THE ECONOMIC PARTNERSHIPS

From July 1, 2012, another type of legal entities – the economic partnerships – related to profit organizations will appear in the Russian Federation.

Participants in economic partnerships may be individuals and (or) legal entities. The economic partnership is founded by two or more persons. The founding document of the partnership is the founding charter which is to be signed by all the founders of the partnership. Establishment of the partnership through restructuring of the existing legal entity is inadmissible, at the same time, the partnership can be restructured only into a joint-stock company. The partnership is not allowed to be a founder of or participant in other legal entities, except for unions and associations. The partnership is responsible for its liabilities with all the property which belongs to it; participants in the partnership are not answerable for the obligations of the partnership, they bear the risks only within the limits of the amount of their contributions. Each participant is obligated to make a contribution to the pooled capital of the partnership. A participant in the partnership cannot be relieved from the obligation to make a contribution to the partnership's pooled capital. The Government of the Russian Federation may establish normals of adequacy of the capital base of partnerships which engage in certain types of activities. The partnership is not in a position to issue bonds or other securities. Nor is it allowed to place advertising of its activities. The partnership establishes a sole executive authority (the General Director, President and other) which is elected from among the participants of the partnership in accordance with the procedure and for the term determined by the founding charter or a unanimous decision of all the participants for the entire period of the partnership's activities. In establishing the partnership, the founders of the partnership approve the auditor of the partnership. An audit company or an individual auditor is approved as the auditor of the partnership (in accordance with the Federal Law on Auditing). Also, the above Federal Law on Economic Partnerships regulates other issues related to the establishment of the economic partnerships, the specifics of their operations, management, relations between its participants, as well as restructuring and liquidation of partnerships.

3. Federal Law No. 418-FZ of December 07, 2011 ON AMENDMENT OF ARTICLE 31.1 AND ARTICLE 55 OF THE FEDERAL LAW ON PLACEMENT OF ORDERS FOR SUPPLIES OF GOODS, FULFILLMENT OF JOBS AND RENDERING OF SERVICES FOR STATE AND MUNICIPAL NEEDS

The instances of justified placement of orders with a sole supplier (performer and contractor) without holding of an auction have been specified. According to legislative amendments, placement of orders with a sole supplier is now admissible also in cases of:

- supplies of goods (jobs and services), particularly, for the needs of theatres, museums, libraries, archives and state educational establishments provided that within the quarter of the year the amount of the order does not exceed Rb 400,000;
- placement of an order for sales of entrance tickets and subscriptions to theatrical, cultural and entertainment events, as well as sightseeing tickets and tourist vouchers whose form is approved as blank forms for which strict records are kept. ●

AN OVERVIEW OF NORMATIVE DOCUMENTS ON TAXATION ISSUES IN NOVEMBER–DECEMBER 2011

L. Anisimova

In December, after the State Duma elections, on the eve of presidential elections, new trends were observed in the positions of the top leaders of the Russian Federation. Russia should make a “tax maneuver” to optimize revenues, said at a meeting with entrepreneurs (the Jubilee Congress of “Business Russia”) on 21.12.2011 Vladimir Putin, the Prime Minister¹. The Russian President Dmitry Medvedev, in his annual message to the Federal Assembly of 22.12.2011² has confirmed that Russia should transfer to the election of Governors by direct vote. Herewith, a package of bills aimed at decentralization of power will be introduced to the State Duma. Their implementation will allow for a significant redistribution of powers and fiscal resources to the regions and municipalities. Additional income of regions and municipalities from the redistribution of tax resources can make up to Rb 1 trillion.

Another advertised campaign “to restore the order” in the system of fiscal relations is alerting. Authorities have not yet figured out the problem of health insurance premiums (2010 reform), but have already announced a firm intention to resolve problems in the nearest future of both, taxpayers and budgets. We would like to recall that the interests of taxpayers and the budgets still bear opposing vectors. Those who have to maneuver in fiscal relations should be very careful not to be carried away either by abolition of any taxes, or application of a higher tax burden on producers, even with the best intentions.

1. So, what is the deployment of financial resources at the field where you plan to maneuver? Under the effective Russian law, 90% of corporate income tax should be addressed to the regional budgets (18% under the overall rate of 20%). This is the key tax revenue for the regions. Regions have to fight for the investments, reasonably adjusting the tax rate, since the presence of producers in their territory is a pledge of their future development: creating jobs, expanding the revenue base for the corporate income tax. A further crucial source of income for the regions is now the corporate property tax. Property tax and corporate income tax were transferred to the local budgets in the framework of budget and tax reforms of the 2000s. Local budgets were assigned also important and stable income from income tax of individuals – citizens residing in a particular municipality, as well as the property of those individuals and a land tax. Replacement of property tax and land tax for real estate tax will result in the need to distribute the tax revenues between the levels of budget system (the tax is unlikely to reach the level of federal budget revenues, most likely it will be still distributed among regional and local budgets). Herewith, VAT is a federal tax. The principle of its collection has been described in detail in the previous review. Mobilized by means of VAT revenue throughout the country constitute the tax base of the federal budget, which, in addition to servicing the federal needs, is distributed between regions, levelling the social conditions of citizens. Such a framework of market fiscal system, in our opinion, in Russia is the best basis for the organization of financial relations between citizens, state federation and the regions. It certainly has more flexible elements – royalty to be distributed among the producers of raw materials and the state (including regions), excise duties, etc. Tax on mineral extraction is likely to be transformed into a kind of corporate income tax, which tax base will be assessed by comparing the accumulated revenues versus expenses during the period from the beginning of investment until the completion of the investment project. The mechanism for assessment and payment of customs duties has been changed due to the Customs Union formation and will be further amended in connection with the adoption of WTO commitments by Russia.

There is an alerting fact that the order to decentralize the management and redistribution of powers between different levels of government, including adjustment of the tax system and intergovernmental relations, was given by President Dmitry Medvedev in June 2011. At the same

1 Internet newspaper “Dni.ru” of 21.12.2011, ed. article “Putin is planning a “tax maneuver””.

2 Site rian.ru 22.12.2011.

time, throughout the second half of 2011, the State Duma systematically introduced innovations at the level of federal laws to provide incentives and benefits, mainly in regard to income tax, corporate property tax, land tax, abolished the distribution of excise taxes and so on, that is, implemented measures to reduce the tax burden on taxpayers through unilateral and (due to the nature of formation of the Federation Council) forced reduction of the regional revenue base.

Contributions to the state social extrabudgetary funds take an outstanding place. The formation of the revenue base of state extrabudgetary funds is not absolutely transparent. Let us recall, that the total insurance contribution rate was increased from 26.2% in 2010 to 34.2% in 2011 and then the base rate was reduced to 30%. In 2011, the rate of contributions to the Pension Fund was 26%. From 2012, the total tariff rate of the state extrabudgetary funds of 30% is allocated as follows: Pension Fund – 22% (including 6% for the funded part of the retirement pension¹), Social Insurance Fund – 2.9%, Compulsory Medical Insurance Fund – 5, 1%².

Let us make some estimates. We will deliberately assume a small error by combining the total number of disabled children (545,000³) and the total number of pensioners as 39m⁴. In total, we obtain approximately 40 million people, whose insurance should be covered at the expense of social funds. The economically active population, according to Russian Statistical Service, is 75.6m people, excluding the people who are in search for work – about 71m. With the planned average monthly wages of Rb 25,000⁵ we find that the RPF in 2012 can get revenue (if we minimize the number of taxpayers, enjoying beneficial rates) of Rb 4.7m. To ensure payments to pensioners and disabled children at 40% of the average wage Rb 4.8 trillion is required ($\text{Rb } 25,000 * 40\% * 12 * 40\text{m people}$). As you can see, the amount of annual proceeds and disbursements are very close in figures. In case of restoration of a UST scheme for the formation of funds, the cost of maintaining the administrative staff of the funds could be further cut down by transferring control over the income to tax authorities. Preservation of contribution rates to the RPF in 2012 at the level of 2011 (26%) would even surpass the income over expenditure, the balance can be estimated at Rb 0.7 trillion, or 13% ($\text{Rb } 5.5 \text{ trillion}^6 - \text{Rb } 4.8 \text{ trillion} * 100 / 5.5 \text{ trillion}^7$).

In general, the contributions to the Pension Fund rate preset at 22% of a salary, and with a given ratio of pensions and average wages (pension accounts for 40% of a salary), as well as the current ratio of workers versus the number of pensioners in Russia, it is really possible to implement the most simple pension scheme – working generation pays for the retirees. Once the cumulative part is excluded from the calculations (remember, it is 6% of salary for persons born after 1967, and now and the generation of those who are in the age 45 years already belongs to that category), it turns out that the effective rate of pension contributions (it is close to 17% of the total insurance rate⁸) is not enough to fund current pension payments. As a result, on the one hand, there are significant fiduciary operating expenses of the fund (deficit) for which reimbursement it is needed to raise funds somewhere else, and on the other hand, balances with banks, accumulated deferred funds portion of the insurance rate, which supplement the current resources of banks and may be involved in payments only in 10 years (when those who are now 45 years old will retire). To cover the current RPF deficit, the government has either to raise taxes, or borrow from the same banks under the market rate. Since the deposit rate is always lower than the credit one, then in case of

1 Federal Law No. 27-FZ of 01.04.1996 “On the individual (personalized) registration in the system of Art”. 6, Section 3, Para. 1.3.

2 Federal Law No. 379-FZ of 3.12.2011 “On Amendments to Certain Legislative Acts of the Russian Federation on the Reestablishment of Tariffs of Insurance Contributions to the National Extrabudgetary Funds”.

3 According to the Information report of the Minister of Healthcare and Social Development, at a meeting of the Specialized Council for Priority National Projects and Demographic Policy), the site of Rianovosti from 14.08.2009, the “Society” block.

4 According to the Russian Statistical Service, the site gks.ru, “Population” block, “The standard of living”.

5 Information from Duma Speaker of the 5th convocation B. Gryzlov, published on the portal of the site “Guarant” on 24.11/2011.

6 Calculation ($\text{Rb } 25,000 * 12 \text{ months} * 71 \text{ million people} * 26\% = \text{Rb } 5.5 \text{ trillion}$).

7 We would like to recall that the healthcare in Russia is built on the principle of insurance, so any expensive medical treatment for those who need it is paid by means those citizens who did not use the medical services.

8 The share of persons under 45 years in the total number of working age up to 55 years is estimated at 71%. The average tariff rate of contributions to the RPF without accumulative part may be estimated at 17%. Calculation: $(6\% / 22\%) * 72\% = 19.7\%$; $22\% * (100\% - 19.7\%) = 17.6\%$.

borrowing, the government will just “eat up” the pension money due to the difference in rates. A natural solution for administration of funds in such a situation was a proposal to raise insurance premium rates. We would like to remind, that in 2010 a proposal made by extrabudgetary funds was supported. This has led to rather grave consequences for producers. The estimated federal budget revenue for 2011 in accordance with Federal Law No. 357-FZ of 13.12.2010 is Rb 11.1 trillion. The total insurance rate increase for all funds from 26.2% to 34.2% corresponds to Rb 1.7 trillion (calculation: Rb 25,000 rubles * 12 months * 71 million people * 8%), i.e., in 2010, having raised insurance rates for 2011 with one stroke of the pen from 26.2% to 34.2% with the noblest of intentions, the domestic producers were obliged to pay additionally to social funds about 16% of federal revenues (Rb 1.7 trillion / Rb 11 trillion * 100 = 15.3%).

2. There should be noted other negative trends associated with replacing the UST with premiums to the extrabudgetary funds. Federal law No. 379-FZ of December 3, 2011 introduced amendments to some legislative acts of the Russian Federation on the establishment of tariffs of insurance contributions to extrabudgetary funds. Among the innovations is the introduction of administrative responsibility for: 1) failure to submit evidence of payments for accrued and paid contributions (penalty in the amount of 5 percent of the amount of the premiums to be paid for the last three months, but not more than 30 percent of that amount and not less than Rb 1,000 for the failure to comply with the order to present data in electronic format – a penalty of Rb 200 and 2) for the delay in providing information about the closing or opening a bank account – a penalty of Rb 5,000.

We have repeatedly drawn attention to the fact that the replacement of UST with the insurance premiums and the transfer from one supervisory authority – the tax service to a number of parallel supervisory agencies (officials of social funds were included in the number of supervisors) will inevitably lead to economically unjustified surplus burden on taxpayers. The Law clearly illustrates this point. In this case a duplicate sanction is actually established. Previously (before the abolition of UST) penalty was levied only once, and now it may be charged by each supervising body for the same violation – failure to provide information about the opening (closing) bank account.

The disadvantage of a separate law on insurance premiums is the absence of a thorough and conceptual terminology. Thus, the right to apply for beneficial rates now is provided to organizations rendering engineering services of transport and communication (using the simplified tax system), non-profit organizations (other than state or municipal entities applying the simplified taxation system), providing services in the field of social service, R&D, libraries, museums, archives, grassroots sports (except professional sport). The law under consideration defines engineering services as engineering consulting for the preparation of the production and sale of products (feasibility studies, engineering design and other similar services). The term “engineering” is defined only for the law in question and is formulated in general terms, i.e., not an exhaustive specially interpreted definition. As a result, management of the state social extrabudgetary funds is entitled to define, if this or that particular service is related to the concept of “engineering” for the purposes of benefits under an insurance rate or not.

However, version of Para. 5.4, provides (with regard to Para. 5.6) the conditions of application of beneficial rates in respect of engineering services, limiting the scope of this benefit only to large specialized agencies (with personnel of at least 100 people and the share of services in sales of at least 90 %) and in case of positive conclusion of the expert Committee for technology-innovative special economic zones, established in accordance with the Federal Law No. 116-FZ of July 22, 2005 “On special economic zones in the Russian Federation,” but we think the problem of arbitrary interpretation of the term is not completely solved.

A similar problem arises with respect to any other terms used in the Law: “mass sports” “social services”. It seems that now the social funds will be forced in each case to clarify in detail specific issues, if billiards of carting can be included in the definition of “mass sports”, whether the bus transportation of children or the transfer of land to rent for children’s clubs refers to “social service”, etc. All this will inevitably lead to litigation.

In regard to taxation, the situation with the introduction of individual approaches to the provision of benefits was considered as unacceptable, and technical study of the terminology used in the Tax

Code has been focused on the application of the terms, which do not have an exhaustive explanation in terms of tax or other regulations, including industrial laws and international treaties. The Law of 2012 has reduced insurance premium rates to the state social extrabudgetary funds from 34.2% to 30%. Herewith, there was introduced an additional rate of 10% on the amount exceeding the limit base, from which insurance premiums are payable for the basic tariff and which, for 2012, according to the RF Government Decree No. 974 of 24.11.2011 was set at Rb 512,000. This decision, in our opinion, is ineffective. It is clear, that taxpayers will minimize costs by introducing an artificial differentiation of wages – for a number of senior positions there will be established and high-rate wages (to move the base mainly in the sphere of 10%) taxation) and for a number of positions – low rate (to avoid taxation at 30%), followed by “envelope “redistribution of funds. Increasing insurance rates to 34% in practice already had a negative impact on social security of a large number of workers who are forced to get a job with low formal remuneration. Reduction of the base rate to 30%, accompanied with introduction of 10% tariff on the amount exceeding the maximum base tax rate, in our opinion, (despite the recommendations of some experts, for example, those the “Fair Russia” party) will not lead to higher incomes, but will only increase small number of violations for which the sanctions. The introduction of this tariff will increase the number of audits on the part of the funds and, therefore, increase the need for the number of auditors and remuneration thereof.

Among other amendments to the existing scheme of formation of the state social funds provided by the law under review, there should be noted an expansion of the insured persons for whose benefit the employer will pay the premiums. Now foreign nationals with the status of temporary stay in Russia are included in the insured persons. This will allow some level of competitiveness of Russian citizens in the labor market against migrants.

3. Federal law No. 407-FZ of December 6, 2011 has made amendments to Art. 140 and 241 of the RF Criminal Procedural Code. Changes in Art. 140 provide that the reason for initiating a criminal case on tax crimes (Article 198-199.2 of the RF Criminal Code) may be based only on those materials that are directed by the tax authorities in accordance with the legislation on taxes and levies specifically related to the issue of a criminal case. It is more difficult to understand the motivation of the amendments to Art. 241, according to which in the case of criminal proceedings on crimes in the sphere of economic activity based on a court ruling or order only an introduction and the operative part of the sentence may be disclosed. According to experts, this may be due to the fact that the texts of judicial decisions should be published, i.e., made available for review.

4. Pursuant Federal law No.392-FZ of December 3, 2011 it is allowed to create a zone of territorial development in the Russian Federation as per the list approved by the Government. In fact, those Subjects of the Russian Federation, which meet the criteria mentioned in the Law, may be included in the list of regions where it is permitted to create a zone with special investment conditions. For inclusion in the list of the Subjects of the Russian Federation must meet certain criteria, such as: 1) a certain share of employees in business partnerships and companies engaged in the private sector, and 2) the established level of fiscal capacity of the Subject of the Russian Federation, and 3) the annual average indicators of industrial production, etc. (Art. 4) – which limits (criteria) are established by the RF Government. It is forbidden to create zones of territorial development within the boundaries of traditional subsistence territories of indigenous peoples of the North, Siberia and the Far East of the Russian Federation.

The Law provides for the development of the regions for the targeted indicators of socio-economic development, which are supposed to be achieved by the end of their operation in accordance with the values of growth rates specified Art. 4. Pursuant to Art. 7, the decision on establishment of Regional Development should be issued by the Decree of the Russian Government. Support will be provided in the form of tax incentives in the framework of legislation on taxes and fees, granted to the Subjects of the Russian Federation. Residents of the areas of territorial development can be granted an investment tax credit for up to 10 years (in the amount not exceeding 100% of the cost of capital investments for the acquisition, development, additional equipment, renovation,

modernization, technical re-equipment of depreciable property, designated and used by residents of the zones of territorial development projects). Herewith, interest is not charged on such an investment tax credit for the amount of the debt. If the entity who received an investment tax credit violated the obligation in connection with the execution of which it was obtained, within three months from the date of termination of the agreement on such investment tax credit, it must pay the full amount of the unpaid tax, plus interest on that amount, which is charged for each calendar day from the day following the day of the contract termination to the date of tax payment. The interest rate is the refinancing rate of the Central Bank effective on those dates.

5. Regulations for granting benefits to the SEZ residents are improved.

Federal Law No. 365-FZ of 30.11.2011 “On Amending the Federal Law” on Special Economic Zones in the Russian Federation” and some Legislative Acts of the Russian Federation”, residents of techno-innovation, tourism and recreational special economic zones, combined by the resolution of the RF Government in a cluster, the corporate profit tax portion, transferred to the federal budget is established at zero rate, and the refined version of the Tax Code provides the right to the regions to reduce the tax rate for residents of the SEZ below 13.5% on the income tax payable to the regional budget. At the same time, the adopted law allows to extend the term when the SEZ residents are exempt from property tax from 5 to 10 years. In addition to residents, management companies of the SEZ are exempt from real estate tax. The rules for payment of insurance premiums are changed as well – benefits are no longer the SEZ residents, but to the organizations and businesses that have entered into agreements with the administration of the SEZ on the implementation of technical innovations and tourism and recreation activities, united in clusters and make payments to physical persons working in the SEZ.

6. Federal Law No. 338-FZ of 28.11.2011 has introduced a number of amendments to the Tax Code and other laws related primarily to amendments in excise rates. The definition of excisable alcoholic beverages is clarified.

The terms of a bank guarantee for excise duty payer exemption from paying the excise tax on the export or import in the case of alcohol or alcohol-containing products are clarified. It is permitted to provide a single bank guarantee for the simultaneous exemption from advance payment of excise duty and excise tax assessed for the same alcoholic products, when exported outside the territory of the Russian Federation under the export customs procedure. The warranty period shall be not less than 12 months, following the tax reporting period in which the transactions recognized the object of excises were performed.

There introduced a provision requiring from the federal agency in charge of control and supervision in the field of taxes and fees, as well as the federal agency authorized for customs procedures to publish in an electronic system for public access information on maximum retail prices for tobacco products.

From the second half of 2012 it is planned to increase the excise rates on tobacco and alcohol products, and the maximum growth rate of excise duty on those goods is related to 2013 and 2014 (the increase of growth for tobacco products in excise tax is planned by 120-140% as compared to 2012, on alcohol – by 100%, in particular, to Rb 500 per 1 liter of anhydrous ethanol in alcoholic beverages by volume of ethyl alcohol over 9%). Up to Rb 74 (against Rb 34 in 2011) will be increased the excise tax on a liter of “dry” alcohol, sold by distillery to organizations producing alcoholic beverages, do not pay advance payments. To the payers of advance installments or payers who provided a duly executed bank guarantee, the zero rate is maintained. On vehicles, fuels and lubricants excise tax rate is changed not so much (in general by 30-40% before 2014). It is even foreseen to reduce excise taxes for gasoline and diesel fuel Euro-5.

In addition, the adopted law has withdrawn from the imposition of VAT on the provision of services to the passage of vehicles on commercial roads of federal importance (except for the fees remaining at the disposal of the concessionaire).

All restrictions are removed on the size of deductible expenses in the form of interest on the loan monetary assets obtained in the framework of REPO operations in regard to the tax base for

personal income (before such costs of individuals were subject to the rules similar to the method of thin capitalization, established in Art. 269 for organizations). This decision will not significantly affect budget revenues, since expenses of individual for securities transactions in any case are assessed within the income from operations with securities. Physical persons' income in the form of lump-sum compensation to healthcare professionals in the age of 35, who arrived in 2011-2012 to work after graduation in rural areas and have concluded a contract for work on the basis of Art. 51 of the Federal Law "On Compulsory Health Insurance" is tax exempt.

Changes are introduced in the procedure of paying tax on the extraction of minerals. Absolute (fixed in rubles) tax rates are established on the extraction of gas condensate, rather than ad valorem rates (on turnover). At the same time, rates for natural gas were increased from Rb 251 per 1,000 m³ to Rb 509, which has brought the rates closer to the extraction of 1 ton of gas condensate and 1 m³ of natural gas. By 2014 the tax rate will rise to Rb 647 and Rb 622 respectively. For oil produced in the territories of the republics of Tatarstan and Bashkortostan, taxpayers are provided a tax deduction, which depends on fluctuations in the rates of customs duty on crude oil "Urals".

Individual entrepreneurs, applying the simplified taxation system, now can, in assessing the tax base apply a deduction of income not only on contributions for their employees, but also to their own contributions. Herewith, entrepreneurs who have no employees, shall pay the insurance premiums for themselves based on the cost of the insurance year¹ (in this case, the amount of their deductions may even exceed the allowed 50% limit of reduction the amount of tax or advance tax payments established by Art. 346.21 of the RF Tax Code).

7. Federal Law of November 21, 2011 No. 328-FZ introduced amendments to legislative acts with regard to the detalization of provisions of the Federal Law No. 275-FZ dated of December 30, 2006 "On the order of formation and use of endowment capital of non-profit organizations." With regard to taxation, we are talking about issues related to the dissolution of the targeted fund due to the termination of the non-profit organization and distribution of its assets among the donors. A major part of the text of the Federal Law No. 328-FZ is devoted to a detailed step by step description of the scheme of calculation the taxable income of donors for each type of property and for each type of donors – legal entities or individuals, described in the Tax Code. The Law explained in detail how to estimate income for the return of real estate, how to assess interest on funds placed on bank deposits, on securities, on property situated in a fiduciary management. The specifics of the scheme for assessment the tax base in such a situation is that the donors did not commit transactions of sale, when transferring property to the endowment capital, but a change of ownership, however, took place, and as a result, the owner obtained some income in the form of assets or liabilities. Since the property was donated for specific purposes, as a result of dissolution the endowment donors, on the one hand, simply get back the property previously donated due to the loss of donation purpose, and in regard to the property formed during operation of the non-profit organization as a result of placement and use of endowment, contributors are regarded by the Law heirs or beneficiaries. Without entering into a legally complex issue whether it is rightful to assign to donors the income of non-profit organization derived from the use of endowment capital, it may be noted that as long as the Constitutional Court does not confirm the legal validity of such assignment, or determines in respect to such income (in the absence of legal successors of a founder of the nonprofit organization) the legal status of ownerless property, there are no formal grounds not to consider such income as the taxable income of donors. In the event of an alternative decision of the Constitutional Court the tax base of donors' income from the dissolution of a nonprofit organization may be adjusted accordingly.

It should be added that individual donors are granted a tax deduction for the individual income tax in the amount of actual expenses incurred, but not more than 25% of the amount of income raised in the tax reporting period and subject to taxation. When the taxpayer gets back donations, he should include it in the tax base of the tax period in which the property or its cash equivalent

¹ Defined in Article 13 of the Federal Law No. 212-FZ of 24.07.2009 "On the insurance premiums to the Pension Fund of the Russian Federation, the Social Insurance Fund of the Russian Federation of the Federal Health Insurance Fund and the territorial mandatory health insurance funds".

were in fact obtained, the amount of social tax deduction provided in connection with the transfer of an appropriate non-profit donations.

8. In connection with the adoption of the Federal Law No. 335-FZ of 28.11.2011 “On the investment partnership”, which established rules for participation of the Russian legal entities and individuals, as well as foreign participants in the partnership without establishing a legal entity, whose objective is the implementation of joint investments in securities (shares, participatory interest), financial instruments, relevant amendments were made to the Tax Code. These changes have been made by the Federal Law No. 336-FZ of 28.11.2011. In particular, it is stipulated that each party to the agreement of the investment partnership unilaterally performs his liabilities in regard to profit tax, tax on personal income, arising in connection with his participation in this partnership. Managing partner is acting as a tax agent for income of foreign participants in the partnership. Income of foreign citizens from participating in an investment partnership is attributable to the income from sources in Russia. Managing partner tax is responsible for accounting in the manner prescribed by Chapter 25 of the Tax Code “On Profit Tax”, the presentation of the financial results of partnership, for reporting on the opening of accounts of the partnership. He has also to provide information to other partners about revenues received and distributed costs of the partnership (by type of investment in securities and financial instruments) in proportion to the contributions of partners. In general, the developed scheme fully complies with the Tax Code, taxation on profit and personal income tax applied to revenue from private investments in securities and financial instruments, and investment company under the Tax Code is reasonably regarded as a form of collective investment (herewith, the remuneration of Managing Partner, as well as its costs of managing the investment partnership are non-taxable, as they reflect an internal relocation of revenues and costs and do not affect the overall tax base of the investment partnership).

With regard to VAT, payment for services Managing Partner is exempt from VAT, as well as contributions of members of investment partnership agreement and the distribution of the shares of common ownership of the partnership (in proportion to the amount invested by each partner). Managing Partner has the right to independently decide, whether to account the input VAT on the costs of the partnership or apply for an offset (refund). Otherwise, common VAT rules established for a simple (not investment) company are applicable.

There is an enforcement mechanism for tax violations in regard to funds in the accounts of the investment partnership Management Partners, other partners, the mechanism of foreclosure on their property, the mechanism of suspension of transactions with the accounts, the mechanism of property seizure, etc.

9. Federal Law No. 339-FZ of November 28, 2011 introduced technical clarifications in a number of laws governing special accounting procedures, taxation, payments of insurance premiums to the state extrabudgetary social funds for the residents of “Skolkovo” innovation zone. The general trend is to give a more explicit wording in the Law that the tax incentives are limited to participants of the projects, not just area residents. In addition, some items are refined, for instance, such point as the obligation to restore the income and pay tax on the profit for the period in which the withdrawal of the participant from the project occurred, is supplemented by an indication that a similar scheme is used when the party’s income for some period reached Rb 300m. Participants of the project “Skolkovo” applying accounting of income and expenditures under the simplified system, keep accounting of income and expenses on a cash basis without an overall limit, allowing a simplified system only in cases where the marginal revenue from sales (VAT excluded) does not exceed Rb 1m for each of the four preceding quarters. Technical details are specified in the legislation on payments to the state social extrabudgetary funds as well. ●

CHANGES IN THE NORMATIVE BASE OF BUDGETING

M. Goldin

In November–December 2011, the following changes took place in the normative base of budgeting: state academies of sciences have been granted the right to carry out on behalf of the Russian Federation the authorities of founders of state unitary enterprises and state institutions; due to a lack of financing realization of individual provisions of the legislation of the Russian Federation in the period of from January 1, 2012 till January 1, 2015 is suspended; such amendments have been introduced in the Federal Law on the Fund for Facilitation of Restructuring of Housing and Public Utilities as specify the terms and procedure for provision of the financial support to constituent entities of the Russian Federation at the expense of resources of the Fund for Restructuring of Housing and Public Utilities; a simplified procedure for transfer of unutilized real property of the Ministry of Defense of the Russian Federation into the ownership of Moscow, St. Petersburg or municipalities has been established.

Federal Law No. 291-FZ of November 6, 2012 on Introduction of Amendments to Individual Statutory Acts of the Russian Federation as Regards the Activities of State Academies of Sciences and Entities which are Under Their Jurisdiction grants state academies of sciences the right to carry out on behalf of the Russian Federation the authorities of founders of state unitary enterprises and state institutions.

The function of keeping of registers of federal property which is transferred to state academies of sciences, as well as that of keeping of lists of entities which are under the jurisdiction of state academies of sciences are attributed to the authorities of the Government of the Russian Federation. In addition to the above, in accordance with that law state academies of sciences have been granted the right to carry out on behalf of the Russian Federation the authorities of owners of federal property vested in them, including the authorities as regards changing of the type of state institutions which are under their jurisdiction, vesting of property in entities which are under their jurisdiction, appointing of managers of such entities, entering into and termination of labor agreements with such managers and approval and amendment of articles of incorporation of entities which are under their jurisdiction.

Federal Law No. 301-FZ of November 6, 2011 on Suspension of Individual Provisions of Statutory Acts of the Russian Federation Due to the Federal Law *on the Federal Budget in 2012 and the Planning Period of 2013 and 2014*, Recognition as Null and Void of Individual Provisions of Article 2 of the Federal Law *on Amendment of Article 31 of the Federal Law on Introduction of Amendments to Individual Statutory Acts of the Russian Federation* and Suspension of Individual Provisions of Statutory Acts of the Russian Federation Due to the Federal Law *on the Federal Budget in 2011 and the Planning Period of 2012 and 2013* suspends due to a lack of financing realization of individual provisions of the legislation of the Russian Federation in the period of from January 1, 2012 till January 1, 2015.

In particular, financing of expenditures of the federal budget has been suspended as regards the following:

- transfer of individuals' insured savings into purpose debt instruments of the Russian Federation;
- in the sphere of culture as regards assignment of authorities related to preservation of cultural heritage projects which are in the federal ownership;
- in the sphere of physical culture and sports as regards assignment of authorities of the Russian Federation related to execution and maintenance of sports passports to state authorities of the constituent entities of the Russian Federation due to the fact that realization of legal provisions will require establishment of the specialized information system and implementation of the entire complex of organizational measures.

Federal Law No. 350-FZ of November 30, 2011 on Amendment of Federal Law *on the Fund For Restructuring of Housing and Public Utilities* specifies the terms and procedure for provision of financial support to constituent entities of the Russian Federation for the purpose of restructuring of housing and public utilities.

According to amendments, constituent entities of the Russian Federation are in a position to submit applications for financial support from the Fund for Facilitation of Restructuring of Housing and Public Utilities (hereinafter, the Fund) until June 1, 2012. Earlier, such deadlines for submission of such applications did not exist and were determined by regions at their own discretion.

The previous wording of the Federal Law on the Fund for Facilitation of Restructuring Housing and Public Utilities included a requirement on correspondence of the number of apartment houses where overhaul repair is to be carried out to the planned number of such houses set in regional target programs which realization was financed from the Fund until December 31, 2010. The above requirement was recognized too tough as reduction in the number of apartment houses in which overhaul repair was actually carried out could result in passing of a decision on suspension of financial support from the Fund. Federal Law No. 350-FZ determined that the number of apartment houses which are subject to overhaul repair at the expense of the Fund can be reduced as a result of the following:

- passing by the general meeting of members of the condominium, housing cooperative, cooperative housing society or other specialized consumer cooperative or owners of premises at the apartment houses of a decision on refusal to participate in the respective regional target program on overhaul repair;
- recognition as null and void of the decision on participation in a regional target program;
- failure by the general meeting of members of the condominium, housing cooperative, cooperative housing society or other specialized consumer cooperative or owners of premises at the apartment houses to pass a decision on shared financing of overhaul repair of the apartment house and approval of the budget estimate of the overhaul repair of the apartment house.

In addition to the above, Federal Law No. 350-FZ has determined the procedure for redistribution in 2012 of balances of the unutilized limits of financial support from the Fund which limits are set in respect of constituent entities of the Russian Federation.

Federal Law No. 423-FZ of December 12, 2011 on the Procedure for Compensation-Free Transfer of Military Property into Ownership of Constituent Entities of the Russian Federation – Federal Importance Cities of Moscow and St. Petersburg and Municipalities and Introduction of Amendments to Individual Statutory Acts of the Russian Federation has established a simplified procedure for transfer of unutilized real property of the Ministry of Defense of the Russian Federation into ownership of Moscow and St. Petersburg or municipalities.

According to the above amendments, the real property which is not utilized for military purposes is subject to a compensation-free transfer into ownership of Moscow, St. Petersburg or municipalities.

Under the amendments, the above property includes buildings, structures and projects whose development is not completed (except for such buildings, structures and projects whose development remains unaccomplished as are needed by federal state authorities for fulfillment of powers related to the defense and security of the state) as well as land plots (including unbuilt land plots) which are situated:

- 1) within the limits of garrisons (except for closed garrisons);
- 2) within the limits of land plots used for support of activities of the armed forces of the Russian Federation, other forces, military formations and bodies and institutions, enterprises and entities which carry out functions related to the defense and security of the state if on such land plots there are facilities (including those whose construction is not completed) in which living quarters of the above armed forces, military formations and bodies and institutions, enterprises and entities are situated. It is to be noted that the borders of garrisons are the borders of land plots used for deployment of respective military units (detachments), forces, military educational establishments of higher professional education, other entities of the armed forces of the Russian Federation, internal security troops of the Ministry of the Interior of the Russian Federation and state security bodies.

A simplified procedure has been introduced because the general procedure for transfer of the military property to municipalities is rather complex. In particular, if the land plot is utilized on a permanent (termless) basis by a state entity which is under the jurisdiction of the Ministry of Defense of the Russian Federation the above state entity is required first to give up its right to permanent (termless) utilization of that land plot, and then such a land plot is transferred to the treasury of the Russian Federation. After that, the land plot is assigned into ownership of a municipal establishment. In addition to the above, in cases where the borders of the land plot are not determined in cadastral accounting, nor does exist there a state registration of the title of the RF to that land plot, or the data on registration of that land plot is missing in the Unified State Register of Titles to Real Property and Transactions with It the procedure for giving up the right to permanent (termless) utilization of the land plot may be rather complicated. In accordance with Article 53 (3.1) of the Land Code of the Russian Federation, for securing a decision on termination of the right to permanent (termless) utilization of the land plot the Ministry of Defense needs the following documents:

- a copy of the document which certifies the state registration of the legal entity;
- cadastral passport of the land plot (in case there is such a data in the state cadastre of the real property on the land plot as is required for issuing of the cadastral passport of the land plot);
- documents which certify the title to land, while in case of absence thereof, a copy of the resolution of the state executive authority which has the relevant powers to provide a land plot.

In accordance with Federal Law No. 423-FZ, absence of the state registration of the title of the Russian Federation to the military real property and (or) absence of state accounting of such property and absence of such borders of the land plot as are determined in compliance with the legislation of the Russian Federation is not an obstacle to passing of a decision on the compensation-free transfer of the military real property from the federal ownership to the ownership of the constituent entity of the Russian Federation, that is, the cities of federal importance – Moscow and St. Petersburg – or municipalities.

Decision on transfer of property is taken by the authorized federal executive authority operating in the sphere of management of the property of the armed forces of the Russian Federation, internal security troops of the Ministry of the Interior of the Russian Federation or the state security bodies.

Registration of the assignment of the title to the property will be carried out without application of the possessor of the right within 10 days from the day of receipt of the relevant decision. ●

ANALYSIS OF UNIFIED TAX ON IMPUTED INCOME IMPLEMENTED FOR CERTAIN ACTIVITIES (UTII)

M.Esipova

Before the crisis, in the absence of budget deficit, the key challenges of tax system were two seemingly contradictory issues: improving tax collection and reducing tax burden. These very objectives can be traced in the elaborated concept of the unified tax.

For the first time this system of taxation was introduced by Federal Law No. 148-FZ of July 31, 1998 “On the united tax on imputed income for certain types of business activity” (hereinafter – the Law No. 148-FZ).

This system was characterized by the fact, that tax payment was based on a special document – a certificate. Imputed tax is estimated as potential gross income of the taxpayer, less potentially necessary expenses, assessed with the account to the totality of factors that directly affect the receipt of such income, based on the data, obtained through statistical studies, audits of tax and other government agencies, as well as independent organizations’ assessments.

Opportunity to pay a united tax on imputed income, as well as the tax rate, was made dependent on adoption of special legislation by the relevant Subjects of the Russian Federation. Only tax assessment formulas were recommended at the federal level¹.

With the introduction of the Law No. 148-FZ applied to this tax regime, a taxpayer’s right to choose, whether to pay united tax or use a different system of taxation for was excluded.

The transition to the united tax for specific activities defined by the law becomes a liability, and perhaps provides a doubtful advantage of this special tax regime. Activities defined by the Law for UTII taxation are primarily related to the provision of services, i.e., to the end users. Consequently, in accordance with the regime, the most uncontrolled types of activities, primarily due to the use of cash payments for work performed and services rendered were subject to taxation. Therefore, we can conclude, that this regime is intended primarily for small businesses. In addition, quantitative criteria – the maximum number of employees was introduced for specific types of activities.

Due to the need to administer difficult to control activities, the following approach was adopted: Subjects of the Russian Federation have been granted the right to determine the average and the potential income of taxpayers, depending on the type of their activity.

With the adoption of the Federal Law No. 104-FZ of July 22, 2002, the Chapter 26.3 of the Tax Code of the Russian Federation (hereinafter – the RF Tax Code) was brought into effect.

The legislator has not fundamentally change the concept of the special tax regime, but has tried to take into account some shortcomings, that have become apparent with the enforcement of the Unified tax on imputed income.

Payment of united tax by businesses implied their exemption from the liability to pay corporate income tax, property tax and unified social tax.

For individual entrepreneurs the unified tax replaced the tax on personal income, personal property tax and unified social tax.

The right to determine the average size of the basic profitability was transferred to the federal level, and the factors that affect the amount of tax have been identified at the federal level as well. Tax payment on the basis of the certificate was canceled.

However, a similar procedure for payment of tax on the basis of a fiscal approval re-emerged in 2006 with the entry into force of the Federal Law No. 101-FZ of July 21, 2005, which introduced the possibility of tax payment, associated with the use of the simplified tax system (hereinafter – STS) on the basis of a patent.

¹ Letter of the RF Government No. 4435p-P5 of 07.09.1998 “On the recommended formula for calculating the amount of the unified tax and a list of recommended constituents”.

This system was introduced only for individual entrepreneurs with the number of employees not exceeding 5 people.

The patent system is used for certain activities and it should be noted, that their list is duplicated by consumer services, subject to the UTII payment, although there is no term of “consumer services” in Art. 346.25.1 of the Tax Code.

The amount of annual income potentially to be obtained by an individual entrepreneur is established by the laws of Russian Federation for each type of business activity, in which individual entrepreneurs are allowed to use UTII on the basis of a patent. At the same time, there is differentiation of annual income, taking into account the nature and place of business activity. The amount of the potential annual income is also subject to annual indexing by the deflator factor.

Therefore, a return to the patent system was made.

However, evaluating the legislative initiative under review, it should be noted, that this system, in fact, duplicates the UTII by types of activity and by mechanism of tax assessment. The difference lies in the voluntary of tax payment on the basis of patent, as opposed to UTII, in the requirements for taxpayers and the tax rate – the rate for patents is 6% of potential earned income, as opposed to UTII, for which the rate at 15% has been established.

Therefore, we can presume that the legislator has introduced another tax regime in addition to small businesses, different tax terms for microenterprises.

With the introduction of the patent system of taxation the Russian Federation Subjects were required to review the possibility of using one of the tax systems, as an imputed liability (UTII) and innovation system (patent when applying STS) provides the right of a choice.

Federal Law No. 95-FZ of July 29, 2006 has brought into effect changes, according to which the decision on implementation and other terms of tax system in the form of UTII were made from January 1, 2007 by representative bodies of municipalities, municipal districts, the legislative (representative) government authorities in Moscow and Saint-Petersburg, the cities of federal significance.

Although UTII is not an estimated, but imputed tax, not dependent on the actual amount of revenues and expenditures, the responsibility for business accounting for taxpayers applying it has been preserved.

The said Law has provided an opportunity to change the basic profitability amount from 0.005 to 1, i.e., according to decision of municipal authorities, the tax amount can be changed by adjusting factor of basic profitability by 200 times. Earlier the minimum factor was only 0.01. Amendment of allowable values of the adjusting factor was due to a more objective assessment of seasonality, type of activity, specifics of business location, the range of goods can made at the municipal level, which reduces the distance between taxpayers and the authorities that determine their tax rate.

However, most of the representative bodies of municipalities interested in replenishment of the budgets at their level, taking advantage of the new law, are setting the maximum adjusting factor of basic profitability. Unfortunately, the fiscal interest was accompanied by the absence of objective analysis of consequences of adopted innovations, designed to ensure fair taxation, depending on various conditions of doing business.

As a result, the tax burden continued to be estimated not on income principle, with regard to the entrepreneurs’ characteristics and perceptions about the potential benefits, subjectively estimated by the legislator.

It can be assumed, that the legislator considers that one can assess the specifics and difficulties of doing business at the local level with greater accuracy and in future promptly and adequately respond to these conditions. However, the legislator has made no provision for review and approval of decisions taken by the municipal authorities of the Russian Federation to create common legal and economic environment in the region.

Perhaps in response to the established in Article 3 of the Tax Code principle of equal taxation, the Subjects of the Russian Federation should have defined the values of adjusting factor of basic profitability on the basis of calculated formula. Therefore, the UTII taxpayers would be in a better position in terms of legal protection, if the value of the fixed factor would be economically unjustified.

Moreover, with the Federal Law No. 101-FZ of July 21, 2005 adoption, the decision on the adjustment of the basic profitability depending on the cadastral value of the land at business

location was abolished. The decision was based on the fact that the factor determining this value did not contribute to solving the problem of equalizing the tax burden, but rather complicated the UTII calculation technique.

At present, a special tax regime in the form of UTII provides general rules for the system of taxation at the federal level, but it tries to take into account the federal structure of Russia and different economic conditions in each municipality.

In the post-crisis period the need to create incentives for economic growth through tax benefits (i.e., tax reduction for the overall economy or its individual sectors) has been questioned¹.

Among the acute and short-term problems, there has been identified simplification of taxation and mechanism for its collection.

As a result, from 2012, according to the draft federal law “On Amendments to Article 18 of Part one, Part two of the Tax Code of the Russian Federation and Certain Legislative Acts of the Russian Federation and the Abolition of Certain legislative acts (provisions of legislative acts) of the Russian Federation” (hereinafter – the Draft Law) there will be further amendments to the UTII.

According to the key trends in tax policy of the Russian Federation in 2012 and the planned period of 2013 and 2014, a gradual abandonment of the tax system in the form of a united tax on imputed income and the development of the patent system of taxation will be performed.

Under the Draft Law the simplified taxation system for individual entrepreneurs on the basis of a patent is proposed to be specified in a separate Article of the Tax Code, “The patent system of taxation”, which will be introduced by the laws of the Subjects of the Russian Federation.

The list of business activities in respect of which the patent system can be used is cut down.

Thus, since January 1, 2013 the following activities will be excluded from the list of business activities that can be transferred to pay the united tax:

- retail trade in stores and pavilions with floor area not exceeding 150 sq. m for each trading facility;

- catering services provided through facilities with an area for visitors’ services not exceeding 150 sq. m for each catering facility.

For these types of business activities from January 1 to December 31, 2012 a limit on the average number of employees of 50 persons is established.

Laws of the Subjects of the Russian Federation will also determine the amount of potential individual entrepreneur’s annual income by type of businesses being transferred to the patent system of taxation, within the minimum (Rb 100,000) and maximum (Rb 500,000) sizes.

Thus, the experience of more than a decade of UTII did not give a clear understanding of what should be the system: should the key indicators of the tax burden be identified by the Subjects of the Russian Federation or by municipalities.

There is also provided an annual indexation of restrictions on the coefficient-deflator.

Transfer to the patent system of taxation will be carried out voluntarily, and the patent will be issued at the option of taxpayers for the period from 1 to 12 months within the calendar year.

The tax rate will remain at 6 percent. Taxpayers may be individual entrepreneurs employing 10 people with an annual turnover of up to Rb 60m, i.e., the number of employees that may be involved by an individual entrepreneur is doubled as compared with the current system.

Taxpayers of the patent system will be exempt from submission of tax returns to the tax authorities. At the same time, they will be obliged to keep accounting for revenue from the sales in the ledger of income to be submitted to the tax authorities when payment of the balance cost of the patent is due.

The Draft Law provides that individual entrepreneurs, who are taxpayers of the patent system of taxation, may make cash payments and (or) settlements using a payment cards without the use of cash registers, subject to issuing at the request of the buyer (client) a document (sales receipt, a receipt or another document), confirming the acceptance of funds for the relevant goods (works, services).

Therefore, the new system not only reduces the tax burden compared to the tax regime in the form of UTII, but makes the regime more simple in terms of monitoring and enforcement by:

- the abolition of duties on filing returns;

1 “Key trends of tax policy of the Russian Federation for 2010 and for the planned period of 2011 and 2012”.

– reduction of tax accounting, as UTII application does not exempt from the obligation to keep accounting in full.

According to the Ministry of Economic Development position, reflected in the letter No. D05-1013 of 06.04.2011¹, the purpose of the Draft Law are tax incentives for small business development through improving the simplified tax system based on the patent for individual entrepreneurs and the elimination of the internal contradictions in the application UTII and STS. However, it is also noted that during the period of 2012-2014 the patent system of taxation and a united tax on imputed income will be applied at the same time.

This approach, according to the Ministry of Economic Development of Russia, will allow to review the use by taxpayers of the patent system of taxation and the unified tax on imputed income during the transition period, to assess the dynamics of transition from a taxpayer to another tax system and, if necessary, to revise the timeframes of the abolition of the unified tax on imputed income for individual entrepreneurs.

Thus, the legislator does not feel absolute confidence in the correctness of the proposed changes. Businesses demonstrate different reactions to the Draft Law².

Statistics show that employers support the patent system: the number of those transferred to the patent system over the preceding 3 years increased by 10 times.

One cannot insist that such growth was due to reduction in the number of UTII taxpayers – reduction is indeed observed, but insignificant, and it is most likely due to the closure of a number of companies in crisis.

Furthermore, the number of taxpayers who use UTII, in 2010 still amounted to more than half of all taxpayers, applying special tax regimes – 2.77m, while there are 2.2m of STS taxpayers, and 0.131 of Single Agricultural Tax payers³.

As noted earlier, the main advantage of the patent system of taxation is lower than UTII tax rate. Furthermore, the purchase of a patent for a certain period (12 months) significantly reduces the cost of accounting and reporting.

Despite the fact that UTII is paid basing on the profitability, imputed by the legislator, the payers applying this system of taxation are not exempt from the obligation to keep accounting in full. For taxpayers who use STS, including on the basis of the patent, such responsibility is preserved in respect of income and expenditures, as well as intangible assets.

Thus, the patent system is more simple in terms of tax accounting and less burdensome in terms of the tax burden.

Apparently, this is not the only reason that prompted the legislator to change the approach to the taxation of small businesses. Other reasons include the following:

1. Application of the tax system in the form of UTII for certain types of activities allows business entities to minimize tax liabilities. This is true for retail, catering services, where the real tax burden is assessed, for example, for SST, where the tax is much higher on the income actually received, rather than with application of imputed tax UTII.

As to restrictions in the number of workers involved and the area of trade halls, catering halls area – perhaps this could be avoided.

2. As already noted, at the municipal level the right to set the factor of the basic profitability, the situation in the level of taxation depending on the location of business is questionable. Where a policy of supporting small business is pursued, the authorities are interested in creating a favorable tax regime, and set minimum factors. In those municipalities where the basic rate has been aimed at increasing tax revenues, maximum rates have been set. As a result, the taxation level was significantly different across the country.

3. The adoption of the Draft Law will eliminate duplication of the two tax systems: STS and UTII.

Now the imputed tax in the form of a patent will be valid only for very small businesses engaged primarily in services provision to final consumers, are the most difficult to control.

After the complete abolition of UTII there will be only STS, which, based on established criteria in terms of income, can be called a system of taxation of small businesses.

1 ConsultantPlus Reference System.

2 <http://opora.ru/analysis/discussions/440/1427/>

3 www.nalog.ru

Speaking about the advantages of the new tax system, one should note some possible negative consequences.

1. With the abolition of UTII, patent taxation will be impossible for such activities as retail trade and catering, if the sales area exceeds 10 m². This will force many of the small and medium-sized businesses to move to a common system of taxation, or STS.

However, in this case the use of a common system of taxation would need to establish the accounting department, the implementation of tax and financial accounting.

USN is rather liberal system of taxation, but restrictions on revenue and turnover make it suitable only for small businesses. Business development, increasing the volume of sales within this system is impossible, as well as the implementation of activities in the industrial sector (due to the impossibility of making VAT offset with contractors who use a common system of taxation).

One of the ways out is to increase the threshold revenue for individual entrepreneurs and organizations up to Rb 400m per year. This is the amount of proceeds from the sale of goods (works, services) for the preceding year, less value added tax preset for small businesses¹.

2. In view of the increasing cost of doing business associated with changes in the tax system, the cost of commercial services to the population may increase, which were previously decreased under the UTII taxation.

3. One of the drawbacks of the proposed tax system is its “presumptive nature” and inconsistency of the objective level of solvency and profitability of business with understanding of such indicators of the legislator.

In this regard, it is expedient to recommend to the legislator to establish at the federal level:

- common approach to assessment of the basic profitability;
- common approach to setting the factor of basic profitability.

4. In connection with the abolition of the right to use UTII legal entities also lose the right not to use cash registers, which has long been a subject of disputes between employers and tax authorities, but it will also cause an increase in costs due to the need to purchase such equipment, its registration and maintenance.

Based on the analysis of UTII application in the Russian Federation, one can say that the frequent and rather radical changes in UTII application are not the result of thoughtful decisions made in pursuit of development objectives of small business segment.

On the contrary, one more Draft Law is aimed exclusively at supporting microenterprises. For small businesses (in the meaning of the Federal Law No. 209-FZ of 24.07.2007 “On the development of small and medium enterprises in the Russian Federation”) the tax burden will be increased. The discrepancy between the criteria for small businesses in the tax laws and in the legislation that defines the system of state support, also demonstrates that there is no uniform policy to support small business. ●

¹ RF Government Resolution No. 556 of 22.07.2008 “On the limits of proceeds from the sale of goods (works, services) for each category of small and medium-sized businesses”.