



RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES

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MONTHLY BULLETIN:

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RUSSIAN ECONOMY IN JANUARY 2012: PRELIMINARY DATA AND MAJOR TRENDS

Political Background: in Expectation of a Victory that Feels like Defeat

In January 2012, despite New Year's celebrations and holidays, the political situation in Russia remained rather tense. These tensions were caused, on the one hand, by the start of the final stage of the election campaign, while on the other hand by the Opposition's announcement that some further mass protest rallies of its supporters would be held in early February. All their liberal inclinations notwithstanding, the draft laws on political reform introduced into the State Duma as a result of Dmitry Medvedev's initiative look to be rather half-hearted, incomplete and quite contradictory from a legal point of view. Therefore it is unlikely that they will be able to satisfy and calm down the Opposition. Thus, the draft law on gubernatorial elections still mentions 'the President's philter' and the possibility that a governor can be dismissed by the President on the arbitrary pretext that the former 'has lost the confidence' of the latter.

The energetic pro-Putin campaign in the state and quasi-state mass media has managed to temporarily curb the decline of his approval rating but has failed, so far, to instigate its growth. Although public opinion polls indicate that Putin's victory in the first round can indeed be possible, it should be borne in mind that the results of such polls prior to the State Duma elections were systematically and considerably tampered with in favor of the 'regime'. The dismissals of the governors and the heads of the electoral committees of those regions where United Russia had a poor showing in the State Duma elections (meaning an insufficiently high level of falsifications) bear witness to the authorities' intention to make full use of administrative means in order to ensure a 'convincing victory' for Putin.

Both analysts and investor funds are skeptical about the outcome of the current political situation in Russia – they believe that political risks are coming to the fore. It is beyond doubt that Putin will win, but this certainty does not eliminate these risks and negative expectations: Putin's legitimacy will be low, the official results will be contested by the Opposition, and the newly elected president's approval rating will most likely continue to decline in the aftermath of the election. Putin's weakened legitimacy will drastically impinge on the ability of this new 'old' president to carry out sound economic reforms and will push his economic policies towards populism, thus seriously undermining Russia's macroeconomic situation. Putin's electoral economic policy statements leave the audience with mixed feelings, because they set forth mutually exclusive goals and tasks, and utterances in favor of improving Russia's business climate coexist with some blatantly dirigiste ideas. Skepticism with regard to the post-election development of the situation is further increased by the 'Medvedev problem'. Dmitry Medvedev has been promised the post of Prime Minister, but many important bureaucrats and businessmen believe that he will not manage to create even a functional government, let alone an efficient one, that will be capable of resisting a second wave of the crisis, the reality of which is becoming increasingly likely.

Macroeconomic Background: Entangled in Contradictions

In January, the macroeconomic situation in Russia was determined by super-high oil prices, the continuing problems in the Eurozone, and low domestic inflation. Brent crude oil prices, that had already been close to their peak levels, now rose by 3.7% on December (from \$ 107.5 to \$ 111.5 per barrel). The second important trend of January was a considerable strengthening of the ruble against the currency basket (in January, the value of the bi-currency basket decreased from Rb 33.46 to Rb 34.69), the dollar and the euro. This rise of the ruble had a positive effect on the behavior of the stock market: the MICEX Index grew by more than 100 points (from 1,402 points as of 30 December to 1,514 points as of 31 January).

Inflation was only 0.5% in January (against 2.4% in January 2011). However, this achievement was partly artificial: the restrained growth rate of prices had been determined by the politically

motivated postponement of the annual indexation of tariffs on services provided by natural monopolies until the spring and summer of 2012. In annual terms, inflation is still hovering around ten-year lows (6.1%). However, to a considerable degree, this result has been achieved due to the high inflation levels of last year's autumn and winter; by the summer of the current year, the said base effect will be exhausted. The forthcoming indexation of regulated prices and the exhaustion of the base effect can significantly accelerate the current rate of price growth.

On the whole, the rate of inflation still fluctuates too widely to pronounce that Russia's inflation has become persistently low or to expect a systemic effect from its decline. It should be remembered that in the summer of 2010 the annual inflation rate stood at the level of 6% and lower, while from January to April 2011 it reached almost 9%, and returned to the level of 6% only by December 2011. In the next few months the rate of price growth will remain at the current level, or even dwindle further. However, towards summer it will go up again, thus making it rather difficult for the RF Ministry of Economic Development's forecast of a 5 to 6% inflation rate to materialize. A considerable role in reducing the rate of price growth in the course of 2011 was also played by a sharp drop in the rate of growth of the monetary base in a broad sense: in 2011, Russia's monetary base in a broad sense increased by 5.5%, to Rb 8,644.1bn (while in 2010 it had grown by 26.6%). This deceleration was primarily caused by a substantial rise in the residual balances in the RF Government's accounts with the Bank of Russia.

The liquidity problems in the banking sector that began in the summer of 2011 had a significant impact on the excess reserves of Russian banks: over the year, correspondent accounts declined by 1.3% and deposits – by 1.6 times, while credit institutions' investments in bonds issued by the Bank of Russia dropped to zero. Although in late 2011 the situation more or less stabilized, it is still not certain whether the liquidity crisis has been overcome. The positive dynamics of the excess reserves of the banking sector can be explained by the traditional rise in budget expenditures at the end of a year. The situation in the money market is better judged by analyzing the liquidity position of Russia's banks, which became negative in the autumn of 2011 – for the first time in two years, and has remained in that condition ever since. As early as January 2012, the beginning of the tax payment period and the necessity to repay debts to the RF Ministry of Finance revived tension in the liquidity market. And there are two more important indicators that a new round of tension has already begun – the demand of Russian banks for the RF Ministry of Finance's funds within the framework of deposit auctions surpasses the available supply, and the demand of banks for repo transactions is currently very high.

In January, final data on capital outflows from Russia in 2011 were released. Net capital outflow from Russia amounted to \$ 84.2bn, thus dwarfing even the most pessimistic forecasts of the RF Central Bank (that had been regularly adjusted upwards throughout the year). In Q4 2011 alone, \$ 37.8bn was withdrawn from Russia – a sum that is greater than that withdrawn over the whole of 2010 (\$ 33.6bn). Capital outflows from the non-financial sector rose almost three-fold (to \$ 30.3bn), while capital outflows dwindled (to \$ 7.5bn). The rise in capital outflows from the non-financial sector in Q4 resulted both from the arrival of the peak period of Russian companies' external debt repayments and from a climb in economic and political risks.

The Real Sector: A Growth through Credit

Data of the entrepreneur confidence index for January 2012, released by Rosstat, indicate that although business executives' assessments remain in the negative territory, they have slightly improved on December 2011. However this phenomenon is purely seasonal in nature; when cleared of the seasonal factor, some improvement (to the zero values of the balance) can be observed in processing industries, but not in extracting industries.

The business opinion surveys carried out by the Gaidar Institute in December 2011 also indicated that the downward dynamics observed in late 2011 were gradually giving way to stagnation or a slight rise in optimism. In conditions of dwindling demand, industry restrains production growth, accurately manages stocks of finished products, and continues to cut prices and sack workers. The growth rate of sales has managed to climb up only to the zero level after a two-month-long plunge in sales, the intensity of which was record-high for 2010 and 2011. In December, demand forecasts remained unchanged at a two-year low level with regard to initial data and at their lowest level

since May 2011 with regard to data cleared of the seasonal factor. A sharp drop in the optimism of sales forecasts took place in September, with the beginning of a new round of Europe's debt problems.

In Q4 2011, the majority of industrial enterprises (57%) assessed the volume of investments as normal (vs. 48% in December 2010). Nevertheless, this rise in satisfaction with the volume of investments coexists with a rise in the estimates of redundant production capacities: in Q4 2011, the percentage of such capacities increased to 20% of the total, while the balance of capacity assessments (more than adequate minus less than adequate) reached 11 points vs only 5 points at the beginning of 2011.

According to preliminary data released by the RF Ministry of Economic Development in January 2012, the rate of GDP growth in real terms in 2011 amounted to 104.3%. The accelerated dynamics of GDP growth has been registered since the second half of 2011. It has been determined by a rise in investment and consumer demand.

In the first half of 2011, GDP growth was sustained by both the favorable situation in the world raw materials market and the growth of consumer demand. It should be borne in mind that, in 2011, oil prices rose by more than 30% on the previous year. This led to a 30% rise in the value of exports. In the second half of 2011, the acceleration of GDP dynamics was determined by its structural components: under the influence of the base effect, both the growth rate of investment in fixed assets and the growth rates in construction and agriculture production experienced a greater acceleration than they did in the corresponding period of 2010.

Set against the backdrop of a decline in the growth rate of wages and that of the real income of the population (they grew only by 0.8% in 2011 vs. by 4.2 in 2010), both the growth in demand and the rise in retail turnover registered in 2011 were based on a reduction in the savings rate of the population and an increase in consumer credit: credits granted to physical persons in December 2011 amounted to R. 5,176.6bn, representing a 1.31-times rise on December 2010. However, there arises a question: can such a situation be sustained for yet another year? If the answer is negative, the result may be a stagnation of consumer demand, which will have an adverse effect on the industrial growth rate. At the same time, in 2010 and 2011 investment in fixed assets grew at a relatively low rate: in 2011, the growth rate of investment in fixed assets rose by 6.2% on 2010, while the share of investment in GDP stood at 18.1%.

Thus, although it can be said that in 2011 the Russian economy generally overcame the consequences of the economic crisis, the unstable behavior of the main macro-indicators and the slow rate of the recovery of the investment sector impose a number of limitations on Russia's short and medium-term economic development. ●

POLITICO-ECONOMIC RESULTS OF JANUARY 2012

S.Zhavoronkov

In January of 2012 there was defined the list of participants of the election campaign: in addition to the parliamentary parties nominated by Putin, Zyuganov, S. Mironov and V. Zhirinovskiy, it included just registered and collected 2 million signatures M.Prokhorov, while G.Yavlinsky, the leader of non-parliamentary party "Yabloko" registration was rejected. Refusal to register Yavlinsky, who is popular in the capital cities, as well as massive replacement of the local election commissions which did not demonstrate good results in favor of "United Russia" in December, indicates that the Russian authorities have a direct objective to gain Putin's victory in the first round of elections. The opposition, including its non-parliamentary group, still has not developed a unified strategy for the election of March 4, 2012, which increases the chances of Putin's success. Submission to the Parliament of the last two draft laws for liberalization of political system - election of governors and the State Duma elections is announced. As a result, the system of elections to the State Duma is virtually unchanged, and the election of governors is supplemented by the ability of voluntary dismissal of the elected governors by the President of Russia.

In January 2012 the last two of the four draft laws promised by the Russian authorities after massive protests in December 2011 were published: a draft law on requirements reduction to the number of political parties-participants and the number of signatures in support of presidential candidate were supplemented with the draft laws on the election of governors and deputies of the RF State Duma.

Election of governors will have roughly the same form in which they existed prior to their abolition thereof in 2004, candidates for governor will be offered by political parties (without signatures collection), and by citizens who will have to collect signatures in the amount established by regional law. Regional legislation will also set the election procedure (in one or two rounds) and the term of office (not more than 5 years). However, relatively free from the legal point of view, the procedure for electing the governor is counterbalanced by two very serious limitations of citizens' rights. The draft law preserves the existing today right of the President of Russia to dismiss the Governor from office on the basis of the "loss of the President's confidence", which occurs when corruption and the unresolved conflict of interest are "detected". Herewith, the President of Russia on his own "detects" such facts on the basis of self-understanding, and he also appoints the Acting Governor for the period before new elections (up to 2004 there was a possibility of the governor dismissal from office through the court, but in this case his deputy became an acting governor). Therefore, although the governor cannot be appointed directly, he has every incentive to obey the political demands of the President. Another very serious pitfall is a transitional provision, under which appointed governors shall hold office until the expiration of the old law. Thus, for example, three new governors (I.Orlov in Arkhangelsk region, O.Kuvshinnikov in Vologda region and S.Bozhenov in Volgograd region), appointed last month instead of their predecessors, removed for poor rating of "United Russia" in the elections, obtained the electoral mandate without any elections for a period comparable with the powers of the new parliament. Moreover, there is a risk of a massive governors replacement before the entry of the draft law into force, which would make the elections of governors a distant future (which, as it approached, can be postponed again, and so on).

The last draft law published was the law on the State Duma elections. This law has been associated with exciting expectations - there were rumors about the introduction of exotic two-mandate system with 225 local districts, the lists of candidates were to be nominated by the political parties (this system would allow a number of districts with sufficient gap of the first list from the second one, to pass both mandate to the winner and most importantly, would make no sense to take any place in the election, except for the first and second, which would be ridiculous in regard to the very idea of proportional voting). However, in the end, the law has undergone

minimal changes compared to the currently effective procedure. 225 districts have turned into 225 baskets in the lists of each party - that is, the number of baskets was increased several times as compared with the today minimum. In this case, the top of the list is eliminated altogether. The distribution of seats is made between the parties which cross the 5% threshold throughout Russia. The parties failed to overcome the 5% threshold (even if they won in some of the regional baskets) lose their votes, which are redistributed among the parties which have overcome the 5% threshold, and then among the regional lists of these parties, like now, by the absolute number of votes.

Assessing such a system in a nutshell, we can say that it is in the interest of those who have a strong regional structure (primarily the “United Russia” and “Fair Russia”), and creates the maximum threat to the LDPR, where there is the highest risk in voting for the party leader - now he can enter his name only in one of 225 listings. But the “United Russia” will lose something too, because now V. Putin, D. Medvedev, and other similar federal political figures cannot be put at the top of the list, and it is doubtful, that every region can find the top leader of the list, who would be more popular than Putin, for example. Indirectly, of course, this draft law addresses the long-term problems with V. Putin rating (more precisely - the ratio of rating against negative rating), whose candidacy four years ago has contributed to a significant increase in votes for the ruling party.

January was the month when the presidential campaign was continued (formally, the media campaign, paid from the election fund, started only on February 5, but the candidates, of course, promote themselves in other ways). The campaign goes on without any surprises so far with one exception - the Central Election Commission did not admit to elections G.Yavlinsky, the leader of the non-parliamentary party “Yabloko”, having rejected a large number of signatures in support of his candidacy. As a result, candidates were registered only from the parliamentary parties – V. Putin, G.Zyuganov, S. Mironov, V. Zhirinovskiy, as well as M.Prokhorov, a large businessman, two million signatures in whose support were considered reliable. D. Mezentsev, the appointed Governor of Irkutsk Region, technical candidate from the ruling party, has also failed to get registered for elections. The only meaning of his nomination was to ensure the elections cancellation in case if all the other candidates, except for Putin would withdraw, but the government clearly believes that this will not happen. As to Yavlinsky, his dismissal from the election due to the fact that he had insufficient funds to arrange countrywide campaign, he nevertheless was able to attract considerable support in Moscow and St. Petersburg (about 10%, even according to official figures), and active surveillance in the course elections. The absence of G. Yavlinsky on the ballot will reduce the participation of his voters in the elections, as well as deprive him of the right to appoint observers - they may be designated only by registered candidates. If before the elections of December 4 the authorities thought that G.Yavlinsky participation in the presidential campaign could add legitimacy thereto, but poses no threat, after December 4, when the “United Russia” even according to official statistics did not receive a majority of votes, it became obvious that V. Putin’s victory in the first round of elections is problematic, even those some more than three percent obtained by Yavlinsky, were superfluous.

Putin placed his bets to win in the first round of elections, as evidenced by his statements, as well as by the overall strategy of the campaign, in which the expectations are based on the falsification of election results even to a greater extent than before December 4. It is important to note that despite the seemingly significant benefits in the issues of parties’ registration, election of governors and so on, the government did not recognize even the most obvious cases of electoral fraud on December 4, like the mass publication on the Central Election Commission website the voting protocols different from the existing copies of the observers, or mass removal of observers from the polling stations in Moscow, followed by publication of information on the fantastic 60-90% of voting for the “United Russia”. Moreover, in January, there was a mass replacement of the heads of district and territorial election commissions, where poor rating of “United Russia” was observed – has affected both, province and capital cities. Post-election appointment of the governor of a large and economically developed region of Volgograd of Bozhenov, the Mayor of a small and depressive Astrakhan, for example, is difficult to be treated differently as scandalous - Bozhenov is known in his own region as the organizer of massive election fraud, the expulsion of observers, fights at polling stations and similar actions, which made it possible to declare the “United Russia” result at 62%. Hence, by the way, the options of political system further development is observed - free

registration of political parties or the elections of governors on counter-democracy terms, when it is possible to enter any voting percent in the official list or candidate.

Speaking about the situation of March 4, it is important to understand that even a sharp increase in volunteer observers in major cities may not balance the absence of the total of commercial observers from the systemic parties. In the greater territory of Russia, including rural areas and small towns, the bulk of the observers was hired in December by the candidates from the Communist Party, Fair Russia and the Liberal Democratic Party, who gained passing and semi-passing ratings in the listings of the State Duma, as well as in two dozen regions in the listings of candidates to the regional legislatures. Observers were available in nearly all regions. But this time, the incentives to invest in monitoring the presidential elections are low – nobody believes in the ultimate victory in the presidential election, for example, of G. Zyuganov or V. Zhirinovskiy. Of course, further protest involvement of voters who ignored the elections of December 4 should not be ignored, they thought their outcome was predetermined, but they were encouraged by the low result of governing party.

In fact, the presidential campaign was going in January at rather low rate. Prime Minister V. Putin announced his electoral program, published three articles in press, and made several campaign trips, where he did not make any special statements. Two of the three articles (“Russia is focusing” and “On our economic objectives”) are in line with overall government policy documents and set up the routine tasks that seem to undisputable, but each time the implementation of which is highly problematic: diversification of the economy, reduced budget dependence on the price of hydrocarbons, a balanced budget, innovations development, encouragement of private investments, business promotion, and so on. But even within the insignificant items there observed typical in recent years political inconsistencies and lack of priorities: there are references to the rejection of the non-oil taxes growth, but it is not mentioned, that in the last years there have been raised taxes on payroll, which add the burden on “middle class”, which is supposed to be declaratively promoted in every possible way. It is declared of the government withdrawal from of the economy, but at the same time, public sector expansion growth is justified in the last decade, and “withdrawal “ indicators are defined very vaguely up to 2016, and there is no information on the sale of controlling shares in public companies. One of the key problems of the economy, the pension system has deserved only two lines with substantial promise of “*balancing*” it in some way, but it is said in what way exactly. The third article - “*Russia: the national issues*” seems to be aimed at attracting those who are concerned with this issue. However, its interpretation did not add to the candidate rating in their impression – V. Putin talks about the crisis of the concept of national state, protects multi-national culture, praises the Soviet Union, speaks of “*self-determination of the Russian people as multi-ethnic civilization, strengthened by the Russian cultural core*”. As a complementary to the nationalists stories, it was mentioned about nothing else but criminal responsibility for violation of migration rules; however, in the situation of visa-free regime with the countries of Central Asia, these rules are not difficult to be observed. In general, one can say that, as during the parliament election campaign, the authorities are not trying to offer some new initiatives to community, but are limited to maneuvering between different ideologies, social groups and interests in the attempt to please everyone and avoid irritation.

As to the other presidential candidates, their public statements to varying degrees (more on the part of Mironov and Prokhorov, less on the part of Zhirinovskiy) were in line with the massive protest actions and the opposition as such, and various requirements. In the situation of conservative dynamics of the campaign, the well recognizable Zyuganov and Zhirinovskiy may expect a renewal of the parliamentary results, but it will be much more difficult for Mironov, whose party rating was built as the sum of the campaigns of candidates who led the regional lists. So far, Prokhorov has not headed any campaign outside the capital cities – there is a feeling that his key function is to attract the support of opposition-minded inhabitants of the capital cities, for whom a large number of the Internet articles, statements and so on are displayed. After the election, as Prokhorov announced, he will form his own political party, which is likely to try to attract the capital cities’ residents. However, in the sustained dynamics of the campaign, Prokhorov risks to gain few votes across the country, which, given the unfortunate experience with the “Right Cause “ is quite risky for him. There is still a confusion among among the non-

parliamentary opposition groups: over more than a month of meetings of various committees they failed to develop a unified position on the most important issue - the strategy of voting on March 4, some opposition members continue to advocate in support of the exotic and apparently unpopular among population options, like spoiling of ballots, and there is a risk that this option can be supported by G. Yavlinsky, dismissed from participation in the election campaign. It is no mere chance, that by the end of January, a popular topic of negotiations between the authorities and opposition a month ago has actually disappeared: the gap between the demands of the opposition and the willingness of the authorities to compromise became great, and the potential for street protests to expand or at least to be sustained at the impressive December level is doubtful, especially with regard to severe cold. ●

INFLATION AND MONETARY POLICY

N.Luksha

As a result of 2011, inflation made 6.1% - the minimum indicator in the post-Soviet history of our country. In January 2012 growth rate of consumer prices was also restrained: as per 23 days of the month it accounted to 0.4%. In 2011, the monetary base in broad definition was growing slowly and increased by 5.5% (against 26.6% in 2010). The volume of gold and foreign currency reserves for the year has also increased slightly (+4%). Net capital outflow from the country in 2011 has reached \$84.2bn, which was the highest indicator since the 2008 crisis.

Consumer price index in 2011 made 6.1%, the minimal value over the past twenty years (see Figure 1). In the previous two years, inflation for the year was significantly higher and reached 8.8%.

Since the beginning of 2011 and up to the summer, except for the first month of the year, the dynamics of inflation was comparable with the level of 2010. In this connection, achievement of the official inflation forecast, announced in early 2011 at the rate of 6-7% for the year, seemed unlikely. However, in summer, largely due to favorable weather and good harvest, the rate of price growth has slowed down considerably as compared with 2010, and in August seasonal deflation was observed. In the second half of 2011 the reduced growth rate of prices also contributed to the moderate growth of monetary supply M2. As a result, for the first time in modern history of our country, the official inflation rate was estimated at the lowest limit.

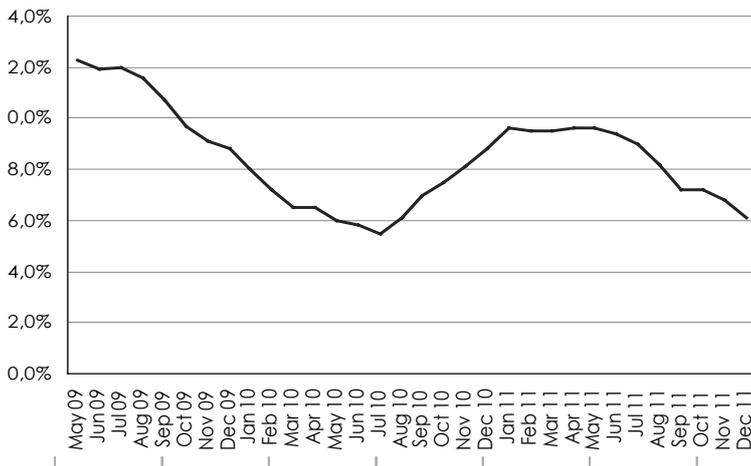
In the last month of 2011 there was no traditional upsurge of inflation - the CPI in December made, as in the previous month, 0.4% (against 1.1% in December 2010). Index of food prices in December has grown by 0.2 p.p. as compared with November and amounted to 0.7%. However, this figure was three times lower than in December of the last year. In December, prices went down for sugar, cereals and beans (by 3%); like a month before eggs got more expensive (+5.6%). If by 2010 annual results there was no deflation in any of the food products, within 2011 prices have declined for a number of products – granulated sugar, fruit and vegetables, cereals, which, which were the leaders of growth in prices in 2010. The largest price increase for the year was observed for fish and seafood, meat and poultry, as well as bread and bakery products (from 8.9% to 10.3%).

The growth rate of prices for industrial goods in December (+0.3%) was lower than in November 2011 (+0.6%) and December 2010 (0.5%). The slowdown in growth rates in this group of goods in the last month of 2011 was contributed by the decline in gasoline prices (-0.3%), which however, as per the year results came to the second place after tobacco in terms of price increase among the list of CPI items published by the Russian Statistical Service.

In December there was observed an accelerated growth rate of prices for commercial services, which made 0.3% (against 0.1% in November 2011). Decreasing in prices healthcare and fitness services (-0.2%) and foreign tourism services (-0.1%) were joined by insurance services (-0.4%). At the same time, passenger transport fees stopped to decrease and have somewhat grown (+1.5%). The reason for this was a planned increase in fees for long-distance train trips at the end of the year. As a result of the year, the utmost growth in the list of commercial services was traditionally noted in housing and public utilities (+11.7%). This is followed by pre-school education and services of cultural organizations (+ 11.3% each), and then healthcare services (+10%). There was no reduction in prices and tariffs in 2011 in any type of commercial services.

The basic consumer price index¹ in December 2011 has somewhat declined and made 0.4% (0.7% in 2010).

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. CPI growth rate in 2009–2011 (% year to year)

Due to the high base effect and the transfer of tariffs indexing on the services of natural monopolies to the mid-summer, there was no the traditional upsurge of inflation in January. As a result of 23 days of January, the consumer price index amounted to 0.4% (against 1.8% in 2011). During the week from January 17 to 23 inflation accelerated to 0.2% after preceding ten-weeks period of growth at the rate of 0.1% per week.

The official forecast of annual inflation, developed by the Ministry of Economic Development in 2012, is 5-6%. Whether inflation meets the estimated targets, will be clear only in the second half of the year, when inflation starts to

rise due to tariffs indexation and the effect of the low base in summer 2011. At the same time in the first half of 2012 the slowdown of inflation is likely to continue. The same factors as in late 2011 will affect the reducing rate of inflation at the beginning of 2012.

As a result of 2011, the monetary base in broad definition increased by 5.5%, having made Rb 8,644.1bn. Thus, the growth rate of broad monetary base has declined significantly as compared with 2010 (26.6%). Slower growth in the monetary base is primarily associated with a significant increase in cash balances at the accounts of the Russian Government with the Bank of Russia.

The main reasons of growth of monetary base in broad definition in 2011 were the availability of cash money (aggregate M0), as well as mandatory reserves. The increase of mandatory reserves was associated with a threefold raise of reserves threshold, established by the Central Bank in the first half of the year. Monetary base in a narrow definition (cash plus mandatory reserves)¹ increased by 21.8% as per 2011 results (see Fig. 2).

Liquidity problems in the banking sector, which began in late summer, reflected in the excessive reserves of banks: correspondent accounts within the year have decreased by 1.3%,

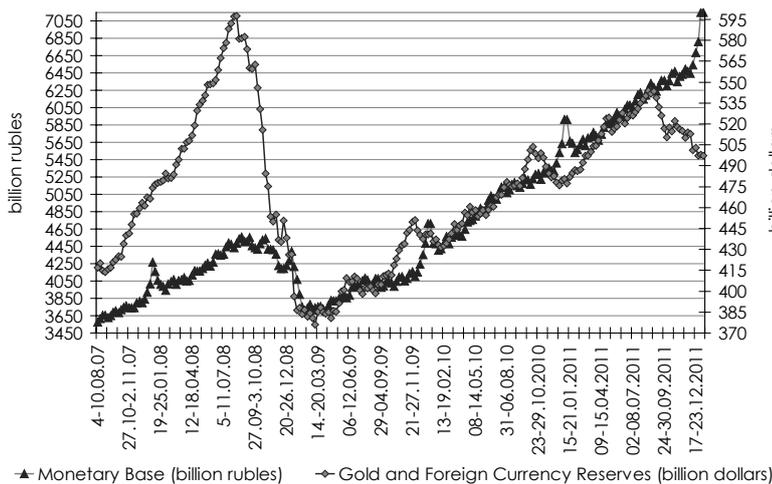


Fig. 2. Dynamics of the RF monetary base (in narrow definition) and gold and foreign currency reserves in 2007–2011.

deposits - by 1.6 times, investments of credit organizations with the Bank of Russia have reduced to 0. In the end of September the Central Bank announced the suspension of the auctions on placement of bond issues of the Bank of Russia of series 21.

In the last month of 2011 changes in the basic articles of the monetary base in broad definition were traditional for this month. In December, all components of the monetary base (except for the Bank of Russia bonds) were growing. As a result, within the month the broad monetary base growth amounted to 15.8%, which is the highest level since the beginning of the year.

¹ 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.

In December, the excessive reserves of commercial banks¹ continued to grow: within the month they have increased almost six-fold to Rb 1.3699bn. The volume of corresponding accounts with the Central Bank increased by one third to Rb 981.6bn, and deposits – by 1.8 times to Rb 388.3bn.

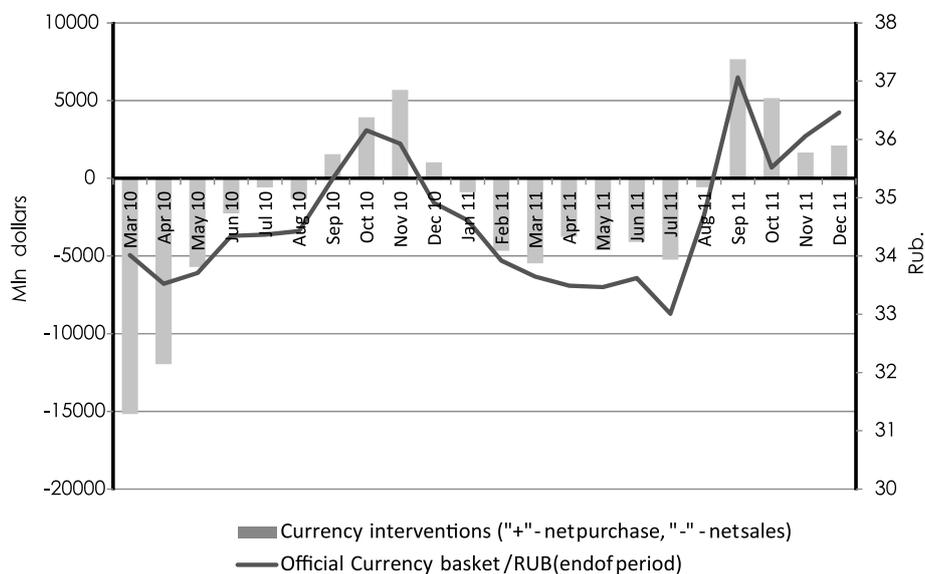
However, the question whether the liquidity crisis is to avoided, remains open. On the one hand, the first Deputy Chairman of the Central Bank A.Ulyukaev at the Gaidar's forum "Russia and the World: 2012-2020" said that at present there is no shortage of liquidity. According to him, it is expedient to reduce the presence of the Ministry of Finance in the monetary market. The Ministry of Finance, in turn, announced the intention to increase by 8 times the volume of OFZ placement in the I quarter of 2012. Those statements are supported by comfortable as of December 2011 level of excessive reserves in the banking system.

On the other hand, the dynamics of excessive reserves is based on the increase of budget expenditures at the end of the year. In addition, the relatively high amount of liquidity in the banks is not an accurate indicator of the adequacy of their liquidity level. The state of the monetary market is better assessed by the net liquidity² position of banks, which since autumn 2011, for the first time in two years, has shifted to the negative values. The onset of the period of tax payments and the need to repay the debt to the Ministry of finance already in January 2012 has restored liquidity tensions at the market. A new round of tension with the banking liquidity is also confirmed by the excess of the banks' demand over supply of the Ministry of Finance funds in the framework of deposit auctions in January 2012 and the high demand from banks for repo operations.

As a result of 2011, the net volume of gold and foreign currency reserves increased by 4% from \$484.2bn to \$498.6bn, almost in line with the last adjusted estimates of the Bank of Russia. Since the beginning of the year until the second half of August, reserves were growing, increasing by nearly 13% to \$544bn, which was the maximum value since autumn 2008. However, due to the instability in the global financial markets and the depreciation of Euro against dollar, as well as a result of the Central Bank of Russia interventions, since autumn international reserves were declining. In January 2012, reserves have continued to decrease: on January 16, they amounted to \$497.1bn.

In December 2011 the Bank of Russia foreign currency interventions were insignificant: net sales of foreign currency in the domestic market amounted to \$1,773.14m and Euro 191.7m (see Fig. 3³).

As a result of 2011, net capital outflows from the country reached \$84.2bn, which has exceeded all forecasts of the RF CB. The outflow of capital in 2011 was the greatest since the crisis of 2008, when \$133.7bn was exported from the country. According to the Central Bank preliminary estimates, the main outflow took place in the IV quarter (-\$37.8bn) - nearly as much as during the entire previous year. Moreover, we should



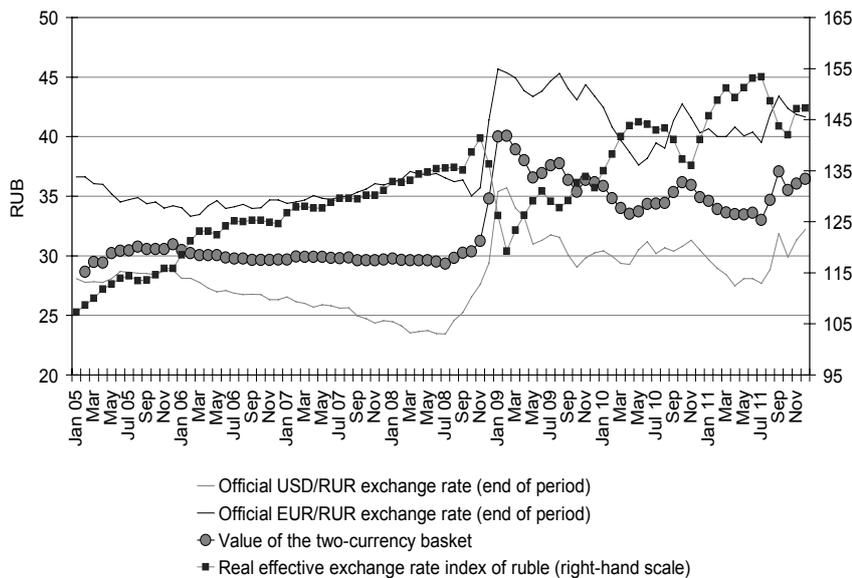
Source: RF Central Bank, author's estimates.

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

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 Net liquidity position is estimated as the difference between the amount of liquidity assets (correspondent accounts with the Central Bank, deposits with the Central Bank, CB bonds) and the total value of banks' liabilities to the Central Bank and Ministry of Finance of Russia.

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



Source: RF Central Bank, author's estimates.

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

the elections, as well as external reasons - global financial crisis aggravation.

As a result of 2011, strengthening of ruble in real terms against the two-currency basket made only 4.7% (9.6% in 2010). In December, the real effective exchange rate continued to strengthen (+0.1%). As a result, the index of real effective exchange rate rose to 147.28¹ (see Fig. 4).

The most important event in January 2012, which influenced the exchange rate of European currency, became the first since 1975 downgrading of the top credit rating of France and Austria by the international agency Standard & Poor's. In addition, the ratings of Italy, Spain and five other countries in Eurozone were lowered. The result was a sharp depreciation of Euro in the global currency markets. This news has also devalued Euro against ruble (-1.1%). In general, the dynamics of Euro in January, remained volatile with a downward trend: within three weeks of January Euro fell down against Russian currency by 2.6%. Weak economic indicators of Eurozone, and reduced credit ratings urges investors to switch to less risky assets, such as dollar, government bonds of the USA and Germany.

In January the dollar rate was declining, except for the middle of the month, when the S&P decision was announced in regard to Eurozone countries. After three weeks of the month, it devalued against ruble by 2.8%. As a result, the value of the two-currency basket decreased to Rb 35.48 (-1.6%).

On December 27, 2011 the Bank of Russia has symmetrically expanded the operational interval of admissible values of two-currency basket from Rb 5 to Rb 6 and reduced the amount of accumulated interventions, leading to a shift in the operational interval by 5 kopecks, from \$600m to \$500m. Therefore, the Central Bank continued to pursue the priority objective in the exchange rate policy - reduction of the direct intervention of the CBR in the rate fixing at the domestic foreign exchange market and the transition to a regime of free floating of the ruble rate. This is the second expansion of two-currency corridor and reduction of the value of accumulated interventions in 2011. During 2011 the Bank of Russia demonstrated a willingness to minimize its intervention in the foreign exchange market, allowing for significant fluctuations in the ruble nominal exchange rate. This policy reduces the predictability of Rb exchange rate dynamics and is another step in the RF CB to the transition to inflation targeting regime. ●

note that in the last quarter the outflow of capital from non-financial sector grew almost three times (\$30.3bn), while the outflow from the banking sector was reducing (\$7.5bn). The growth of the outflow from non-financial sector in the IV quarter is explained on the one hand, by the peak of payments of Russian companies under foreign debts, which accounted for the year end, and on the other hand, by the preservation of significant economic and political risks in Russia.

The main reasons for such a large outflow of capital from the country in 2011 are both, internal grounds - unfavorable investment climate, growth of the political tensions in view of

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

FINANCIAL MARKET

N.Burkova, E.Khudko

In January 2012, the situation in the Russian financial market was characterized by a considerable decline in trading activity on the share and derivatives markets caused by the long New Year and Christmas holidays. At the same time, there was a rise in the main stock market indices and the prices of most shares issued by the most liquid Russian companies. On the contrary, Russia's domestic corporate bond market experienced a rebound: all the key indicators, including the volume and the index of the bond market, as well as the trading indicators of the secondary market, showed positive dynamics.

The Government Securities Market

The absence of substantial fluctuations in world markets, resulting from the lengthy Christmas and New Year holidays, and the strengthening of the ruble caused a rise in investors' attention to the government securities market and produced a drop in the yield to maturity, observed in the market throughout January. Thus, the yield to maturity of the majority of Russian Eurobonds declined by 2 to 6%. The biggest loser (by 12.88%) was RUS-15 Eurobonds, which belong to the category of the 'shortest' securities tradable on that market (Fig. 1).

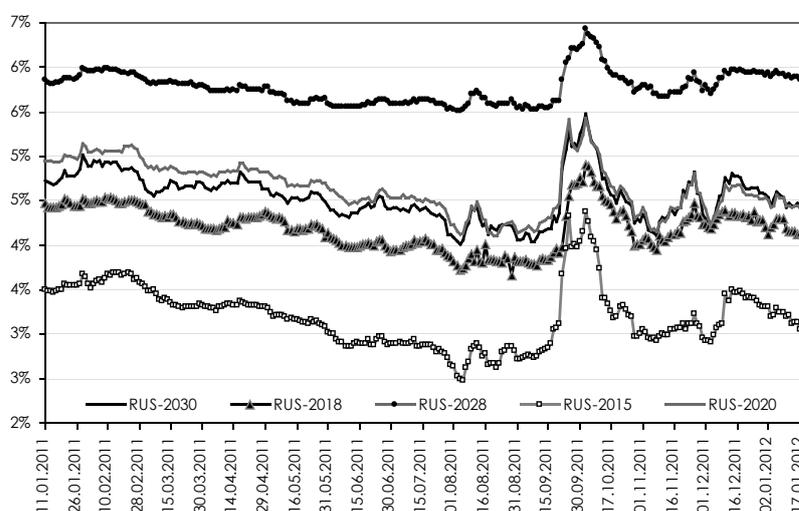
Over the period from 21 December 2011 to 22 January 2012, the combined turnover of the secondary market of OFZ bonds amounted to Rb 71.7bn, while the average daily turnover amounted to about Rb 3.26bn, which corresponds to a 0.3% rise of the average daily turnover over than month by comparison with the previous period.

Between 21 December 2011 and 22 January 2012, one primary placement auction of OFZ bonds was held in Russia (vs. one auction one month earlier). A placement auction of OFZ-25079 with the placement volume of Rb 20bn took place on 18 January; the actual placement volume amounted to Rb 18.57bn, while the average weighted yield was about 7.67% per annum. Thus, the actual placement volume over the period under consideration amounted to 92.8% of the planned figure (vs. 92.5% one month earlier). No additional auctions for additional placement of OFZ on the secondary market were held over that period. According to the RF Ministry of Finance's preliminary schedule of placement auctions of OFZ bonds for Q1 2012, the placement volume of those auctions is planned to be three times as much as in Q4 2011 (Rb 284.87bn).

The Stock Market

Factors in the Dynamics of the Russian Stock Market

From the third week of December until the end of that month, the Russian stock market showed a sideways trend and was characterized by a low trading activity in anticipation of the New Year



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 – November 2011)

and Christmas holidays. On 3 January 2012, the first trading day of the new year, the Russian stock market surged in response to the positive external news, including the positive macroeconomic news from the USA with regard to the state of its labor market and business activity, as well as a rise in orders for durable goods in the USA. For the following four days, the market was consolidating its gains. On 10 January, the official first working day in Russia, the stock market again surged, spurred by a jump in oil prices.

Among the most important events of the period from 11th to 16th January, one should note a drop in Spanish and Italian bond yields; and the decision, of the European Central Bank and the Bank of England, to keep their key refinancing rates unchanged, on the one hand; and on the other, there was the decision of the international rating agency Standard & Poor's to downgrade the sovereign credit rating of France from AAA to AA+, and to downgrade the sovereign credit ratings of another eight countries of the eurozone (including Italy, Spain and Austria) and the credit rating of the European Financial Stability Facility from AAA to AA+. Also, Fitch Ratings lowered Russia's credit rating outlook from positive to stable. In Q4 2011, China's GDP grew 8.9% on the corresponding period of 2010, which significantly alleviated investors' concern that the recovery of the global economy was losing momentum. As a result, from 17 January to the third week of that month, the downward trend of the market was replaced by an upward one. The successful placement of government bonds by Germany, Portugal, Spain and France, and the IMF's plans to attract additional resources also buoyed the market.

On the whole, over the month, the markets under consideration grew by 2 to 10% (and declined by 0 to 3% since the year's beginning) (see Table 1 and Fig. 2).

Table 1

THE DYNAMICS OF WORLD STOCK EXCHANGE INDICES

Index	Value (as of 22.01.2012)	Change over month (%)*	Change since beginning of year (%)
MICEX (Russia)	1,491.15	5.77	0.54
RTS (Russia)	1,496.41	7.21	1.01
Dow Jones Industrial Average (USA)	12,720.48	5.10	-0.93
NASDAQ Composite (USA)	2,786.70	7.03	-0.05
S&P 500 (USA)	1,315.38	5.97	-1.30
FTSE 100 (UK)	5,728.55	5.70	-2.74
DAX-30 (Germany)	6,404.39	9.53	-0.87
CAC-40 (France)	3,321.50	8.71	-3.30
Swiss Market (Switzerland)	6,122.67	5.48	-2.22
Nikkei-225 (Japan)	8,766.36	5.16	-1.41
Bovespa (Brazil)	62,312.13	9.58	0.20
IPC (Mexico)	37,384.21	3.16	-2.26
IPSA (Chile)	4,278.17	2.37	0.04
Straits Times (Singapore)	2,849.38	8.99	-1.21
Seoul Composite (South Korea)	1,949.89	8.75	-1.79
ISE National-100 (Turkey)	54,888.55	5.30	1.68
BSE 30 (India)	16,739.01	10.31	-1.81
Shanghai Composite (China)	2,319.12	4.66	0.75
Morgan Stanley Emerging&Frontier Markets Index	785.40	10.14	-1.65

* – As a percentage of an index's value on 20 December 2011

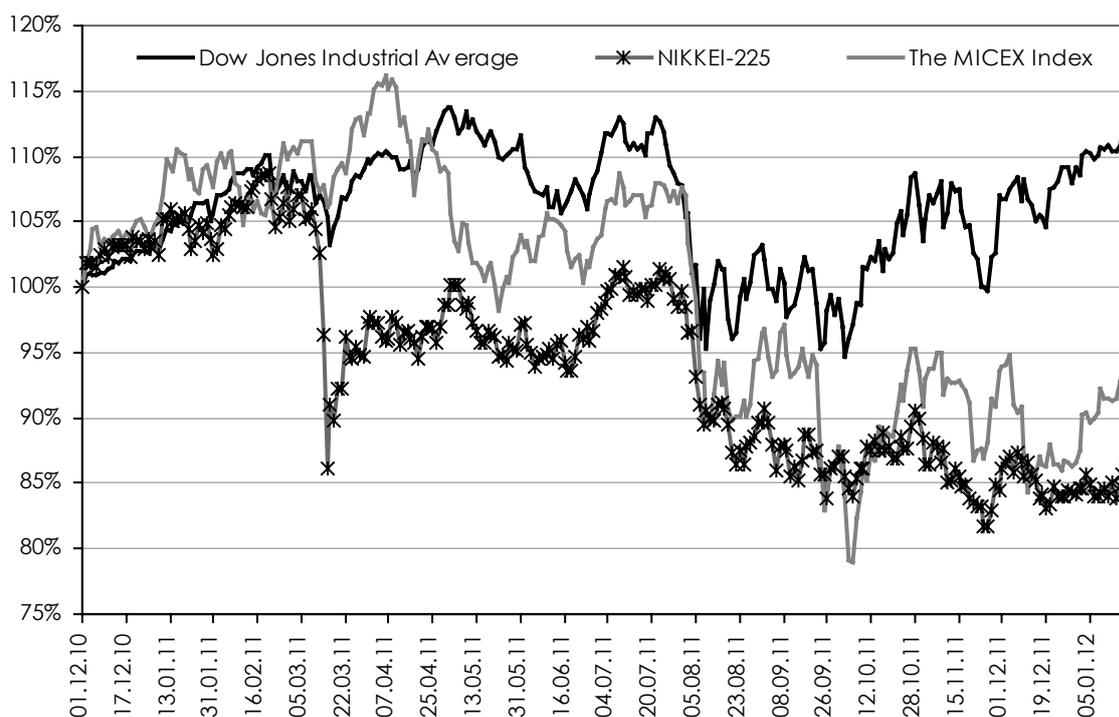


Fig. 2. Dynamics of the Main USA, Japanese and Russian Stock Indexes (As a Percentage of Their Values on 1 December 2010)*

Among the positive domestic factors in the dynamics of the Russian stock market, we should note the Bank of Russia's decision to reduce its rate of refinancing (to 8%).

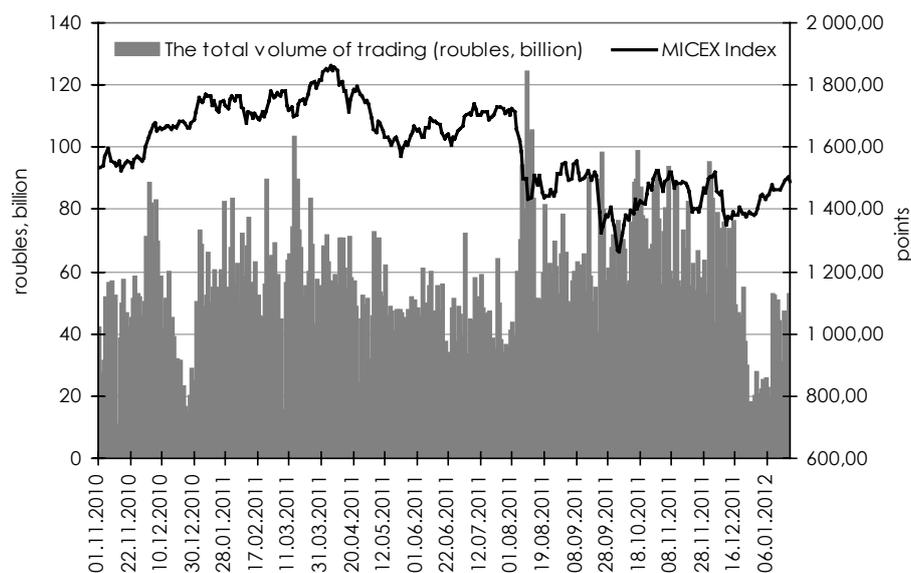
The Situation on the Share Market

The MICEX Index reached its monthly peak on 19 January November when it hit 1,503.07 points (vs. 1,517.89 points one month earlier). The MICEX Index dropped to its monthly lowest on 5 January when it hit 1,434.91 points (vs. 1,349.96 points one month earlier) (Fig. 3).

On the whole, over the period between 21 December 2011 and 22 January 2012, the MICEX Index grew by 5.77%, or by 81.31 points in absolute terms (between 23 January 2011 and 22 January 2012, the MICEX Index dropped by 14.66%), while the trading volume of the shares included in the MICEX Index climbed to Rb 772.5bn. By comparison with the previous period, in January the average daily level of investor activity on the stock market declined by 47%.

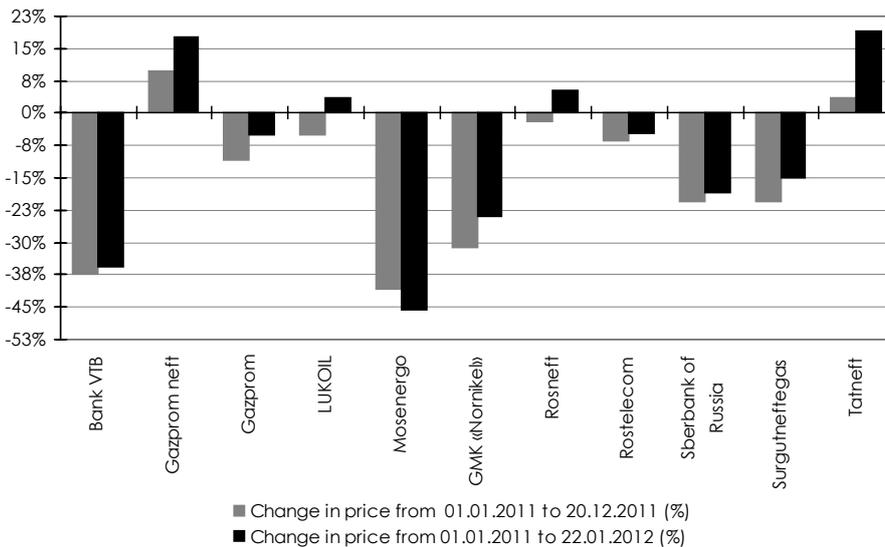
In the period from 1 January 2011 to 22 January 2012, the biggest price losers among the blue chips were shares in *Mosenergo* and *VTB Bank*, which shed 45.72% and 35.63% of their value respectively (Fig. 4).

According to MICEX-RTS data, as of 22 January 2012 the five Russian companies holding leadership in terms of market capitalization were



Source: MICEX-RTS.

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



Source: MICEX-RTS.

Fig. 4. The Dynamics of Russian Blue Chip Stocks

as follows: *Gazprom* – Rb 4,386.94bn (vs. Rb 3,973.36bn as of 20 December 2011); *Rosneft* – Rb 2,449.77bn (vs. Rb 2,223.71bn); the Savings Bank of the Russian Federation (*Sberbank*) – Rb 1,845.68bn (vs. Rb 1,759.77bn); *LUKoil* – Rb 1,539.69bn (vs. Rb 1,390.5bn); and *GMK NorNickel* – Rb 1,043.31bn (vs. Rb 937.89bn).

The Futures Market

In January 2012 (from 21 December 2011 to 22 January 2012), the average daily trading volume in the MICEX futures market amounted to Rb 4.87bn (vs.

Rb 7.9bn one month earlier). The highest trading volume – Rb 4.83bn (455 transactions) – was recorded by transactions with foreign exchange futures. By the trading volume in this section of the MICEX futures market, the first place belonged to cash-settled US dollar futures contracts, followed by euro-ruble currency pair futures contracts and euro-US dollar currency pair futures contracts. The prices of the ruble-US dollar currency pair futures contracts with the date of execution set for 15 March 2012 concluded in the MICEX futures market in December 2011 were, on average, within the limits of 31.5 to 32.5 rubles per US dollar, which means that participants of this MICEX market expected that the ruble would become weaker by 0.7 to 3.9% by comparison with its value as of 22 January 2012 (31.29 rubles per US dollar). The prices of the ruble-Euro currency pair futures contracts with the date of execution set for 15 March 2012 were, on average, within the limits of 40.7 to 41.7 rubles per Euro, which means that market participants expected that the ruble would become weaker by 0.3 to 2.7% by comparison with its value as of 22 January 2012 (40.59 rubles per Euro). The trading volume of funds futures was Rb 14m (109 transactions). By the trading volume in the funds section of the MICEX futures market, the first place belonged to cash settled MICEX Index futures, followed by delivery futures contracts on shares in *Gazprom*, the Savings Bank of the Russian Federation (*Sberbank*), *NorNickel* and *LUKoil*. 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 1,500 points, which means that most of the market participants expected that the MICEX index would decline by 0 to 8.1% by comparison with its value as of 20 December 2011. The trading volume of commodity futures was Rb 18m. No interest instruments futures transactions were concluded in January 2012.

In January, the FORTS futures market saw a decline in average daily investor activity (by 35.7% 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, ruble-Euro currency pair futures contracts, and futures contracts on shares in the Savings Bank of the Russian Federation (*Sberbank*) and *Gazprom*. The prices of the latest transactions concluded on the FORTS futures market under ruble-US dollar currency pair futures contracts with the date of execution set for 15 March 2012, were, as a rule, within the limits of 31.5 to 32.6 rubles per US dollar, and those concluded under ruble-Euro currency pair futures contracts – within the limits of 40.6 to 42 rubles per Euro, 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 concluded 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 1,370 to 1,490

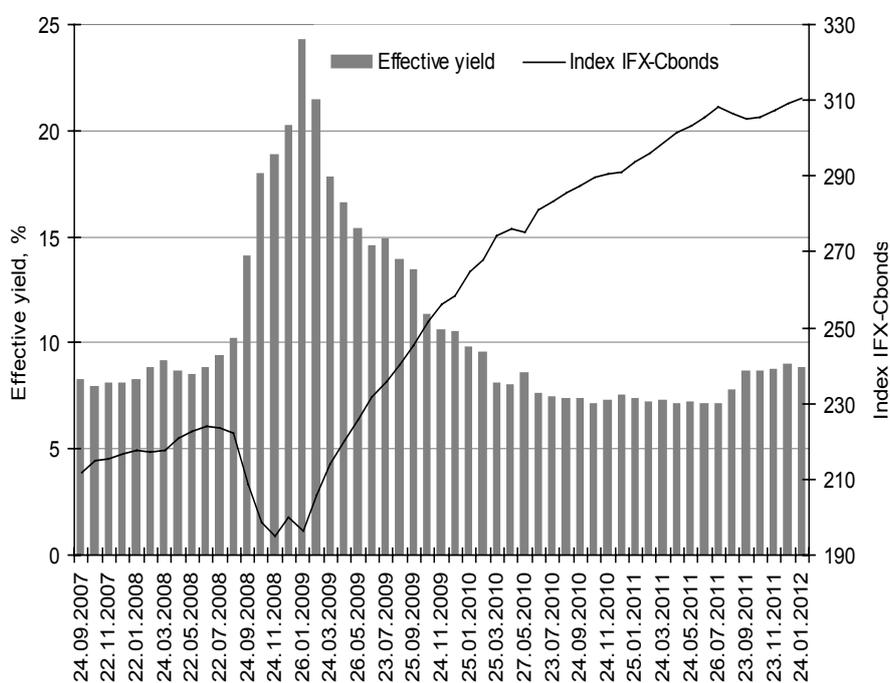
points, which means that market participants expected that the RTS Index would decline by 0.4 to 8.4% by comparison with its value as of 22 January 2012, and those with the date of execution set for 15 June 2012 – within the limits of 1,350 to 1,450 points. Options were in much less demand, with the options turnover amounting to approximately Rb 149.84bn (while the futures turnover was Rb 2,510.18bn). By the trading volume in this section of the FORTS futures market, the first place belonged to futures-style options on a futures contract on the RTS Index.

The Corporate Bond Market

At the beginning of 2012, the volume of Russia's domestic corporate bond market (by the nominal value of ruble-denominated securities in circulation) continued to grow. In late January, it amounted to Rb 3,304.6bn, or by 1.5% more than at the end of 2011¹. Thus, the market once again reached its new historic high. This occurred due to a considerable increase in the number of bond loans (777 issues of corporate bonds denominated in the national currency vs. 764 emissions as of the end of the previous month) and an increase in the number of the emitters represented in the debt market (341 companies vs. 337 companies one month earlier). Of all the issues denominated in foreign currencies, only one, yen-denominated, issue of bonds still remained in circulation.

At the beginning of 2012, the secondary corporate bond market's trading indicators also went up: the combined volume of transactions carried out on the MICEX stock exchange from 21 December 2011 to 20 January amounted to Rb 117.7bn (for reference: from 23 November to 20 December 2011 the trade turnover was Rb 94.7bn, while in October-November 2011, it amounted to only about Rb 70bn). The number of transactions was 23.9 thousand (vs. 20.8 thousand in the previous period)². These dynamics markedly differed from the trends of previous years, when investor activity had traditionally declined in January. One of the contributing factors to this significant rise in the corporate bond market's trading indicators was the uninterrupted continuation of trading on the MICEX stock exchange during the holidays.

At the beginning of 2012, the IFX-Cbonds index of the Russian corporate bond market continued to rise: by late January it climbed up by 1.6 point (or 0.5%) from the end of last year. At the same time, the weighted average effective yield remained practically the same as one month earlier: 8.84% as of the end of January vs. 8.97% as of the end of the previous month (Fig. 5). Thus, factors like the reduction of the refinancing rate in late December 2011 and then the stable situation at the beginning of the new year failed, nevertheless, to produce a more significant drop in the level of yield in the corporate debt market. This state of affairs can be explained by the continuing presence of relatively high domestic political risks and the unabated instability of world markets.



Source: According to data released by the Cbonds company.

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

1 According to data released by the Rusbonds company.

2 According to data released by the Finmarket information agency.

The corporate bond portfolio duration index once again slightly decreased to 742 days by the end of the month (a 25-day drop on the end of last year). Despite this drop, it has remained high enough, which proves that the corporate bond market has a sufficiently high proportion of long-term bonds.

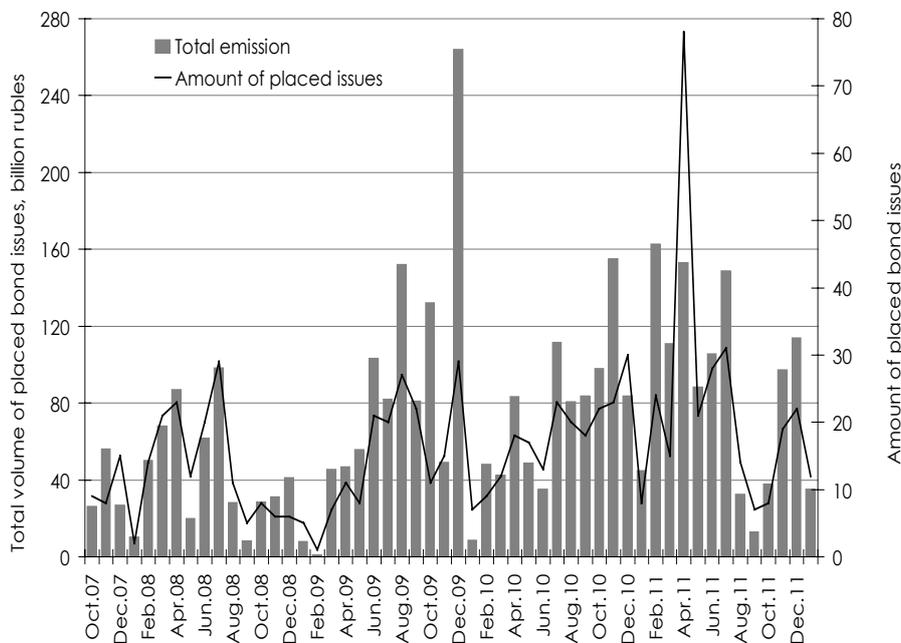
In January 2012, the biggest bond-yield losers (by more than 2 p.p.) were securities issued by AFK *Sistema* (Series 03 bonds), OJSC Rostelekom (Series 03, 05 and 06 bonds) and OJSC *MDM Bank* (Series BO-01 bonds)¹. The leaders with regard to yield growth were securities issued by OJSC *AIZhK* [The Agency for Housing Mortgage Lending] (Series 05 bonds), OJSC *Mechel* (Series BO-03 bonds), OJSC Commercial Bank *Petrokommerts* (Series 07 bonds), and OJSC *Rossiiskii sel'skokhoziaistvennyi bank* [Russian Agricultural Bank] (Series 12 bonds).

In this connection, it can be pointed out that the overall insignificant drop in the weighted average yield of the corporate bond market occurred in the main due to companies operating in the real sector of the economy. The most noticeable decline was demonstrated by the bonds issued by big telecommunications companies and energy producers. Yields on the bonds issued by companies operating in the raw materials and metallurgical sector also declined, although less significantly.

In the financial sector, many liquid bond issues demonstrated growth of their yields. Thus, in particular, yields on bonds issued by OJSC *AIZhK* [The Agency for Housing Mortgage Lending], OJSC *Bank VTB*, OJSC *Bank Petrokommerts*, and OJSC *Rossiiskii sel'skokhoziaistvennyi bank* [Russian Agricultural Bank] increased quite significantly.

Late December 2011 and January 2012 saw a rather high activity (for that period of a year) of emitters in the debt segment. Thus, in the period from 23 December through 24 January, 18 emitters registered 49 issues of ruble-denominated corporate bonds with a total face amount of Rb 166.4bn (for reference: from 24 November through 22 December registration was granted to 60 bond issues with a total face amount of Rb 199.6bn). Besides, *Vneshekonombank* [Bank for Development and Foreign Economic Affairs] registered 5 bond issues with a total face amount of \$ 3bn. Over the period under consideration, the biggest issues were registered by OJSC *Gazprom neft'* (6 bond series with a combined face amount of Rb 60bn), LLC *VTB Capital Finance* (12 bond series with a combined face amount of Rb 25bn), OJSC *Cheliabinskii Truboprolatnyi Zavod* [Chelyabinsk Tube-Rolling Plant (*ChelPipe*)] (4 bond series with a combined face amount of Rb 20bn).²

However, investor activity on the primary bond market responded, nevertheless, to the seasonal downward trend: from 23 December 2011 through 24 January 2012, only 11 emitters placed 12 issues of securities with a total face amount of Rb 35.1bn (from 24 November through 22 December, 22 bond issues with a total face amount of Rb 113.8bn were successfully placed) (Fig. 6). Among the placed loans, one-half was constituted by initial placements of bond issues. The biggest bond loans were placed by emitters operating in the financial sector.



Source: according to data released by the Rusbonds company.

Fig. 6. The Dynamics of the Primary Placements of Corporate Bond Issues Denominated in the National Currency

1 According to data released by the Finmarket information agency.

2 According to data released by the Rusbonds company.

The indicators of the initial placements could have been much higher if a large number of bond issues had not been annulled due to failure to place even a single security. Thus, in the period from 23 December to 24 January, the Federal Financial Markets Service of Russia annulled 7 securities issues among whose emitters there were, among others, the affiliations of some major Russian companies – LLC *Gazprom Capital*, LLC *MegaFon Finance*, OJSC *KuibyshevAzot Invest*. However, it should be noted that in the second half-year the number of bond issues annulled for that reason amounted to 15–20 per month¹.

During the period between 23 December and 24 January, 3 emitters who were obliged to redeem their bond loans did so in due time (in December the bond market also saw no technical defaults on redeeming the face value of securities). It is expected that, in February 2012, twelve issues of corporate bonds with a total face amount of Rb 24.1bn will be redeemed.²

Early this year, the situation with regard to actual defaults continued to be rather uneasy. In the period from 23 December to 24 January, three emitters failed to fulfill their current obligations against bond loans in due time or within the framework of a technical default (in the period from 24 November to 22 December, 2 emitters declared a technical default on the payment of the coupons to the securities holders³).

No actual defaults on redeeming the face value of securities were registered in November (in the preceding month this happened to 2 emitters). 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. In January, just as during the preceding month, one emitter failed to redeem the face value of the placed bonds even within the framework of a technical default and to achieve with the bondholders a debt restructuring agreement.

However, all the emitters in due time redeemed the bonds before their maturity by means of a buyback offer to their current holders (last month, declared an actual default). ●

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

2 According to data released by the Rusbonds company.

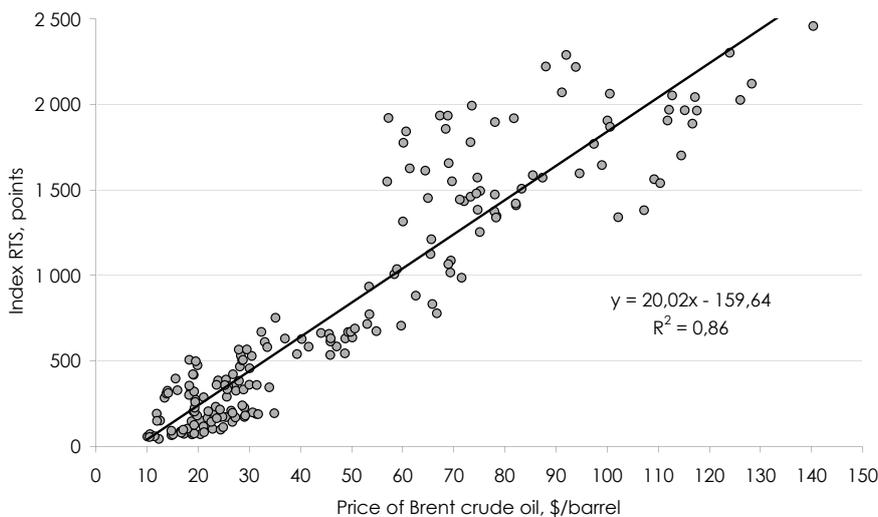
3 According to data released by the Cbonds company.

FINANCIAL MARKET RISKS IN 2012

A.Abramov

In 2012, the Russian financial market will continue to be heavily influenced by the same factors as determined its dynamics in 2011, and first of all by the relatively high oil prices and the outflow of capital from Russia.

The Financial Market's Dependence on Oil

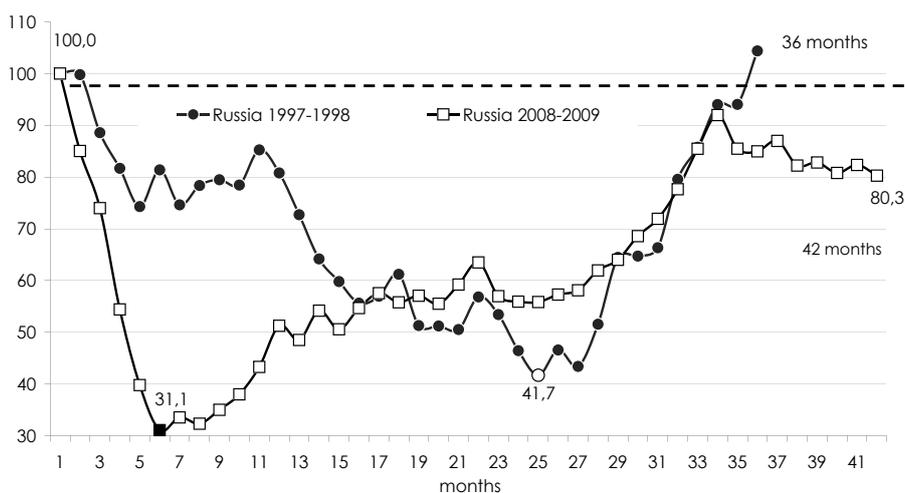


Source: data released by IFS IMF and MICEX-RTS.

Fig. 1. Relationship between RTS Index and Price of Brent Crude Oil from September 1995 to December 2011

It is a well known fact that the Russian issuers share market is heavily dependent on oil prices. The coefficient of determination (R^2) for the relationship between the absolute monthly values of the RTS Index and the prices of Brent from September 1995 through December 2011, shown in Fig. 1, is equal to 0.86, which is indicative of a very strong dependence between these indices.

According to the latest forecasts released by international financial institutions and the Ministry of Economic Development of the Russian Federation, the next few years will not see any robust growth in oil prices. Moreover, starting from mid-2008, the approaching global recession has apparently been causing oil prices to follow a W-shaped trajectory (Fig. 2). In comparison with the 1997-1998 crisis, oil prices will be returning to their pre-crisis values at a much slower rate, and it is doubtful whether this recovery will ever take place in the next ten years. Under the innovation scenario, which forms the basis of the forecast released by the RF Ministry of Economic Development on 8 February



Source: IFS IMF.

Fig. 2. Drops and Recoveries of Price of Brent Crude Oil in Course of Financial Crises in Russia (Peak Price = 100%)

2011 and is integrated in Russia's Strategy-2020, the price of Urals in 2020 will continue to hover around \$ 109 per barrel. According to that forecast, in 2012 the annual average price of oil will drop from the current \$ 111 to approximately \$ 100.

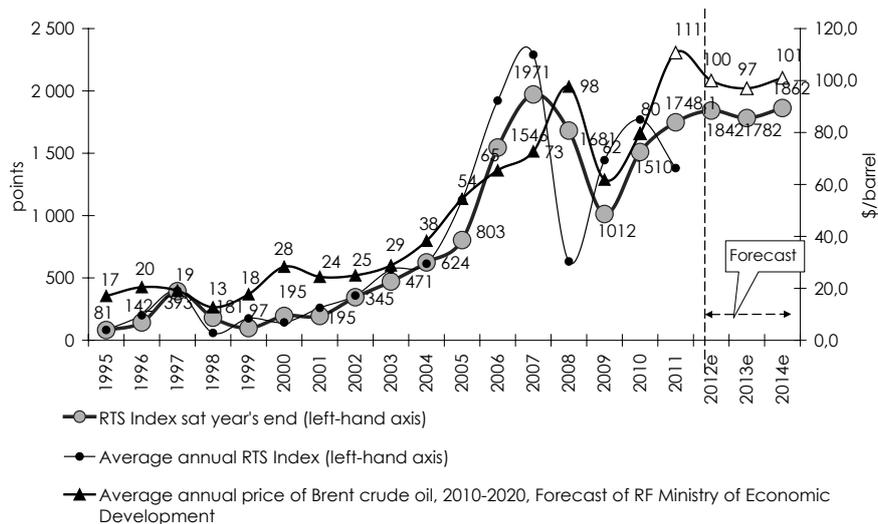
If the equation describing the relationship between the price of oil and the index indicated in *Fig. 1* is applied to the RF Ministry of Economic Development's medium term forecast of oil prices for the 2012-2014 period, the result will be stagnation on the market, as is shown in *Fig. 3*. The RTS Index will demonstrate volatility, but its medium value will not exceed 1,900 p.p. In order to further invigorate the market, some new ideas for economic growth should be applied, but it is unlikely that any such ideas are going to have any immediate effect on the situation¹.

Economic forecasts are, in fact, rarely accurate. In our report on the development of Russia's stock market in 2009², we forecasted, on the basis of the formula describing the relationship between the RTS Index and oil prices, that the average annual value of the Index in 2010 would hover around 1,503 points, while in reality its actual value turned out to be 1,510. When analyzing the stock market's performance in 2010, we expected that in 2011 the average annual price of oil would rise from \$ 80 to \$ 105 per barrel³. In fact, it rose even higher – almost to \$ 111 per barrel. However, instead of growing in 2011 to 2,017 points, as predicted, the average annual value of the RTS Index actually rose only to 1,748 points. Moreover, as of the end of 2011, the RTS Index had dwindled from 1,770 points as of the end of 2010 to 1,381.87 points, or by 21.9%. The discrepancy between the actual value and the forecast value was caused by the larger than expected capital outflow from Russia.

According to our estimates, in 2012 the average annual value of the RTS Index will increase from 1,748 points to 1,842 points, or by 5.4%, against the background of slightly reduced average annual oil prices. The multidirectional dynamics of the average values of oil prices and the RTS Index will be caused by a slowdown in capital outflow from Russia.

Flight of Portfolio Investments

The 21.9% drop suffered by the RTS stock index in 2011 was caused, to a considerable extent, by the capital outflow resulting from a number of factors, such as the cyclic withdrawal of resources from the foreign investment funds investing in securities issued by Russian emitters; the flight of Russian capital due to an adverse business climate and growth of political risks; the repayment of external debts of Russian organizations carried out in conditions when it was no longer possible to refinance debts in foreign markets; and the provision of credits, by the Russian subsidiaries of foreign banks, to their mother companies.



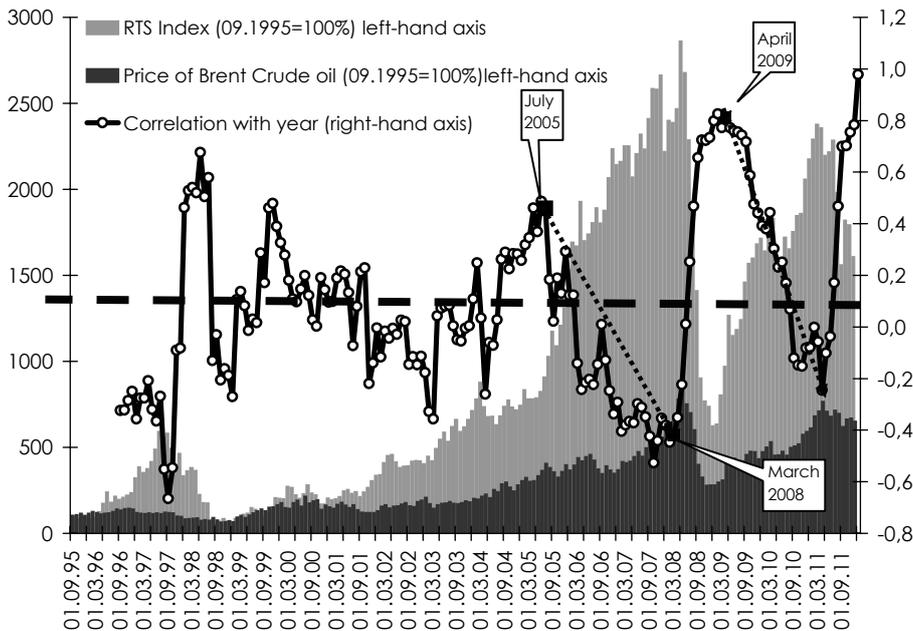
Source: Estimates are based on data contained in Strategy-2020 or released by the MICEX-RTS stock exchange

Fig. 3. Forecast of RTS Index up to 2014, Based on RF Ministry of Economic Development's Forecast of Oil Prices

1 Under different versions of Strategy-2020, such ideas are a radical change of the business climate, a new economic policy, and innovations.

2 *Russian Economy in 2009: Trends and Outlooks*. Moscow: IET, 2010. P. 133.

3 *Russian Economy in 2011: Trends and Perspectives*. Issue 7. Moscow: Gaidar Institute Publishers, 2011.



Source: Estimates are based on data released by the IFS IMF and the MICEX-RTS stock exchange.

Fig. 4. Correlation Between Fluctuations of RTS Index and those of Price of Brent Crude Oil from September 1995 to December 2011

between the RTS Index and oil prices disappeared – that is, when the values began to change in opposite directions. In both cases, the major factor responsible for those phenomena was changes in the direction of the flow of short-term portfolio investments, monitored by EPRF. These changes are shown in Fig. 5. Conversely, a sharp growth of the correlation between the relative changes of the RTS Index and oil prices (for example, in the second half of 2008 and in 2011) occurred in a period characterized by an outflow of resources from investment funds taking place against the background of a decline in oil prices.

The resource inflow and outflow of the foreign funds investing in Russia clearly have a cyclic character, which increases the cyclic character of the Russian share market. Fig. 5 shows the changes that have occurred since 2000 in the accumulated amount of foreign investment in shares issued by Russian companies. In the period between late 2004-early 2005 (when Russia received its first investment-grade ratings from international rating agencies) and the end of April 2006, the funds investing in Russia experienced a surge in resource inflows. After this trend reversed in May 2006, resources were predominantly withdrawn from the funds. The process of their withdrawal – which continued, practically, until March 2009 – deprived the funds of about \$ 9.5bn. From April 2009 through April 2011, the funds were once again actively attracting resources from new investors. That trend was reversed in May 2011, thus reactivating the process of resource withdrawal, which continued until the very end of December 2011. The strategy of foreign portfolio investors is simple: investments flow in so long as the market is underrated and the growth potential of oil prices remains high; as soon as there emerge the first signs that the trend will be reversed – the risks

As regards the aforementioned factors, the heaviest impact on the domestic share market was produced by the outflow of resources from the foreign investment funds investing in Russia (this outflow is monitored by *Emerging Portfolio Fund Research (EPFR)*)¹. Its impact on the prices of shares issued by Russian emitters compares well with that of oil prices.

Fig. 4 presents data on the behavior of the correlation coefficient between the monthly changes of the RTS Index and Brent prices. The analysis is based on a sliding correlation curve with a rolling 12-month average. The figure indicates two periods when the correlation

1 EPFR's data on the inflow/outflow of resources from the foreign investment funds investing in Russia could be considered as an indicator of the investor behavior of bigger foreign portfolio investors, including global and regional funds. According to our estimates, the portfolios of specialized funds account for 10% of the value of all portfolio investments in Russia. If investors in a specialized fund withdraw their investments from this fund, it does not mean that capital is being withdrawn from Russia. The latter phenomenon will take place only if the said fund, in order to fulfill its obligations to investors, begins to sell out its shares in Russian joint-stock companies. If resources are being withdrawn from global or regional funds, it is practically impossible to quantitatively assess the downward influence of this operation on the amount of those funds' investments in the shares in Russian companies, because they constitute only a small part of the overall portfolios of the said funds. Nevertheless, if a withdrawal of resources from the foreign funds specializing in investing in Russia is taking place, it is most probable that global and regional portfolio investors are also reducing their investments in Russia.

of an oil-price drop and of a drop in the exchange rate of the ruble – resources will begin to be withdrawn.

An interesting explanation of the factors that predetermine trend reversal points in the dynamics of resources of the funds specializing in investment in one or other market is offered by the IMF's experts in their Global Financial Stability Report September 2011.¹ The Report is based on EPFR data on the resource inflow and outflow of specialized investment funds for the period from January 2005 through May 2011 with regard to equity

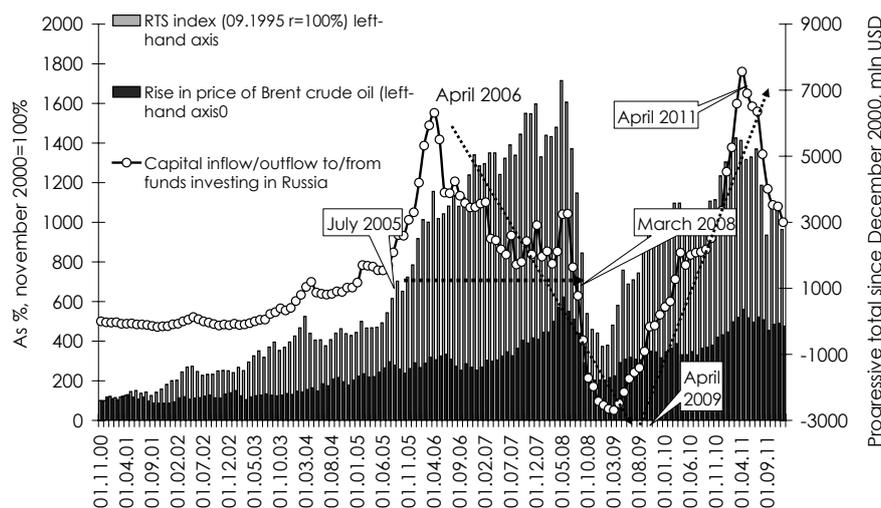
and bond investment funds in the world, in Asia, Latin America, Europe and the Middle East, and in developed countries. According to the IMF Report, the most potent factors (with the value of around 1%) influencing the flows in and out of the funds are as follows:

- official growth forecasts of real GDP (with the plus sign (+));
- volatility of the GDP growth rate (with the minus sign (-));
- volatility of currency exchange rates (with the minus sign (-));
- the VIX index measuring the expected risk for the share market (with the minus sign (-)).

The effects of interest rates and exchange rate rigidity were found to be of low significance.

The afore-said factors could be considered as advance indicators of financial crisis. These indicators are taken advantage of, with some success, by the portfolio managers of the investment funds specializing in one or other market. It is worth mentioning that, according to the authors of this IMF research, the hardest shock to the funds specializing in investment in Europe, the Middle East and Africa was inflicted precisely in June 2006, characterized by the largest monthly net outflows amounting to \$ 4.4bn. As is shown in *Fig. 5*, it was during that month that the upward trend experienced by the funds investing in shares issued by Russian joint-stock companies reversed its direction. In those conditions, the downward trend in the GDP growth rates of the most important developed and developing economies that took place in the second half of 2005 and was first recorded by IMF analysts in their *World Economic Outlook* published in April 2006², and the fluctuations of the VIX index – which also began in Q2 2005³ - could serve as the signals that caused an outflow of portfolio investments. The surges of volatility in GDP growth forecasts and share price forecasts reflected the markets' and experts' concerns over the rising disproportions in international trade balances, the deepening crisis in the US mortgage-backed securities market, and other factors, which would eventually cause the 2008 recession.

It is worth mentioning that by withdrawing, in June 2006, capital from the funds investing in shares issued by European companies - including Russian, Middle Eastern and African ones – global portfolio investors turned out to be astonishingly sensitive in their misgivings. Their



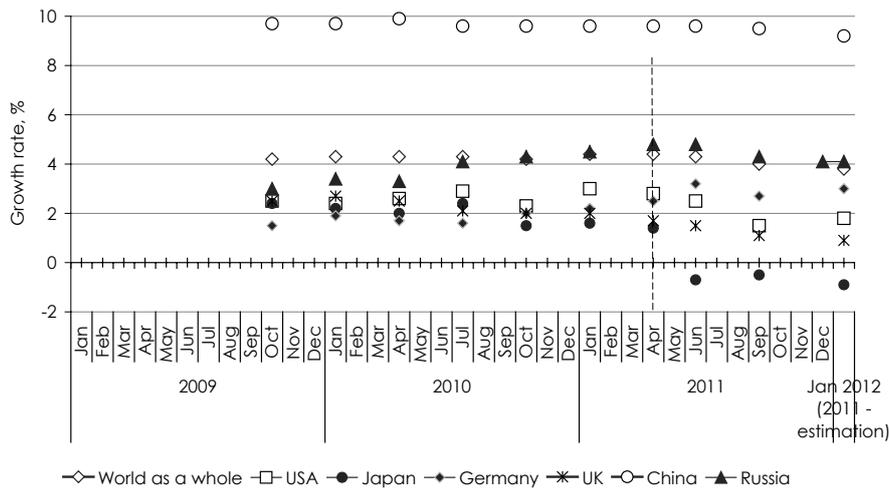
Source: Estimates are based on data released by the IFS IMF, the MICEX-RTS stock exchange and EPFR.

Fig. 5. Rise in RTS Index and Price of Oil, Capital Inflows (Outflows) to (from) Funds Investing in Russia (November 2000 – December 2011)

1 IMF. *Financial Stability Report*. September 2011. Pp. 11–18. Posted to www.imf.org.

2 *World Economic Outlook (WEO)*, April 2006. Fig. 1.8. Posted to www.imf.org.

3 In his book *Fault Lines: How Hidden Fractures Still Threaten the World Economy* (Princeton University Press, 2010, p. 147), Raghuram G. Rajan notes that 'from the second quarter of 2005 to the second quarter of 2007, the two-year implied volatility of S&P 500 option prices – the market's expectations of the volatility of share prices two years ahead – was 30 to 40 percent higher than the short-term one-month volatility'.



Source: calculations are based on data presented in the quarterly *WEO IMF* for 2009-2011.

Fig. 6. The RF Ministry of Economic Development's Quarterly Forecasts of Real GDP Growth in 2011, %

response came much earlier than the warnings of the most audacious prophets of the impending financial crisis. The famous warning of the approaching mortgage crisis, made by American Professor Nouriel Roubini at an IMF conference, dates back to as late as September 2006.

The events triggering the beginning, in June 2006, of the capital outflow from the funds investing in Russia were in many respects similar to the events that began in May 2011 and led to yet another massive outflow of capital from the funds investing in Russia.

As in June 2006, global portfolio investors were again worried by the rising volatility of global economic growth forecasts and the dwindling forecasts of GDP growth in the world's largest economies, issued by international financial institutions. As is shown in *Fig. 6*, in April 2011 the IMF reduced its 2011 GDP growth forecast for the USA, the UK and Japan. In the following quarters, the IMF reduced its GDP growth forecasts for Germany, China, Russia and the world as a whole. The outcome was not surprising: according to EPRF, in May 2011, in response to the rising uncertainty in the global economy, portfolio investors began to steadily withdraw from the Russian share market.

The afore-described approach makes it possible to define the conditions that must be met for portfolio investments to begin to return. This will happen when the IMF and other international financial institutions decide to no longer reduce their economic growth forecasts for the world's largest economies, and when the VIX index's fluctuations decrease. Bearing in mind the deepening economic crisis in the EU and the absence of positive changes in the US economy, it is unlikely that this will happen in the first half of 2012. Accordingly, this period will see the continuation of foreign portfolio investment withdrawals from the Russian Federation, although on a much smaller scale than in May-December 2011, when about \$ 4.5bn worth of investments was withdrawn from the funds investing in Russia.

Other Forms of Capital Outflow

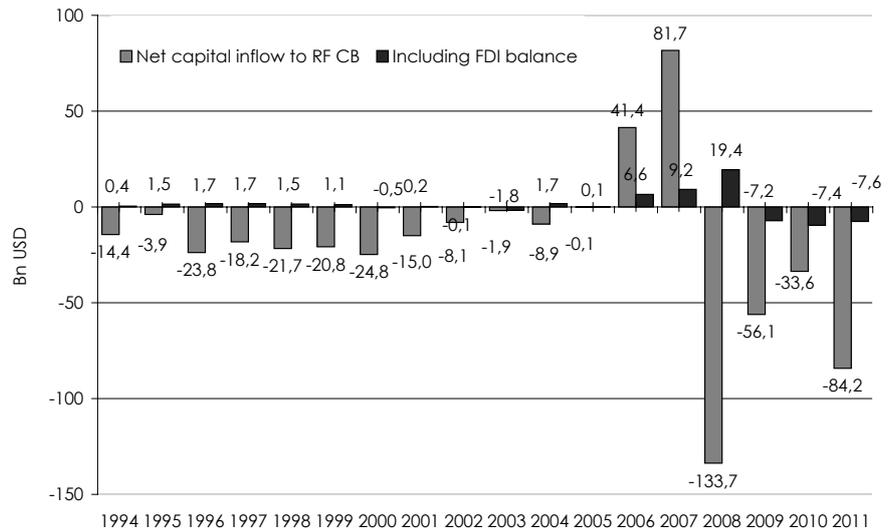
The long-term growth prospects of Russia's stock market and her economy as a whole will strongly depend on how long Russia will be able to attract long-term investment, notably foreign direct investment (FDI). As is shown in *Fig. 7*, this is the fourth year in a row when Russia has failed to put an end to capital outflow, including in the form of FDI. In 2008, capital outflow from Russia amounted to \$ 133.7bn; in 2009 – to \$ 56.1bn; in 2010 – to \$ 33.6bn; and in 2011 – to \$ 84.2bn. And this is the third year in a row that Russia has recorded a negative FDI balance, which amounted to \$ 7.2bn in 2009, to \$ 7.4bn in 2010, and \$ 7.6bn for the first nine months of 2011.

In 2011, the growth rate of capital outflow from Russia was influenced by a number of factors, including the flight of foreign and Russian capital caused by adverse business climate; the growth of political uncertainty; the absence of clear growth prospects for the internal economy; the repayment of Russian companies' debts to non-residents; and the provision of credits, by the non-resident-owned Russian subsidiaries of foreign banks, to their mother companies. In this case we should note only one phenomenon in the field of capital export. In 2011, Russian banks and non-financial companies were forced to repay their external debts in conditions that limited the possibilities for

those debts to be refinanced in foreign markets. At the same time, according to the Bank of Russia, last year did not see any reduction in the external debt owed by banks and non-financial institutions to non-residents. On the contrary, the external debt of the banking sector increased from \$ 144bn in 2010 to \$ 164bn in 2011, or by 13.7%, while that of non-banking companies – from \$ 298bn in 2010 to \$ 330bn in 2011, or by 10.6%. In our view, this phenomenon can be explained by growth in relatively short-term credits granted to Russia's biggest companies and banks, including at the expense of the funds that those companies and banks were withdrawing abroad for the purpose of crediting their foreign financial intermediaries.

We have good reason to expect that the year 2012 will see a considerable deceleration in capital outflows from Russia once the business climate in that country improves in response to the conclusion of the current (seemingly endless) series of elections.

Thus, in 2012 the Russian stock market is going to be beset by the same problems as in 2011. These problems are persistently brought to life by the stability of oil prices, the deceleration of economic growth, the withdrawal of foreign capital from Russia, and the volatility of the ruble. It is highly probable that some new risks will emerge in the form of growing tensions in the sphere of public finance or in the field of the banking system's liquidity, or further direct state interference in the functioning of financial and infrastructural organizations, or further delays in resolving the main problems of long-term investors, or failure to tackle some central issues of the strategy of financial market development. ●



Source: Bank of Russia.

Fig. 7. Net Capital Inflow – Outflow, Including Foreign Direct Investment

REAL ECONOMY: TRENDS AND FACTORS

O.Izryadnova

According to the preliminary data of the RF Ministry for Economic Development, GDP growth rates in real terms made 104.3% in 2011. The GDP dynamics acceleration has been observed since the second half of 2011 and was determined by the expansion of the investment and consumer demand. The increase in the retail trade turnover as a result of 2011 made 7.2% versus 6.3% a year ago, in investments in fixed assets - 6.2% versus 6.0%. In 2011 the index of industrial growth made 104.7%. As a result the pre-crisis level of 2008 was exceeded by 2.7%. The situation on the labor market throughout the year was characterized by the recovery of the demand for the work force. The level of the general employment decreased from 7.5% in 2010 to 6.6% in 2011.

Throughout 2011 the macroeconomic situation was characterized by the unsteady dynamics of the main indices. According to the preliminary data of the RF Ministry for Economic Development GDP growth rates made 104.3% versus the corresponding period of the previous year. In the first half of the year the growth was supported by the favorable situation at the world market of the raw materials and expansion of the consumer demand. In the second half of 2011 the acceleration of the GDP dynamics was determined by the structural components: investments in fixed assets, workload in construction and agriculture growth rates were observed to accelerate as compared with the corresponding period of the previous year. As a result of 2011 investments in fixed assets went up by 6.2%, workload in construction – by 5.1%, agriculture production – by 22.1%. Cumulative influence of these factors turned out to be sufficient to weaken the trend towards the slowdown of the internal demand for the industrial production and infrastructure services.

In 2011 it was the intensive growth of the foreign trade turnover that had a positive impact on the GDP dynamics. As a result of January-November 2011 the foreign trade turnover went up by 31.9%, export increasing by 31.8% and import – by 32.0% versus the corresponding period of the previous year. Although the anticipating dynamics of import versus export was a characteristic feature of 2011, it should be noted that starting with the 2nd half of the year the growth rates of these foreign trade components were observed to converge.

The growth of the industrial production in 2011 was of recovery nature reaching the pre-crisis level. The specifics of the dynamics throughout 2011 were determined to a large extent by the effect of the base. The index of the industrial production as a result of the year made 104.7% versus 2010. It was the anticipating growth rates of the processing industries that had the prevailing influence on industry dynamics and structure. The index of processing industry made 106.5%, and index of extractive industries made 101.9% versus the figures of 2010.

In 2011 the dynamics of the internal market was determined by the simultaneous growth of both consumer and investment demand. The retail trade turnover made 107.2% versus 2010, the volume of paid services rendered to the population – 102.9%. The consumer activity was supported by the inflation level of 106.1% which is minimum for the last twenty years. The slowdown of inflation growth rate at the foodstuffs market down to 103.9% in 2011 contributed to the expansion of the demand for non-food goods and service. The index of non-food goods retail trade market made 110.7%, of foodstuffs retail trade market – 103.6% versus 2010.

The slowdown of the wages, real volume of accrued pensions resulted in the increase of real incomes by 0.8% versus 4.2% in 2010. Under existing dynamics of the demand and incomes of the population the growth of the retail trade turnover volume was based on the decrease of the savings ratio of the population and the increase in consumer crediting. In December 2011 credits issued to natural persons made RUR 5176.6bn and increased by 1.31 times as compared with the corresponding month of 2010.

In 2010-2011 investments in fixed assets grew at quite slow rates. In 2011 the growth rates of the investments in fixed assets made 106.2% versus the previous year the proportion of the investments

Table 1

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

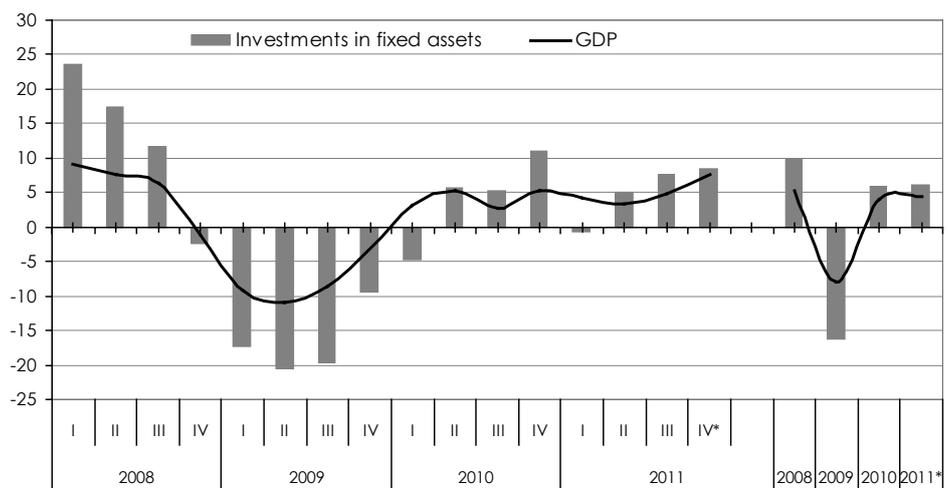
	2010	Quarters				2011	Quarters			
		I	II	III	IV		I	II	III	IV
Gross domestic product	104.3	103.5	105.0	103.1	104.5	104.3*	104.1	103.4	104.8	104.9*
Investments in fixed assets	106.0	95.2	105.6	105.3	111.1	106.2	99.2	105.0	107.7	108.5*
Construction	103.5	92.7	100.8	106.6	107.1	105.1	101.6	101.0	107.6	106.9
Implementation of residential floor area	97.6	91.1	107.3	85.7	102.3	106.6	97.8	95.1	115.0	111.4
Volume of industrial production	108.2	109.5	110.9	106.4	106.5	104.7	105.9	104.8	105.1	103.3
Minerals extraction	103.6	106.7	104.8	101.3	102.0	101.9	103.3	101.7	102.2	101.3
Processing industries	111.8	112.1	116.3	109.5	109.9	106.5	110.6	105.8	105.7	104.6
Electricity, gas and water production	104.1	107.7	102.6	103.9	101.6	100.1	99.0	101.9	101.4	98.5
Agriculture production	88.7	100.5	98.6	79.2	96.2	122.1	100.7	100.6	116.9	132.6
Freight transportation turnover	106.9	111.6	113.0	101.7	102.5	103.4	103.9	105.2	102.4	102.3
Retail trade turnover	106.3	102.2	106.9	108.4	107.4	107.2	105.2	106.1	107.9	109.1
foodstuffs	105.1	103.7	105.7	107.3	103.7	103.6	101.4	101.3	103.8	107.1
non-food goods	107.6	100.9	108.1	109.5	111.0	110.7	109.0	111.0	111.8	110.9
Paid services rendered to population	101.5	99.9	101.6	101.5	102.6	102.9	102.9	103.8	102.4	103.0*
Foreign trade turnover	131.1	144.1	139.0	126.3	121.4	131.9*	129.8.5	139.5	130.0	
Real disposable monetary incomes	104.2	107.3	103.7	104.5	102.1	100.8	100.0	99.0	101.6	102.7
Real wages	105.2	103.1	106.1	105.1	104.2	103.5	101.6	102.7	103.8	105.9
Total number of the unemployed	88.9	96.2	86.6	86.8	85.2	89.1	85.7	88.1	91.8	91.6
Number of officially registered unemployed	90.0	114.2	91.1	81	74.9	76.9	73.1	75.4	78.0	80.2

* - preliminary data

Source: Federal State Statistics Service

in the GDP being 18.1%. Estimating the investments contribution in the economic dynamics low base of 2009 should be taken into account: at that time the drop of investments in fixed assets made 16.2% and was much deeper than in the crisis of 1998. In 2011 the volume of investments in fixed assets made 94.3% versus 2008.

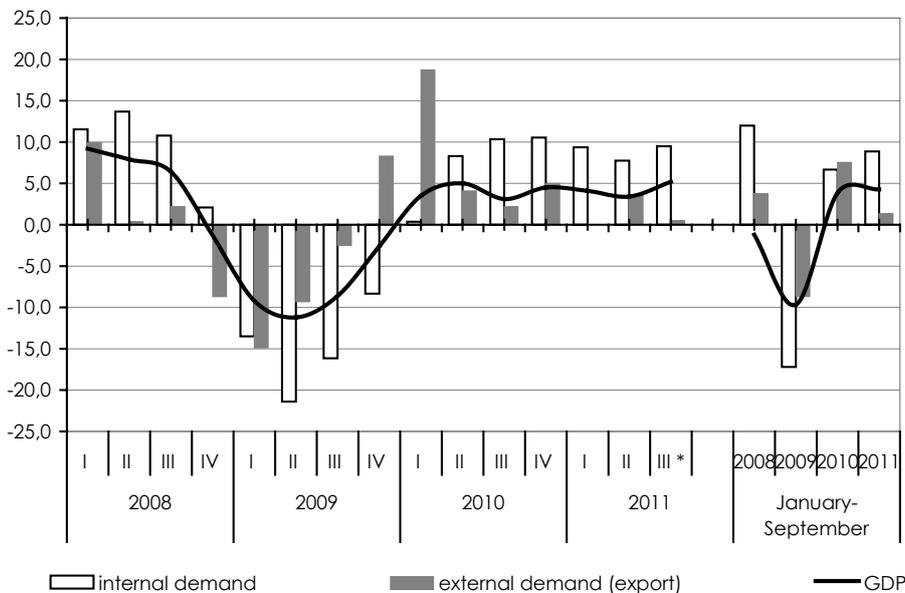
In 2011 macroeconomic situation was formed under the influence of the decrease of external demand contribution



Source: Federal State Statistics Service

* -preliminary data

Fig. 1. Changes in GDP and Investments in Fixed Assets Dynamics in 2008-2011, as Percentage to the Corresponding Period of the Previous Year



*preliminary data

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

Fig. 2. Changes in GDP Dynamics as Broken by Components of Internal and External Demand in 2008-2011, as Percentage to the Corresponding Quarter of the Previous Year

in the GDP dynamics. As a result of January-September 2011 export (in the terminology of national accounts system) went up by 1.4% versus 7.6% in the corresponding period of the previous year.

Taking into account the significance of the internal market expansion as the main factor of the post-crisis economic development in 2009-2011 it should be noted that the situation was defined by the trend for the anticipating import versus export growth and, correspondingly, the decrease of the net export growth rates slowdown for during the last two quarters of 2010 and the first half of 2011.

As a result of 2011 the volume of processing industries production reached the level of 2008 the growth of production being considerably differentiated by types of economic activities.

Whereas the production of foodstuffs, leather, footwear, coke, oil products, chemistry industry production, rubber and plastic goods production, transport vehicles and equipment production exceeded the pre-crisis level in 2011, production of machinery and equipment, electric, electronic and optic equipment, metallurgy production, timber complex production as well as construction materials output are below the figures of 2008. The growth rates fluctuating considerably by the types of processing industries slow recovery rates of machinery production was a dominating factor that had a negative impact on the level of business activity of conjugated industries of construction materials and other intermediate goods production.

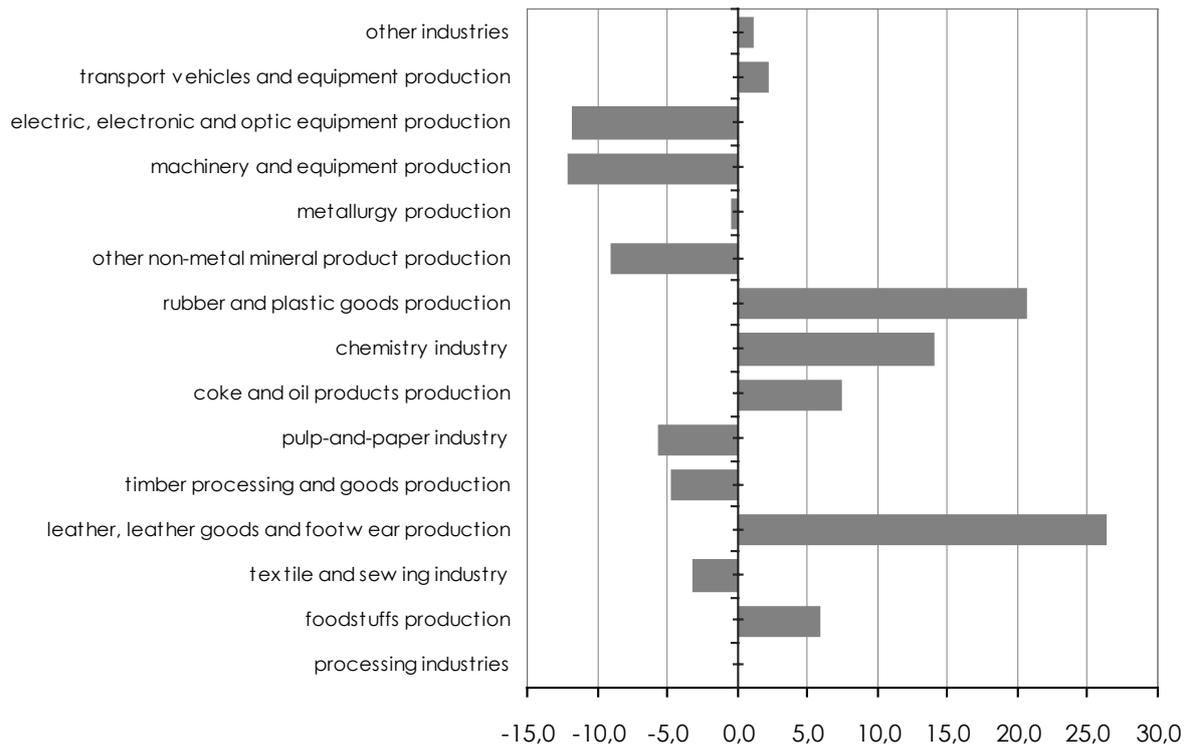
Analysis of the main macroeconomic trends allow making the following conclusion: although on the whole in 2011 the Russian economy overcame the aftermaths of the crisis unsteady dynamics of the main macroeconomic indices and slow recovery rates in the investment sector of the economy determine the limits for the development in short and middle term.

The factors defining the structure and rates of post-crisis recovery in the economy continue to dominate in the economy: the dependence on the world prices for raw export, low domestic demand, slow development of the promising markets of consumer, investment and intermediate goods by the domestic producers, weak financial system.

In 2011 the number of economically active population made 75.7m, of which 70.7m are employed in economic activities and 5.0m are unemployed (calculated on the basis of ILO methodology). The level of employment in 2011 made 63.8%, exceeding by 1.1% the figure of the previous year, while the level of general employment decreased by 0.9% as compared with 2010 to 6.6%.

As on the end of 2011 the total number of the unemployed calculated on the basis of ILO methodology exceeds the number of the unemployed registered in the state employment agencies by 3.6 times. In December 2011 there were 1,286,000 registered as unemployed in the state employment agencies. The tension coefficient (number of the unemployed registered in state employment agencies per 100 positions) in November 2011 as compared with January of the same year decreased from 175.9 to 111.6.

It should be noted that in 2000-2001 the changes in the demand for the work force were defined by the shift of the employment towards the service rendering types of activity. In recent years the decrease in employment was observed in nearly all types of activities in the industry, the



Source: Federal State Statistical Service

Fig. 3. Changes in Industrial Production Rates by Types of Economic Activity in 2011 as Percentage to 2008

number of work places contracting most rapidly in processing industry. The evolution of this trend occurs against the background of the labor efficiency growth slowdown. Low efficiency of production factors use is one of the main reasons for the decrease in competitive ability of the Russian economy. ●

RUSSIAN INDUSTRY SECTOR IN DECEMBER 2011

S.Tsukhlo

According to the Gaidar Institute surveys¹, in the situation of declining demand, industries are restraining production growth, carefully monitor the inventory of finished products, continue to reduce prices and personnel. The crisis of the Eurozone has clearly reduced the estimates for demand, production, employment and investment plans and prevents the recovery thereof.

Demand for industrial products

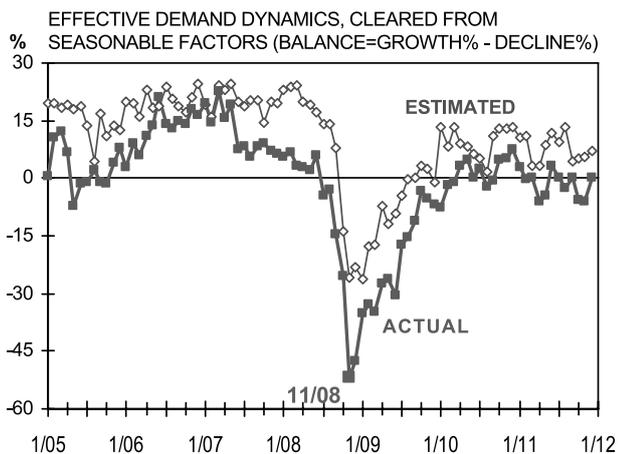


Fig. 1

In December, the dynamics in demand has undergone positive changes. But the positiveness of the changes in demand is relative. The growth rate of sales was only zero after two months of sales decline with a record for 2010-2011 intensity. These results were obtained after clearance from seasonal factors (*Fig. 1*), whereas the baseline data also demonstrate substantially reduced demand during the last quarter, which was preceded by two months of zero growth in the III quarter.

Forecasts of demand in December remained unchanged at the level of a two-year minimum as per initial data and the minimum values after clearance from seasonal factors. The sharp decline in optimism in the sales forecasts occurred in September with the beginning of a new round of debt problems in Europe.

But the slowing rate of demand was not enough for

the enterprises to revise their estimates. In December, the share of answers “below normal” continued to increase reached 40%, which is the maximum indicator throughout the past year.

Stocks of finished products

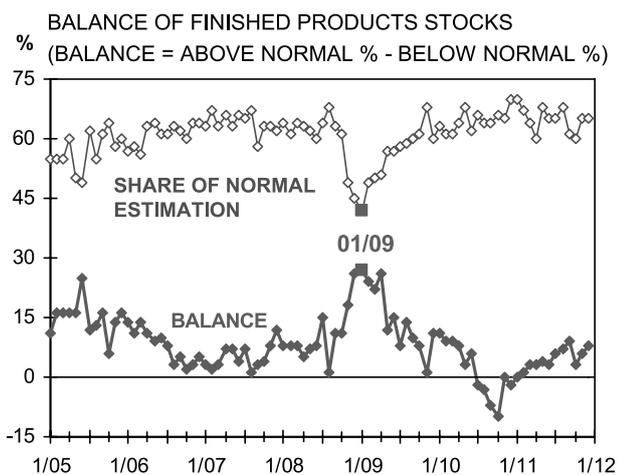


Fig. 2

According to the estimates, in the IV quarter there was some excess of finished products stocks accompanied by lowered physical volumes (*Fig. 2*). That demonstrates strong management of finished products stocks by enterprises and prevents them from using the warehouses as a buffer to increase production at the background of low demand. Over the first three quarters the industries fairly steadily increased the balance of estimates, bringing it to normal pre-crisis levels by September. Such dynamics of the indicator, which began after the collapse of the balance in October 2010, showed a slow and careful recovery of enterprises' expectations for the demand growth. By early autumn of 2011, those expectations have reached the maximum level, but the aggravation of

¹ Surveys among managers of industrial enterprises are conducted by the Gaidar Institute under the European harmonized procedure on the monthly basis since September 1992 and cover the total territory of the Russian Federation. The panel includes about 1,100 enterprises, employing more than 15% of those engaged in industry. The panel is biased towards large companies in each of the sub-sectors. Feedback to questionnaires is 65-70%.

the European debt crisis has stopped the growth. Industry preferred to avoid the risk and began to maintain a minimum surplus of inventory.

Industrial production

Actual growth rate in production also suffered obviously and definitely negative changes since September 2011. Initial Balance (rate) of the change has lost 18 points and so far gained back only 2. The results cleared from seasonal factors have decreased by 6 points, and grown in December by 2 points (Fig. 3).

Initial production estimates lost 35 points since September, and now stay at a significant minus, without any positive change. However, clearance from seasonal factors has demonstrated reduction of the balance of forecasts only by 9 points without going to the «minus». But as a result, the indicator fell down nearly to the eighteen-month minimal level and there is a minimal chance to improve it.

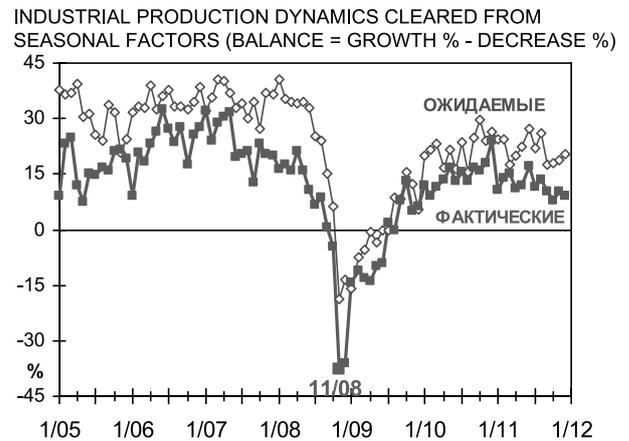


Fig. 3

Investments: assessment and plans of enterprises

Investments in the IV quarter by the majority (57%) of enterprises are estimated as normal. A year ago (in December 2010), there were 48% of such estimates, i.e., the progress is evident. Highest satisfaction with capital investments was registered in the III quarter of 2011, when the share of normal assessments reached 63%.

But investment growth (or rather increased satisfaction with the amounts, which does not always means the increase in their volume) contributed to an increase of excessive capacities as compared to demand. In the IV quarter of 2011 the scope of excessive capacities increased to 20% and the balance of capacity assessments (more than sufficient minus less than sufficient) reached 11 points, although at the year beginning it was only 5 points (Fig. 4).

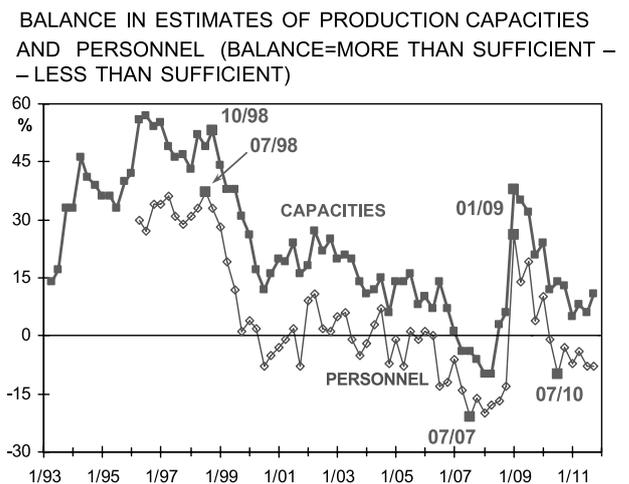


Fig. 4

Enterprises' prices

The industrial enterprises within almost all months of 2011 pursued the same pricing policy, aimed at reduction the rate of growth of wholesale prices after the January upsurge, caused by both, human factor (increase in social premium rates), and natural disasters (drought in 2010). Combination of those two factors provoked the price upsurge in January 2011 to a record peak. No less unique was the end of the year: in December 2011 the companies started to reduce their prices fairly intensively. The higher rate of reduction was recorded over 17 years of monitoring only in December 2008 and July 1998. One more comment: within the pre-crisis 2008 the balance has decreased by 56 points (the result of

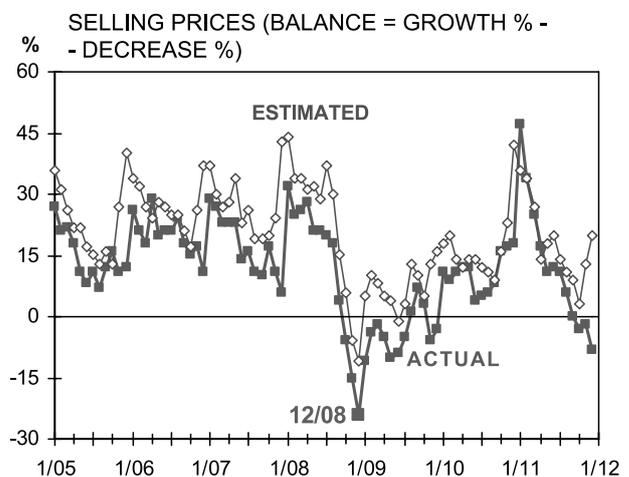


Fig. 5

the crisis December amounted to -24 balance points) over 2011 the decline made 55 points (-8 b.p. as of December results) (*Fig. 5*).

But the price forecasts made in November and December of 2011 showed that the industry still plans to reverse the trend of slowing price growth or absolute decline and to transfer to a more intensive growth. In November, the balance of forecast, after reaching in October a 28-month minimum has increased by 10 points and in December by another 11 points. However, November's plans to increase the rate of increase in prices in December were not implemented. Moreover, the industry was forced to lower prices after their minimum reduction in October and November, and to make more intense reduction in December.

Growing cost of production pushes industries to increase sales prices. If in the III quarter of 2011 growth rate of costs was minimal (+6 b.p.) within all 14 years of monitoring this indicator, in the IV quarter the growth rate increased to 14 b. p.

Actual dynamics and dismissal plans

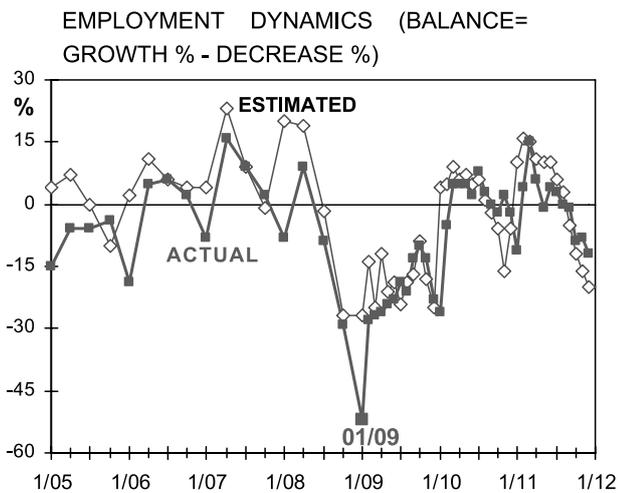


Fig. 6

of the current crisis (registered in late 2008 - early 2009), the index has to «gain» 10 points. At the same time, in the past year the balance of expected changes in the number of personnel lost 33 points, and after August (with the beginning of crisis aggravation in the Eurozone), it became negative and decreased by 20 points in four months. Plans for dismissals (personnel reductions) are also dominant in the IV quarter of the year in all sectors, business scope groups and forms of ownership. ●

In December, the intensity of layoffs in the industry increased again (*Fig. 6*). Balance (rate) changes in this indicator after stabilization in November decreased in December by another 5 points and as a result reached 23-month minimum, i.e., such intense reduction of employees was not observed in the industry since February 2010. In the IV quarter dismissals prevailed over hiring in all sectors, business scope groups and forms of ownership. Leaders as of the quarter results were metal plants (balance -15 points), medium businesses (101-250 of employees) (-12 b.p.) and JSC (-10 b.p.).

Plans of enterprises for the layoffs at the end of the year have also reached a record peak of December 2009, i.e., in early 2012 the industry expects the most intense reduction of employees than in the previous two years. To reach the record

FOREIGN TRADE

N.Volovik, K.Kharina

In November 2011 the cost parameters of both, Russian exports and imports have reached record peaks within the total period under review. Herewith, the growth in exports was mainly due to the sustained high world prices for major commodities exported by Russia, and import prices growth was primarily caused by increase of its physical volumes.

The World Bank report, published in January 2012 “Global Economic Prospects” states that the world economy has entered a phase that is characterized by significant risks and uncertainties. World events are developing by one of the scenarios of economic slowdown, which has been regarded as a risky one in the preceding report’s edition (June 2011). As a result, forecasts for the world economy have been significantly reduced:

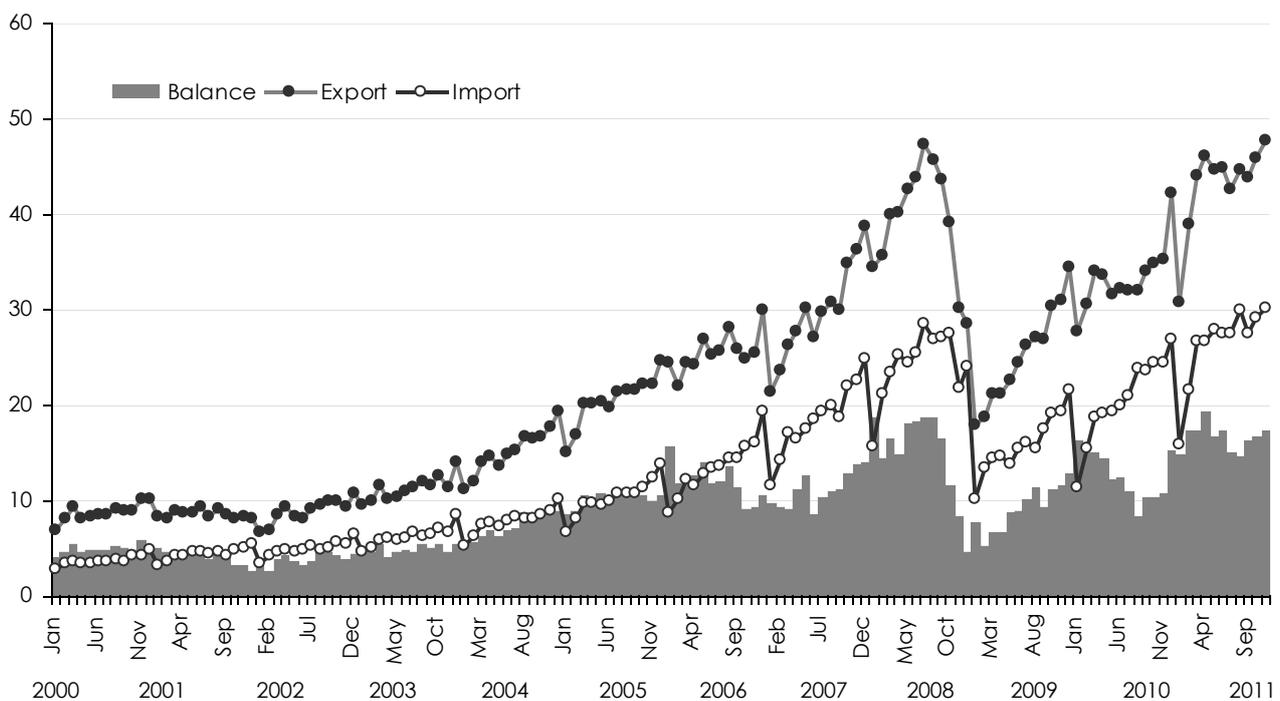
– growth rates in 2012 will reach 2.5%, in 2013 – to 3.1 % , while in the World Bank June report the growth of 3.6% for both years has been estimated.

– within 2012 in high-income countries an economic grow by 1.4 % is expected (herewith, the other Eurozone countries should be ready for the decline by 0.3 %, and the others should expect an increase by 2.1 %). In 2013 – the growth rate will make 2 % (according to the June Report data, the growth was estimated at 2.7 % in 2012 it was expected to make 2.6% in 2013).

– for developing countries growth estimates are decreased from June assessments from 6.2% in 2012 and 6.3 % in 2013 to 5.4% and 6%, accordingly.

Assessment of the RF economy growth rate in 2012 was reduced from 4.1% to 3.5%. In 2011, according to the WB estimates, the world trade growth rate amounted to 6.6% (12.4% in 2010). Against the background of slowing global economy growth in 2012, a reduced rate of the world trade growth to 4.7% in 2013 is expected, as well as its acceleration by 6.8%.

Against that background, the main indicators of Russian foreign trade seem to be very successful. Foreign trade turnover of Russia, calculated by methodology of payments balance, in



Source: RF Central Bank.

Fig 1. Key Indicators of the Russian Foreign Trade (\$bn)

November 2011 made \$78bn, which is by 29.6% more, as compared with the relevant indicator of the preceding year.

In November 2011 the Russian export volume amounted to \$47.7bn, which was by 34.4% more as compared with November 2010. However, increase in the export value was still due to the world markets conditions, favorable to the Russian export market. The average export price index made 139%, with its physical volume index of 104.3%.

In November 2011, oil prices in the world markets were influenced by an increased geopolitical tension caused by Iran's nuclear program and by expectation of a seasonal winter demand.

The average price of Brent crude oil in November 2011 remained at \$110.5/ barrel against \$86.17/barrel in November 2010. The maximum price was fixed on November 8 (\$115.11/ barrel), the minimum – on November 25 (\$104.02/ barrel). The average price of Urals oil in November 2011 amounted to \$110.65/barrel, which was by 31.1% higher than the relevant indicator of November 2010 (\$84.38/barrel. Within 11 months of 2011 the average price of Urals oil was fixed at \$109.5/ barrel, while In January-November 2010 it was less than \$79.2/barrel.

According to the monitoring for the period since December 15, 2011 to January 14, 2012 inclusive, the average price of Urals oil made \$107.7 per barrel. Therefore, according to the decree of the Russian Federal Government No. 3 of January 25, 2012 “On approval of the rates of export customs duties on crude oil and certain types of goods produced from oil exported from the territory of the Russian Federation and the territory of member-states of the Customs Union”, export duty on oil from February 1, 2012 will amount to \$393.7 per ton, as compared to \$397.5 per ton in January 2012. The flat rate of export duty on light and dark oil products, except gasoline will be at the level of \$259.8 per ton from February 1, 2012 (against \$262.3 per ton in January 2012). At the same time, the duty on gasoline, preserved at 90% of duty on crude oil, will reach \$354.3 per ton (against \$ 357.7 per ton in January 2012). Beneficial rate of export duty on crude oil from the fields of Eastern Siberia and the two fields of LUKOIL in the Caspian Sea will be decreased to \$191.2 per ton from February 1, 2012 (to \$194.1 per ton in January of the current year).

Negative trend was sustained in the global market of nonferrous metals. In November 2011 the price for aluminum has reached its minimum indicator since July 2010. Since the beginning of 2011 to December price for copper fell down by 24%, and Nickel – by 30%: this metal did not cost so cheap since December 2009. As compared with November 2010 aluminum prices fell down by 20.1%, copper – by 13.8 %, nickel – by 20.9 %. The situation is provoked by decreasing demand from major consumers in Europe, experiencing fiscal and debt problems, and China, whose GDP growth has slowed down. Nevertheless, in January-November 2011, as compared with the relevant period of the preceding year, aluminum prices rose by 12.8%, copper – by 20.9%, nickel – by 8.0%, correspondingly.

Table 1

AVERAGE MONTHLY PRICES IN NOVEMBER OF RELEVANT YEAR

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Oil (Brent), \$/bbl	21.45	27.2	29.6	49.8	58.2	57.9	81.4	79.63	77.42	86.24	110.50
Natural gas*, \$/1m BTU	3.46	3.34	3.90	4.96	7.46	8.99	9.47	15.81	7.81	8.59	11.32
Gasoline, \$/ gallon	0.603	0.801	0.841	1.43	2.056	1.484	2.13	4.195	2.01	2.16	2.58
Copper, \$/t	1405.1	1519.0	1916.4	3012.0	4060	7500	8008	4925.7	6675.6	8756.8	7551.8
Aluminum, \$/t	1280.8	1313.2	1474.8	1822.8	1929	2659	2442	2121.4	1949.3	2596.3	2073.6
Nickel, \$/t	4836.8	6840.9	11030	14483	12403	32348	30999	12140	16991	22600	17882

* European market average contract price, franco border.

Source: estimated according to the London Metal Exchange, Intercontinental Exchange Petroleum (London).

FAO food price index in November 2011 made 215 points, which was 1 point less than in October 2011 and by 23 points below the record level, achieved in February 2011.

In November 2011 Russian imports increased as compared with November, 2010 by 22.7% – up to \$30.3bn. Growth in imports was caused by both, an increase in its volume, with an index of 112.6% and an increase in the index of average import prices, which made 107.6%. It should be

noted, that in November 2011 the cost volumes of both, exports and imports reached their record peaks within the period under review.

Positive balance of the RF foreign trade in November 2011 increased as compared to the relevant period of the preceding year by 1.6 times – from \$10.8bn to \$17.4 bn.

According to the Bank of Russia, in January-November 2011 Russia's foreign trade turnover amounted to \$764.1bn, which is 31.9 % higher than the relevant indicator of the preceding year. Export deliveries rose to \$471.5bn (growth by 31.8%), imports – up to \$292.7bn (growth by 32.0%). The trade balance remained positive at \$178.8bn (against \$136.1bn in January-November 2010).

Exports of energy products increased most rapidly. Within 11 months of 2011 there were exported in the amount of \$323.5bn, by 34.9% more than in the preceding year. Herewith, the physical volume of oil exported abroad has decreased by 6.1%, oil products- by 3.7%, and diesel fuel – by 12.4%.

The monetary volume of exports of metals has increased in comparison with January-November 2010 by 10.3% with a decrease in volume by 9.1%. Export volume of ferroalloys has decreased by 5.1%, semi-finished products of iron and non-alloy steel – by 21.9%, flat rolled products of iron and non-alloy steel – by 14.1 %, copper – by 66.2%, nickel – by 29.7 %. Export supplies of aluminum increased by 3.6%.

Machinery and equipment exports increased only by 3.2% due to increase in the supply of electrical equipment by 20.4 %, railway equipment – by 64.6%, land vehicles (excluding rail) – by 15.7%, instruments and optical apparatus – by 7.7%.

In terms of imports, the purchase of machinery and equipment made the most significant contribution to its growth. Within 11 months of 2011 those commodities were imported for \$127.4bn, which is by 47.4% more than within 11 months of 2010. The growth was mainly due to the increased import of mechanical equipment by 43.4%, electrical equipment – by 22.4%, railway transport – by 54.0%, land vehicles (excluding rail) – by 72.2%, instruments and optical devices – by 22.9%. Physical volume of imports of cars has increased by 48.3%, trucks – by 91.8%.

On October 20, 2011 the report of the World Bank International Finance Corporation “Doing Business in 2012: Doing business in a more transparent world” was published. It has estimated regulations affecting local companies in 183 countries and presented the ratings of these countries in 10 areas of business regulation, including: business incorporation, resolution of insolvency, and foreign trade.

Russian Federation in terms of international trade has risen in 2011 to the 160th place from the 166 one occupied in 2010. This was due to reduction of the documents required for import transactions. Nevertheless, the Russian customs regulations are still unduly hindering for both, exports and imports. Unreasonable administrative pressure, nontransparent and cumbersome customs control, bureaucracy and corruption complicate the activity of foreign trade participants.

In accordance with the legislation, it takes at least three weeks for the goods' clearance at the Russian border (including the time required for documents pre-collection), while and in the most countries it is up to three days. However, the time for customs clearance at the movement of cargo across the border legally can be two days, while in many countries it takes hours or minutes. Russian approach to the organization of the customs process does not meet the requirements of the national innovative development.

At the end of 2011 there were adopted, and in early 2012 came into force, important documents for the field of customs regulation, which should greatly facilitate customs procedures.

On January 5, 2012 the Administrative Regulation for the provision of public services for keeping the Register of authorized economic operators (AEO), approved by the Order of the Federal Customs Service of Russia No. 1877 dated 14.09.2011.

On January 9, 2012 the Order of the FCS of Russia “On approval of a model form of agreement concluded between customs authorities and the authorized economic operator” came into force, which stipulates the procedure for cooperation between customs authorities and the AEO, as well as the regulations on information exchange.

The institution of AEO is an innovation in the customs practice of the Customs Union members and an important step to improve interaction with foreign trade participants. This innovation is based on provisions of the International Convention on the Simplification and Harmonization of

Customs Procedures of May 18, 1973, to which Russia acceded in 2010. The Convention provides for special procedures for the authorized entities compliant with the criteria established by the customs service.

By acquiring the status of authorized economic operator, a Russian legal entity, engaged in foreign trade activities, will be able to use special simplifications, providing temporary storage of goods in their warehouses (open and other sites), the release of goods prior to filing the customs declaration, holding individual customs operations involving the goods clearance directly from the warehouses (open and other sites) of the authorized economic operator.

Until now, the AEO institute could not function in view of the development of by-laws for governing its activities. Benefits granted to authorized economic operator are significant, and in case of successful implementation of this policy can greatly facilitate the work of certain categories of foreign economic activity participants. ●

STATE BUDGET

T.Tishchenko

Initial results of the socio-economic development and the federal budget execution of 2011 were announced at the meeting of the Presidium of the Russian Government on January 12, 2012. In comparison with other developed countries, Russia has one of the leading positions in regard to the main budgetary parameters. However, despite the fact that according to tentative estimates, in 2011 Russia is among the leading economies in the world in terms of the GDP growth rate – 4.2% (in China – 9.5% in India – 7.8%) it is early to speak about the effectiveness of public expenditures while the current model of budget commitments.

Initial results of the socio-economic development and the federal budget execution of 2011 were announced at the meeting of the Presidium of the Russian Government on January 12, 2012. In comparison with other developed countries, Russia has one of the leading positions in regard to the main budgetary parameters. Thus, in conditions of significant budget deficit in the Eurozone (-6.2% of GDP), UK (-11.2% of GDP), USA (-9.6% of GDP) and Japan (-10.3% of GDP) and growth of the federal debt, budget surplus of 0.8% of GDP and the preservation of the public debt in the range of 10.4% of GDP are favorable for the Russian economy. At the same time, this result was achieved mainly due to favorable external economic situation.

The possibility of a prolonged recession both in the global and in Russian economy was predicted by almost all the participants of Gaidar's forum "Russia and the World: 2012–2020"¹, which took place in Moscow in January of the current year. However, when assessing the possible effects of the recession for the national budget system, Russian experts have different opinions. The expediency of significant growth of expenditures for defense in 2012-2014 has become a stumbling block in the development of a coherent position with regard to measures for stabilization the financial system in case the country is going to enter a new wave of the crisis. Therefore, despite the fact that according to tentative estimates, in 2011 Russia is among the leading economies in the world in terms of the GDP growth rate – 4.2% (in China – 9.5% in India – 7.8%) it is early to speak about the effectiveness of public expenditures while the current model of budget commitments.

Tentative estimates of the federal budget for 2011

According to the Ministry of Finance of Russia , the federal budget revenues as of 2011 results amounted to Rb 11,352.2bn. (21.1% of GDP), which exceeds the indicator of 2010 by 3.9 p.p. of GDP (see Table. 1). Federal budget expenditures in cash execution of 98.3% for 12 months of 2011 have amounted to Rb 10,935.6bn (20.4% of GDP), which is by 2.1 p.p. of GDP less than their value as of 2010 results. Oil and gas revenues increased by 2.0 p.p. of GDP up to Rb 5,641.7bn. (10.5% of GDP).

The dynamics of monthly federal budget revenues and payments of taxes, administered by the FTS and the FCS (see Fig. 1) demonstrates a smooth growth of revenue volume during the year in taxes, coming from the Federal Customs Service, which is apparently explained by the stabilization of foreign trade volumes and the lack of abrupt changes in the ruble exchange rate. At the same time, taxes and levies administered by the Federal Tax Service are volatile. In particular, the growth of tax revenues in March and April of the preceding year (Rb 377.8 and Rb 411.9 billion, correspondingly) were caused by payments to the budget from enterprises and organizations of all forms of ownership by the annual and quarterly results of their financial statements.

The problem of irregular cash execution of the federal budget has exacerbated: about 20% of total expenditures accounted for the last month of the year (17.7% in 2010, 15.0 % in 2009), and according to the Russian Ministry of Finance, more than Rb 1 trillion has been spent within the last week of December. The bulk of the unspent balance in the amount of Rb 26.2bn belongs to the Investment and

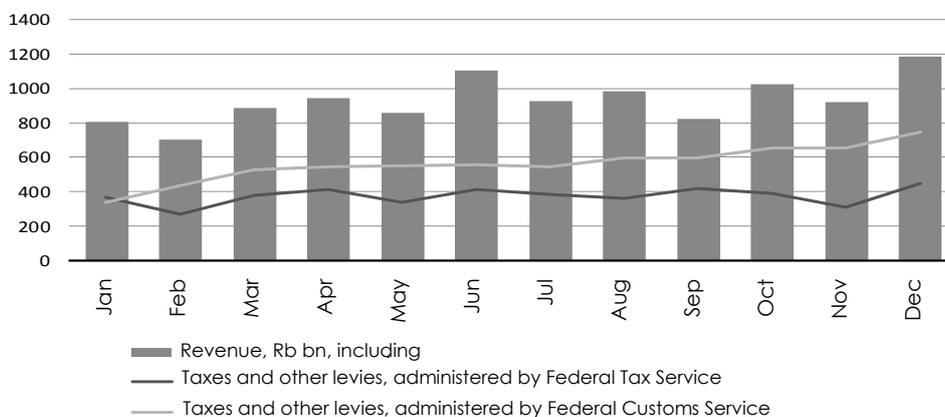
1 See more detailed at: www.iep.ru

Table 1

KEY INDICATORS OF THE RUSSIAN FEDERAL BUDGET IN 2010–2011

	2011		2010		Execution vs 2011 budget estimates, %	Change	
	Rb, bn	GDP %	Rb, bn	GDP %		Rb, bn.	GDP %
Revenues, including:	11 352.2	21.1	8 305.4	18.5	102.1	3046.8	+3.9
Oil and gas revenue	5641.7	10.5	3 830.7	8.5	103.0	1811.0	+2.0
Expenditures, including:	10935.6	20.4	10 117.5	22.5	98.3	818.1	-2.1
Interest expenditures	262.6	0.5	195.0	0.4	98.5	67.6	+0.1
Non- interest expenditures	10673.0	19.9	9922.5	22.1	98.3	750.5	-2.2
Surplus (Deficit) of the federal budget	416.5	0.8	-1 812.0	-4.0		2228.5	+4.8
Non-oil deficit	- 5225.1	-9.7	-5 642.7	-12.6		417.6	-2.9
GDP estimates	53697.6		44 939.2				

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



Source: RF Government, Ministry of Finance of Russia, Gaidar Institute estimates
Fig. 1. Dynamics of monthly revenue from taxes and fees administered by federal tax service and the federal customs service in 2011

the Road Funds assets, carried over to the next fiscal year and transfers to the Pension Fund in the amount of Rb 47bn. In 2011 reduced federal budget revenues in terms of GDP share, as well as growth of revenues due to favorable external situation allowed to execute the federal budget with a surplus of Rb 416.5bn (0.8% of GDP). Non-oil deficit has declined by 2.9 p.p. of GDP, while oil and gas budget revenues have

increased by 2.0 p.p. of GDP and accounted to 49.7% of total federal revenues in 2011 versus 46.1% in 2010.

Analysis of the main indicators of the RF Subjects consolidated budget execution in January–November 2010–2011

The consolidated budget of the Russian Federation Subjects in January – November has been executed with a surplus of Rb 771.7bn. (14.3% of GDP) with the budget cash execution in expenditures of 73.5% (see Table. 2). In January–November 2011 consolidated budget revenues amounted to Rb 6.9284bn. (14.3% of GDP), expenditures made Rb 6.1567bn. (12.7% of GDP). In comparison with the relevant period of 2010, budget revenues have decreased by 0.3 p.p. of GDP, and expenditures have decreased by 0.8 p.p. of GDP.

Comparison of data on taxes and levies revenue to the consolidated budget of the RF Subjects within 11 months of 2010 and 2011 shows:

- revenue growth from corporate income tax by 0.3 p.p. of GDP, or Rb 1,806.4bn. A similar result, i.e., an increase by 0.3 p.p. of GDP has been obtained on the basis of budget execution for the first 9 months of the preceding year, therefore, the trend to reduction of the growth rate of income tax is sustained;

- reduction of revenue from personal income tax revenues by 0.3 p.p. of GDP (as per 9 months results it has reduced by 0.2 p.p. of GDP);
- reduction in revenue from property tax by 0.1 p.p. of GDP (as per 9 months results it has reduced by 0.1 p.p. of GDP), on transport and land tax by 0.1 p.p. of GDP.

Table 2

KEY INDICATORS OF THE RF SUBJECTS CONSOLIDATED BUDGET EXECUTION
IN JANUARY–NOVEMBER 2010–2011

	January–November 2011		January–November 2010		Change, p.p. of GDP
	Rb, bn	GDP %	Rb, bn	GDP %	
Revenues, including:	6928.4	14.3	5 909.1	14.6	-0.3
Corporate profit tax	1806.4	3.7	1388.5	3.4	+0.3
Personal income tax	1699.1	3.5	1532.0	3.8	-0.3
Excise duties on goods manufactured in the RF territory	339.7	0.7	298.5	0.7	0.0
Property tax	660.0	1.4	609.8	1.5	-0.1
Transport tax	79.1	0.1	72.1	0.2	- 0.1
Land tax	116.3	0.2	109.4	0.3	-0.1
MET	31.8	0.0	26.5	0.0	0.0
Expenditures, including:	6156.7	12.7	5484.7	13.5	-0.8
Surplus (Deficit) of the consolidated budget	+771.7	1.6	+424.4	1.0	+0.6
GDP estimates	48541.0		40566.0		

Source: RF Federal Treasury, Gaidar Institute estimates

As of 11 months of 2011 results, consolidated budget surplus of the RF Subjects was sustained in most regions of the country. Only in seven Subjects of the RF the consolidated budget was executed with a deficit. In Volgograd region and the Republic of Mordovia, the deficit amounted to Rb 2.3bn, which is the highest in absolute terms.

Over eleven months of 2011, expenditures of consolidated budget of the RF Subjects decreased by 0.8 p.p. of GDP (see Table. 3), mainly due to the revenues of interbudgetary transfers – by 0.7 p.p. of GDP and under the budget line “Social Policy” – by 0.4 p.p. of GDP. A slight decrease in

Table 3

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

	January–November 2011		January–November 2010		Change, p.p. of GDP
	Rb, bn	GDP %	Rb, bn	GDP %	
Expenditures, total:	6156.7	12.7	5484.7	13.5	-0.8
Including					
Federal issues	390.8	0.8	344.5	0.8	0.0
National defense	2.8	0.0	2.5	0.0	0.0
National defense and law enforcement	221.8	0.5	211.4	0.5	0.0
National Economy	1004.5	2.1	871.5	2.1	0.0
Housing and public utilities	731.7	1.5	657.8	1.6	-0.1
Environmental protection	13.4	0.0	11.2	0.0	0.0
Education	1425.9	2.9	1215.6	3.0	-0.1
Culture, cinematography and mass media	216.5	0.4	185.7	0.5	-0.1
Healthcare and sports	1066.6	2.2	646.0	1.6	+0.6
Social policy	1010.9	2.1	1010.6	2.5	-0.4
Interbudgetary transfers	14.1	0.0	275.2	0.7	-0.7
Public and municipal debt service	56.9	0.1	55.2	0.1	0.0

Source: Federal Treasury, Gaidar Institute estimates.

revenues has occurred in “Housing and communal services” (-0,1 p.p. of GDP),” Education” (-0.1 p.p. of GDP),” Culture, Cinema, Media” (0.1 p.p. of GDP).

The growth of consolidated budget expenditures of the RF Subjects occurred only under the line “Healthcare, physical culture and sports” (by 0.5 p.p. of GDP) due to increased spending on outpatient / inpatient care and implementation of the modernization program of healthcare.

Taking into account the reduced rate of income growth from the main regional taxes and levies, as well as the needs of the execution of about Rb 2 trillion in December, there is a probability of execution of consolidated budget with a deficit in the majority of the Russian Federation Subjects as per results of the year. Herewith, with the sustained trend to reducing rate of revenues growth to regional budgets in 2012, a number of the RF Subjects may need more additional assistance from the federal budget. Therefore, the state of regional budgets can be one of the negative internal factors affecting the stability of the national budget system in 2012. ●

THE RUSSIAN BANKING SECTOR

M.Khromov

December became a record-breaking month in terms of growth of banks' charter capital, which reached the level of Rb 115bn. Banks' profit hit its historic high since December 2009. The loan to deposit ratio in the banking sector markedly improved: as of 1 December, the volume of credits and loans allotted to corporations and the population was higher than that of monies attracted and kept on bank accounts and as deposits placed by physical persons and legal entities. Traditionally, in December the volume of the most liquid assets belonging to banks (monies and resources placed on accounts with the Bank of Russia) increased following rapid growth of their resource base. As demonstrated by that year's results, it amounted to 6.2% of banks' aggregate assets. However, one year earlier the share of liquid assets had been 9.2%. Now the seasonal leap of liquidity only disguises its decline.

Traditionally, December is the month of accelerated growth of the banking sector's financial indices. The principal factor of that acceleration is the uneven character of expenditures in the budgetary system, much of which is executed towards a year's end, thus replenishing the bank accounts of budget recipients. The year 2011 was no exception. In December 2011, the aggregate assets of banks rose by 4.4% (or Rb 1.7 trillion), thus amounting to 22% of the total per annum growth of their assets (23.1%, or Rb 7.8 trillion).

The balance sheet value of the banking system's equity rose in December by 4.6% (over the entire year – by 13.7%). December became the month of record growth of banks' charter capital (+ Rb 112bn). A noticeable contribution in the increasing size of their equity in December was also made by banks' profit. The amount of profit received over that month by the banking sector (before taxes) is Rb 90bn, thus making a per annum return on assets (ROA) of 2.7%, and a return on equity (ROE) of 23.5%. In this connection, the volume of profit in nominal terms in December 2011 hit its historic high since December 2009.

In December, due to a sharp rise in the banking sector's resource base, the loan to deposit ratio noticeably improved. As of 1 December, the total amount of credits and loans allotted to corporations and the population exceeded the volume of monies attracted and kept on the accounts and as deposits of physical persons and legal entities by Rb 655bn, or by 14.6% of banks' equity. In the course of one month the situation reversed. As demonstrated by December's results, it was the deposit base that exceeded the economy's credit portfolio by Rb 740bn, or by 15.9% of the size of capital. It should be noted that one year earlier this 'excess' of deposited resources was much more impressive, amounting to 27.3% of equity. Thus, the persistence of the current trends implies that over much of the year 2012 the banking sector is going to function in a situation of 'credit deficit', thus requiring increased volumes and longer periods of government support aimed at sustaining the growth of financial indices at an unchanged rate.

Attracted Funds

In December, *accounts and deposits of the population* increased by Rb 812bn, or by 7.2%. Out of that amount, approximately 0.5 p.p. resulted from reevaluation of deposits denominated in foreign currencies. At the same time, deposits denominated in foreign currencies remained practically unchanged in dollar terms throughout December. Their volume remained at the level of \$ 67bn. Thus, growth was demonstrated only by ruble-denominated accounts and deposits, which is indicative of lack of the population's demand for savings denominated in foreign currencies.

Although on the whole throughout the year 2011 the savings rate for deposits with banks dropped by nearly 2 p.p. on 2010 – from 7.3% to 5.5% of money incomes, in December that index reached its 'final month of the year's' historic high for the last 14 years.

The maximum interest rate on ruble-denominated deposits established by the top ten banks – deposit market-share leaders in the last ten days of December became as high as 9.51% per annum, having risen over that month by nearly 0.5 p.p. Thus, the real interest rate on the most liquid ruble-denominated deposits at the end of the year 2011 amounted to approximately 3.4%. The rise in the real interest rate on deposits was evidently one of the factors that triggered growth of the savings rate in December 2011.

The amount of money kept on the *accounts of non-banking institutions* increased over December by more than Rb 1 trillion (or 10.7%). Interestingly, in that particular month ruble-denominated accounts demonstrated growth at an even higher rate –16.2%, while accounts denominated in foreign currencies (taken in terms of their equivalent USD value) experienced a drop by 10.0%. Thus, growth of money on the accounts of enterprises and organizations was coupled with its marked ‘dollarization’: over December, the share of accounts denominated in foreign currencies shrank from 22.8% to 19.0%. It is noteworthy that the bulk of that money growth (more than 75%) was created by the upward trend displayed by fixed deposits. In December, the rate of growth of monies kept on settlements accounts was only 5.7%, while fixed deposits increased by 16.1%. For most part, that growth was produced by short-term deposits for periods less than 90 days.

In December, banks’ *foreign liabilities* shrank by \$ 2.4bn, or by 1.7% in dollar terms. This decline of foreign liabilities of banks occurred for the first time in three months. On the whole over Q4 2011, banks’ aggregate debt to non-residents increased, according to their reporting documentation, by \$ 6.5bn. The principal borrowers abroad, as before, were state banks¹. Their external liabilities increased by \$ 1bn in December, and by \$ 7.5bn over Q4 2011. Other (non-state) banks continued to decrease the amount of their external debt.

In December the banking sector’s dependence on resources received by the Bank of Russia and the RF Ministry of Finance became somewhat lower. November’s results demonstrated a historic high reached by the amount of government support granted to the banking sector: the *aggregate debt of banks to the Bank of Russia and the RF Ministry of Finance* was Rb 2.1 trillion as of 1 December 2011, which amounts to 5.3% of banks’ aggregate assets, including Rb 905bn of deposits placed by the RF Ministry of Finance and Rb 1.2 trillion of credits and other resources attracted from the Bank of Russia. Over December 2011 the RF Ministry of Finance’s deposits placed with banks decreased by Rb 343 bn. This decline was produced in the main by the shrinking volume of the placed monies. In December, the limit on the temporarily available funds of the RF Ministry of Finance to be placed through was set at Rb 232bn (of which banks attracted Rb 222 bn), while banks redeemed previously received deposits in the amount of Rb 565bn. Nevertheless, federal budget surplus made it possible to let banks keep a sum of more than Rb 560bn, which would be carried forward to the new financial year. Thus the volume of the RF Ministry of Finance’s monies placed with banks as of 1 January demonstrated its historic high since April 2008, when temporarily free budget resources had first been placed with banks. Until then, because of budget execution with a deficit, such substantial resources could not be left with banks at the end of a financial year. It should be noted that 75% of the RF Ministry of Finance’s deposits are kept at state banks.

The volume of refinancing allotted to banks by the Bank of Russia in December, on the contrary, was increased (by Rb 20bn). Characteristically, the amount of credits granted to state banks increased by Rb 93bn, this category of banks – similarly to the situation with deposits placed by the RF Ministry of Finance – representing the main recipients of state support: they receive almost 80% of all the monies provided by the Bank of Russia (including the subordinated credit to *Sberbank* in the amount of Rb 300bn). On the whole, as seen by December’s results, the volume of state support amounted to Rb 1.8 trillion, or 4.3% of banks’ aggregate assets.

Invested monies

The amount of *credits* granted by banks to *corporate borrowers* in December 2011 increased by 1.4%, which is somewhat below the average monthly growth rate displayed by credits over the entire year (1.8%). The same growth rate was demonstrated by ruble-denominated credits. The amount of credits denominated in foreign currency dropped by 0.9% in dollar terms. At the same

¹ The group of state banks includes biggest banks owned by the State or big state companies: Sberbank, VTB, VTB24, Gazprombank, Rosselkhozbank, Bank Moskvyy [Bank of Moscow], and Transkredit.

Table 1

THE STRUCTURE OF RUSSIA'S BANKING SYSTEM'S LIABILITIES (AS OF MONTH'S END),
AS % OF TOTAL

	12.05	12.06	12.07	12.08	12.09	06.10	12.10	03.11	06.11	09.11	12.11
Liabilities, bn Rb	9,696	13,963	20,125	28,022	29,430	30,417	33,805	34,009	35,237	38,443	41,628
Equity	15.4	14.3	15.3	14.1	19.3	19.7	18.7	18.9	18.5	17.3	16.9
Credits allotted by Bank of Russia	0.2	0.1	0.2	12.0	4.8	1.7	1.0	0.9	0.9	1.3	2.9
Interbank operations	4.0	3.4	4.1	4.4	4.8	5.1	5.5	5.2	5.2	5.4	5.7
Foreign liabilities	13.7	17.1	18.1	16.4	12.1	11.5	11.8	11.2	10.9	11.4	11.1
Physical persons' monies	28.9	27.6	26.2	21.5	25.9	28.3	29.6	30.0	30.4	29.0	29.1
Enterprises and organizations' monies	24.4	24.4	25.8	23.6	25.9	25.4	25.7	25.1	24.3	24.4	26.0
Accounts and deposits of state administrative bodies and local governments	2.0	2.2	1.5	1.0	1.0	1.8	1.5	2.3	3.5	4.9	2.3
Securities issued	7.6	7.2	5.8	4.1	4.1	4.2	4.0	4.1	4.0	3.8	3.7

Source: RF Central Bank; the IEP's estimates.

time, their share in the total volume of credits increased (from 19.5% to 19.6%) following the rising exchange rate of the USD.

The quality of the credit portfolio improved, as shown by the banking reporting documentation for December 2011. The size of stale debt in absolute terms shrank by Rb 28bn, while its share in the total volume of credits decreased from 5.0 to 4.8%. Similarly, the volume of reserves against potential losses associated with credits allotted to corporate borrowers became smaller. Over December, banks released their reserves in the amount of Rb 30bn, and the ratio of that sum to the credit portfolio dropped from 8.6 to 8.3%.

The December slowdown in the growth rate of crediting may be the result of an accelerated growth of banks' investments in corporate bonds, which were replacing credits in the structure of their assets. The banks' portfolio of corporate bonds increased in December by 11.7%. In this connection, over December the aggregate sum of loans allotted to the corporate sector of the national economy (credits and bonds) rose by 2.0%, which is even slightly higher than the average monthly growth rate observed over that year (1.8%).

The volume of debt against *credits allotted to physical persons* increased in December by 4.0%. This is the historic high of its monthly growth rate since the revival of the retail credit portfolio's growth in early 2009. On the whole over the year 2011, the volume of debt against credits to physical persons rose by 36%. Besides, the size of newly allotted credits increased in 2011 by nearly 1.5 times on 2010. When taken relative to commodities turnover, the volume of allotted consumer credits (less housing credits) rose from 14.5% in 2010 to 18.3% in 2011.

Similarly to the situation in the corporate segment of the credit market, the retail credit portfolio displays 'de-dollarization' of debt. The volume of debt against ruble-denominated credits was increasing at a faster rate – 4.2% per month, while that of credits denominated in foreign currencies decreased by 2.9% in dollar terms.

The quality of the retail credit portfolio in December also improved. The share of stale debt declined from 5.6 to 5.3%, while the size of reserves against potential losses shrank from 7.5% to 7.2% of the volume of credits.

The size of investments in government debt obligations rose in December by 4.0%. At the same time, banks are displaying less interest in government bonds. While in 2009 the size of their investments in government securities more than doubled, and then in 2010 further increased by 1.5 times, the results of the year 2011 indicate that the growth of that index was only 26%. In other words, the growth of the government debt market drew a smaller share of the banking sector's resources away from crediting the national economy than it had done in the preceding years.

The volume of the most liquid assets of banks (cash and monies placed on the accounts with the Bank of Russia) in December experienced its traditional rise following rapid growth of their resource base. The size of those assets over that month rose by Rb 709bn (or by 37.6%), thus amounting, as seen by the year's results, to 6.2% of banks' aggregate assets. However, one year earlier the share of liquid assets had been 9.2%. At present, their shortage is simple disguised by the seasonal upsurge of liquidity. Thus, when taken without cash in vaults, the volume of all other liquid assets placed on correspondent accounts and as deposits with the Bank of Russia (Rb 1.4 trillion) becomes one-quarter less than the sum received from the Bank of Russia and the RF Ministry of Finance (Rb 1.8 trillion). When cash in vaults is taken into account, it turns out that 2/3 of liquidity is formed by the funds received from the State. It should be borne in mind that this happened during the most favorable time of the year when the volume of free resources available to banks is at its highest. The results of January (following a seasonal drop of liquidity and stagnation of the resource base) may reveal that the values of these two indices become equal, and so smooth functioning of the banking sector will depend entirely on the ability of the Bank of Russia and the RF Ministry of Finance to make liquidity available to banks.

Table 2

THE STRUCTURE OF RUSSIA'S BANKING SYSTEM'S ASSETS (AS OF MONTH'S END), AS % OF TOTAL

	12.05	12.06	12.07	12.08	12.09	06.10	12.10	03.11	06.11	09.11	12.11
Assets, bn Rb	9,696	13,963	20,125	28,022	29,430	30,417	33,805	34,009	35,237	38,443	41,628
Cash and precious metals	2.7	2.6	2.5	3.0	2.7	2.1	2.7	2.2	2.2	2.3	2.9
Monies placed with Bank of Russia	7.3	7.5	6.9	7.5	6.9	7.8	7.1	5.9	4.5	3.5	4.2
Interbank operations	6.3	5.8	5.4	5.2	5.4	6.2	6.5	6.5	6.4	6.2	6.4
Foreign assets	9.1	9.9	9.8	13.8	14.1	12.7	13.4	13.6	13.8	14.6	14.3
Credits allotted to population	12.1	14.7	16.1	15.5	13.1	13.0	13.0	13.3	14.0	14.2	14.4
Credits allotted to corporate sector	47.0	45.3	47.2	44.5	44.5	45.1	43.6	44.5	45.3	45.1	44.0
Credits and loans allotted to	6.6	5.2	4.1	2.0	4.2	4.2	5.1	5.7	5.8	6.0	5.0
Property	2.4	2.4	2.2	1.9	2.7	2.7	2.6	2.6	2.5	2.4	2.3

Source: RF Central Bank; the IEP's calculations ●.

MORTGAGE IN THE RUSSIAN FEDERATION

G.Zadonsky

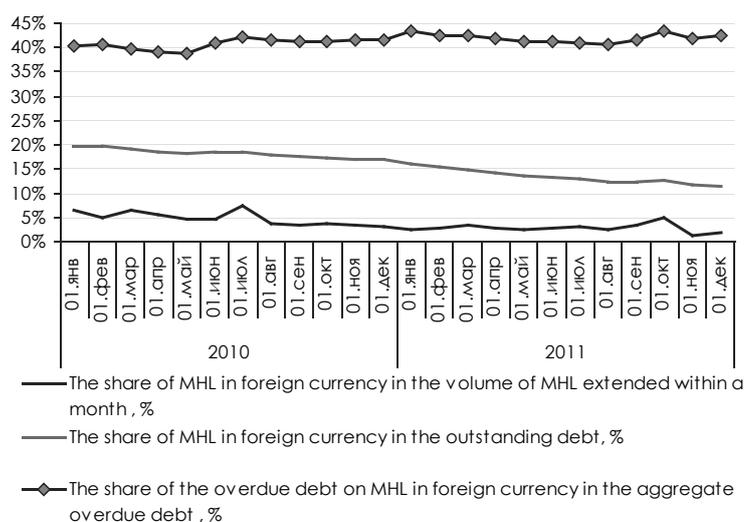
The volume of mortgage housing loans extended within 11 months of 2011 amounted to Rb 613.4bn, which figure exceeds the preliminary forecasts for the entire year. The average weighted rate on mortgage housing loans extended within the month in rubles keeps decreasing and in November it amounted to 11.4%. In November 2011, the overdue debt as a percentage of the outstanding debt on ruble mortgage housing loans decreased, while that on mortgage housing loans in foreign currency rose.

According to the data of the Central Bank of Russia, as of December 1, 2011 449,210 mortgage housing loans (MHL) were extended from the beginning of the year for the total amount of Rb 613.4bn with the debt of Rb 1,425.2bn. By the number of the extended loans and the volume in money terms the figures were 79% and 95% higher as compared to those as of December 1, 2010. As of December 1, 2011, the volume of the extended housing loans (HK) amounted to Rb 662.3bn or 512,066 loans with the debt of Rb 1,573.5bn. Within November 2011, MHL for the total amount of Rb 76.4bn were extended which figure was 9.63% higher than in October. As of December 1, 2011, the overdue debt on MHL increased by 1.78% as compared to November 1 and amounted to Rb 45,158bn. It is to be noted that in November 2011 the share of the overdue debt in the outstanding debt on MHL fell to 2.06% as regards loans in rubles and rose to 11.72% as regards loans in foreign currency. Within November 2011, the total overdue debt as a percentage of the total outstanding debt decreased by 0.05 % and

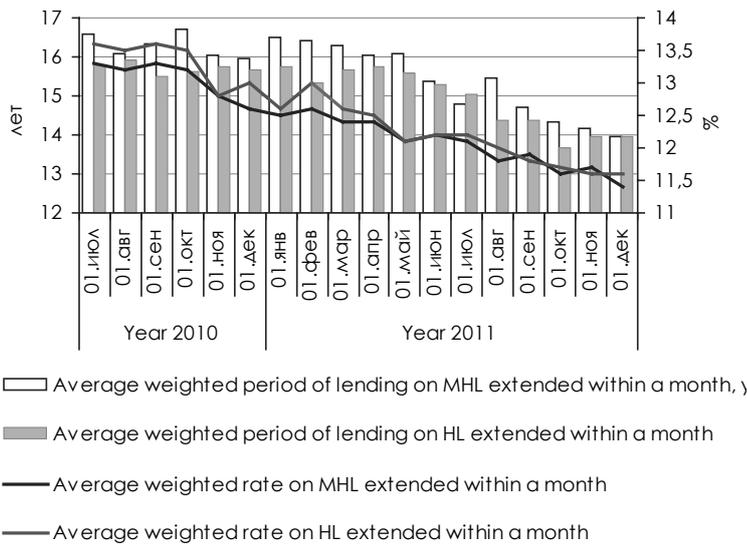
According to the data of the Central Bank of Russia, in November 2011 the share of the debt on MHL without overdue payments to the total amount of the debt on MHL increased by 0.44% and amounted to 92.91%. The share of the defaulted loans (with payments overdue for over 180 days) in the total amount of the debt on MHL fell by 0.05 %.

The share of MHL in foreign currency in the volume of loans extended in November 2011 amounted to 1.9%. As of December 1, 2010, the share of such loans in the outstanding loan amounted to 11.46%, while the share of the overdue debt on MHL in foreign currency in the aggregate overdue debt, to 42.41% (Fig. 1).

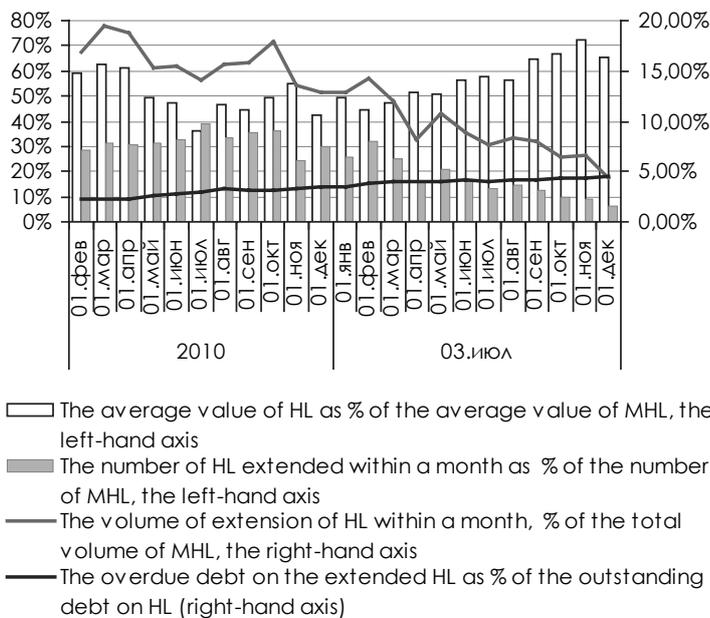
The average weighted rate on MHL in rubles extended within a month in November 2011 amounted to 11.4%, which figure is 0.3% lower than in October, while the average weighted rate on HL in rubles extended within a month remained unchanged as compared to October and amounted to 11.6% (Fig. 2). In November 2011, the average weighted rate on loans refinanced by OAO Agency for Mortgage Housing Lending (AMHL), amounted to 10.94% which figure is 0.06% lower than the rate in October 2011. The average weighted rate on MHL in foreign currency extended from the beginning of the year amounted to 9.5%, which figure is 0.1 % higher than that as of November 1, 2011. In 2011, the average weighted period of lending on MHL extended in rubles within a month kept shrinking and amounted to 13.98 years in November (Fig. 3). In the previous



The Source: on the basis of the data of the Central Bank of Russia
Fig. 1. The dynamics of the Rb/foreign currency ratio in the main MHL indices



The source: The Central Bank of Russia.
 Fig. 2. The average weighted periods and interest rates on loans in rubles extended within a month.



The source: on the basis of the data of the Central Bank of Russia.
 Fig. 3. The dynamics of extension of housing loans without mortgage security

total amount of Rb 4.07bn. The rate of the first coupon of A-class bonds for the amount of Rb 2,931bn amounted to 8.95% per annum.

From January 1, 2012, Federal Law No. 330-FZ of November 21, 2011 has extended the period of the privilege as regards compensation by the entity of a portion of the interest on the mortgage loan to the employee; such a compensation is accounted for in the expenses related to the labor remuneration and is not charged with the individual income tax. Article 99 as amended of Federal Law No. 389 on Court Enforcement Action permits bailiffs to withhold from January 1, 2012 100% of the wages and salaries from the accounts of the debtor—non-payer, except for the amount of the last periodical payment. Experts doubt the legitimacy of such an amendment and do not rule out that it will be appealed against at the Constitutional Court.

year, the average weighted period of lending on HL in rubles decreased to 13.94 years, as well. As of December 1, 2011, the average weighted period of lending on MHL in foreign currency extended from the beginning of the year amounted to 12.98 years.

Apart from MHL, that is, loans with mortgage security, housing loans (HL) also include HL without mortgage security. If on December 1, 2011 the aggregate overdue debt on MHL amounted to 3.17% of the total outstanding loan that on HL without mortgage security, to 4.53%. As the risks of such loans are higher than those related to MHL, the average values of such loans are lower than the average values of MHL (Fig. 3). In 2011, the share of HL without mortgage security kept decreasing as regards both the number of loans and the volume in money terms. (Fig. 3).

As of December 1, 2011, the AMHL refinanced 35,122 mortgage loans whose total value as of the date of refinancing amounted to Rb 44.641bn. The share of mortgage loans refinanced by AMHL in the total number of mortgage loans extended in November 2011 amounted to 7.4%.

In December 2011, OAO AMHL placed A23-series nonconvertible documentary coupon bonds secured with guarantees of the Government of the Russian Federation and with mandatory centralized safe-keeping for the amount of Rb 14bn. The rate of the bonds' first coupon is set at 7.94% per annum.

The Federal Financial Markets Service of Russia (FFMS) registered the report on the results of the issuing of nonconvertible interest-bearing documentary bonds with mortgage security of Vozrozhdenie Bank for the

THE IMPACT OF RUSSIA'S ACCESSION TO THE WTO ON CROSS-BORDER MOVEMENT OF INVESTMENTS IN THE RUSSIAN FEDERATION

A.Pakhomov

On 16 December 2011, at the Eighth WTO Ministerial Conference in Geneva, the Protocol of the Russian Federation's accession to the World Trade Organization was signed. After the ratification of the document package determining the terms of Russia membership in the WTO (her rights and responsibilities) by the Federal Assembly of the Russian Federation and 30 days after the notification thereof of the WTO Secretariat, Russia will officially become a full-fledged member of that international organization¹.

At present, although there exist a great variety of experts' opinions concerning Russia's economic problems and the potential new ways of its development, a majority of specialists agree that the Russian economy lacks necessary investments and so, to ensure stable growth, needs to attract domestic and foreign capital.

In this connection it must be emphasized that in spite of the vast difference between the viewpoints (often conflicting) as to the economic consequences of Russia's accession to the WTO, many experts believe that this move will have a positive effect on foreign capital inflow into the country, including direct investments.

This approach is based on the general systemic conditions – the status of international liabilities and a given country's membership in the WTO, which involves implementing that organization's basic principles in the domestic economy and foreign trade, transparency and predictability of the regulatory environment, understandable legislation based on international standards, and so on.²

At the same time, it should be stressed that, from a formal point of view, the WTO has practically little competence over issues relating to investments.

However, there exist a number of agreements designed to encourage the attraction of investments to the WTO member countries. These are as follows:

- the Agreement on Trade-Related Investment Measures (TRIMs)³;
- some provisions stipulated in the General Agreement on Trade in Services (GATS)⁴;
- the Schedule of Specific Commitments on Services that regulates access to markets for WTO member states (i.e., liberalization) in some sectors, including financial services;
- the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)⁵.

1 The World Trade Organization (WTO) has been established to regulate the trade and political relations between its member countries on the basis of the agreements package adopted during the Uruguay round of multilateral trade negotiations (1986–1994). These documents serve as a legal base for contemporary international trade. The WTO's functions also include the conduct of multilateral trade negotiations (MTN) and administering the system for settling trade disputes arising between its member countries.

2 The basic GATT/WTO principles are as follows: trade without discrimination – that is, mutual granting to foreign goods and services treatment no less favorable than that accorded to like or directly competitive domestically produced goods and services; tariffs should normally be the only instrument used to regulate trade in goods; prohibition of any quantitative or other restrictions; the fullest transparency possible in the trade policies; settlement of trade disputes through consultations, negotiations, etc.

3 Agreement on Trade-Related Investment Measures (TRIMs); the Agreement imposes a ban on the use of a limited number of trade policy measures that can influence foreign investments and be interpreted as contrary to Article III (National Treatment) and Article XI (Quantitative Restrictions) of the General Agreement on Tariffs and Trade (GATT). For more details concerning the provisions stipulated in that document, see Pakhomov A.A.. Soglasheniye po investitsionnym meram, svyazannym s trgovlei. [The Agreement on Trade-Related Investment Measures], Vneshniaia trgovlia [Foreign Trade], No 1-3, 1998, pp.24-25

4 General Agreement on Trade in Services (GATS) sets the main principles of trade in services and the rights and responsibilities of the WTO members.

5 Trade-Related Aspects of Intellectual Property Rights (TRIPS); the document establishes the minimum standard rights and responsibilities of WTO members in the field of intellectual property right protection.

Besides, investments can be more or less influenced by the implementation of some other provisions incorporated in the WTO's agreements package. This is particularly true of the Agreement on Subsidies and Compensatory Measures and the Agreement on Agriculture, which regulate support, at the government level, of national economic agents operating in the spheres of industry and agriculture¹.

On the whole, the implementation of the key principles can create the basic preconditions for the emergence of an investment-friendly environment in each individual country as well as on an international scale.

It should be reminded that in the second half of the 1990s, under the OECD's auspices, a draft of the Multilateral Agreement on Investments (MAI) was prepared, to be signed in 1998. That document was to regulate foreign direct investment (FDI) on an international level. In particular, the MAI envisaged the possibility for foreign companies to dispute the investment policies of the governments of recipient countries that may appear to them to be unjust. However, any further consideration of that draft document was discontinued because of some serious disagreements that arose then even among the OECD members.

In this connection it must be stressed that some other international organizations and institutions, including the World Bank, UNO structures, etc. after many years of fruitless attempts at elaborating agreements in the sphere of global regulation of cross-border investment effectively dropped off their negotiations, focusing instead only on analyzing this dynamically developing activity.

The difficulty inherent in negotiating these complex problems is associated with the existence of some quite opposite approaches practiced by different groups of countries. These differences are determined by their levels of economic development, their roles in the global investment process, national policies with regard to capital investments, and other factors.

At the same time, the growing share of some dynamically developing markets, and primarily the BRIKS countries, in the global movement of FDI across the post-crisis economy may trigger a revival of discussions of this issue, with a possible onset of a new round of multilateral negotiations concerning the regulation of cross-border investments on an international scale.

The influence of the factor created by the existence of the WTO on FDI inflow into a country may be rather controversial, because the opening up of some separate sectors of the domestic market, where the rates of import customs duties will drop dramatically, in theory is going to result in promoting the growth of import of commodities, not investments. However, if one considers the 'specific features' of Russia's national economy, several different scenarios are possible.

Besides, in this context it also necessary to determine the factors associated with the impact of membership in the WTO on legal withdrawal of entrepreneurial capital from Russia. Thus, according to the data published by the RF central Bank, the Russian Federation has been a net exporter of FDI for three years in a row, and in 2011 the level of export of direct investments hit its historic high of \$ 70bn (while FDI inflow amounted to only \$ 48.5bn)².

In recent years, withdrawal of direct investments from Russia has begun to play a special role in the national economy's development³. The positive effects of this process will be determined by its actual scale and the national economy's ability to absorb the advantages of foreign and domestic business practices, which will require the creation of an appropriate institutional environment and development of competition inside the country.

As a rule, the fact itself of a country's accession to the WTO increases its attractiveness in terms of investments and promoted cross-border capital movement. If some real shifts in Russia's economy indeed occur as a result of it, that trend will be directly conducive to the improvement of the image of Russian companies abroad and so expand the global dimension of their entrepreneurial activity.

1 See *The Results of the Uruguay Round of Multilateral Trade Negotiations (The Legal Texts)*, Geneva, 1995

2 *Tsentrāl'nyi Bank Rossiiskoi Federatsii: otsenka placheznogo balans Rossiiskoi Federatsii za 2011 g.* [The Central Bank of the Russian Federation: An Estimation of the Balance of Payments of the Russian Federation for the Year 2011], http://cbr.ru/statistics/print.aspx?file=credit_statistics/bal_of_payments_est.htm&pid=svs&sid=opb

3 For more details, see Pakhomov A.A. *Investitsionnaia deiatel'nost' rossiiskikh kompanii za rubezhom: tendentsii razvitiia.* [The Investment Activity of Russian Companies Abroad: the Development Trends.] *Delo [The Business]*, 2011 r.

Among the direct effects of FDI exports one must, first of all, distinguish the potential benefits that Russian services suppliers will be able to enjoy once they acquire new rights under the GATS and the opportunity to defend those rights on a multilateral basis within the WTO. Such examples have already appeared in the world practice¹.

In the 2010 rating of countries supplying commercial services conducted by the WTO, Russia (\$ 44bn) came 23rd in the world, and its share amounted to 1.2%. In terms of commercial services imports (\$ 70bn) this country was rated 16th, while its share dropped to 2.0%² According to the RF Central Bank's preliminary estimates, in 2011 services exports rose by one-quarter – to \$ 55bn, while imports climbed even higher – by one-third to \$ 92.1bn, which means that chronic deficit in that sphere reached its historic high³.

By now, Russia has already gained some comparative advantages and achievements in exporting a number of services. These are, for example, Internet services (5th in the world), including software, as well as engineering services that determine the development of new sectors of the world economy. Given a sustainable strategy for supplying state-of-the-art hi-tech products in these areas, Russian suppliers could come very close to participating in global supplier networks (or chains) of commodities and services – including through making capital investments abroad.

Theoretically, Russia's potential for exporting services is huge: while that sector's share in the by-branch structure of GDP is 60%, supplied of services to foreign markets at present amount to less than 10% of this country's aggregate exports. If that index climbs at least to the mean world level (20%), the volume of Russia's services exports could become as high as \$ 100–110bn.

The prospects for promoting Russian financial services (banking, insurance, stock market) that are directly linked to capital movement so far have been rather modest. This has to do, first of all, with the weakness and low competitive capacity, on the international level, of this particular sector of the Russian economy. Since the crisis only *Sberbank* has remained active in the sphere of direct investments on foreign markets. Among private structures the same is true of the *Renaissance Capital* investment bank, more than 50% of whose equity is held by foreign shareholders.

In addition, among the positive effects of Russia's accession to the WTO on FDI exports we can point to lesser opportunities for discriminating Russia in terms of the world economy as a whole, as well as a possible change from negative to positive of the attitude to Russian exporters of goods, services and capital on the part of other countries' government bodies and businesses.

And finally, the most important aspect of Russia's accession to the WTO is the reduction in the existing and potential discrimination and the resulting restrictive measures against Russian exporters of goods, suppliers of services and investors on international markets.

In the medium-term perspective, should there indeed occur any positive shifts – including in response to accession to the WTO – in Russia's economy and the qualitative properties of the institutional environment (correction of structural disproportions across the national economy, reduction in the scale of the offshore economy, elimination of Russia's dependence on raw materials exports, etc.), this may result in the emergence of new incentives for optimizing the processes of entrepreneurial capital export.

At present, the principal reason for FDI outflow from Russia – all other conditions being equal – is the absence of any attractive prospects for businesses to invest inside this country. It can be assumed that later on (from the point of view of investor motivation) the scale and forms of FDI outflow will become optimized. This will be followed by branch (and probably also geographical) diversification, as well as growth of capital investments abroad. Besides, in some instances FDI inflow into Russia's economy may indirectly conduce to squeeze Russian capital out of the domestic market. However, it more likely that the result will be cooperation between domestic companies and their foreign counterparts in that sphere.

The specificity of international legal regulation of cross-border capital investments is that they are regulated by bilateral intergovernmental agreements to a greater extent than by the WTO

1 Martin Molinuevo, Can Foreign Investors in Services Benefit from WTO Dispute Settlement? Legal Standing and Remedies in WTO and International Arbitration, Swiss National Center of Competence in Research, Working Paper No 2006/17, Berne, August 2006, 35 p.

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

3 http://cbr.ru/statistics/print.aspx?file=credit_statistics/bal_of_payments_est.htm&pid=svs&sid=opb

norms and rules. Therefore, in any case, it will be necessary to improve Russia's bilateral and multilateral legal base in the sphere of foreign investments, which at present has clearly fallen behind the current situation¹.

In the nearest future, this sphere will be also influenced by the creation of the Joint Economic Space (JES) comprising Russia, Belarus and Kazakhstan. The principles of that entity (developed on the basis of the norms and rules established by the WTO) envisage, in particular, freedom of capital movement between its member states and harmonization of some separate spheres of their economic policies. These processes imply the introduction in Russian legislation, and especially in the mechanisms of its implementation, of certain elements of supranational regulation of the investment sphere².

However, the greatest impact on the processes of qualitative legislation transformation and its adequate application in the investments sphere may be made by the preparation of the Russian Federation's accession to the Organization of Economic Cooperation and Development (OECD). This direction of negotiations, after the accession to the WTO, must be regarded as the next logical – although complicated – step towards Russia's full integration in the world economy.

Thus, in January 2012 the State Duma ratified the *Convention on Combating Bribery of Foreign Public Officials in International Business Transactions*. This international agreement may, in principle, be joined by any state. At the same time, the participation of a country in the Anti-Bribery Convention represents one of the key conditions of its entry into the OECD, similarly to its accession to the WTO.

The issue of bribery of foreign public officials in international business transactions is very relevant to Russia. Thus, in 2011, Russia ranked 28th out of the 28 leading exporting countries on Transparency International Bribe Payers Index 2011, indicating that Russian exporter companies are *always* ready to pay bribes. Naturally, this helps to create a negative image of Russian businesses in the eyes of the world community³.

So, even in its present phase Russia's accession to the WTO, the establishment of the JES and the preparation of Russia's accession to the OECD have created some fundamentally new 'external' conditions, with the predominance of international standards in the sphere of cross-border investment regulation. These trends will require that Russia not only implement the above norms, but also gets actively involved in the process of discussing and elaborating new rules with due regard for national interests in this sphere on the international level. ●

1 Here we refer in the main to the bilateral intergovernmental agreements of the Russian Federation with foreign countries on avoidance of double taxation and the agreements on promotion and mutual protection of capital investments.

2 This applied to the implementation of the basic agreements package on the formation of Joint Economic Space (JES) and the establishment of the Eurasian Commission to which the Russian Federation will delegate some of its national (sovereign) powers in the sphere of economics and foreign trade.

3 Bribe Payers Index Report 2011, <http://bpi.transparency.org/>

RUSSIAN GRAIN MARKET: BASIC TRENDS

N.Karlova

After the lifting of restrictions on export of grain Russia has managed to re-occupy its niche among the major exporting countries on the world market. Record grain exports are expected in 2011/2012 MY – 26.5-30m tons. Accordingly, the Government has once again proclaimed that introduction of grain export restrictions is possible. The anticipated limitation of grain supplies from Russia fostered not only the strengthening of export prices for Russian grain but also the growth of the world market prices. The application of export restrictions will result in poorer utilization of the country's export capacities but won't solve the basic problems of export process – storage and transportation – that remain still pending. The introduction of restraints may be postponed in case of marketing grain from the intervention reserve.

In 2011 the gross output of grain increased by 54% as compared with 2010 – up to 94m tons (Table 1). Production of major grain crops except rice grew sharply. Remarkable growth was observed in production of millet and buckwheat; production of barley and corn more than doubled.

Table 1

OUTPUT AND YIELD OF GRAIN CROPS IN RUSSIA

	2000	2004	2005	2006	2007	2008	2009	2010	2011
Output, 1,000 tons	65420	77832	77803	78227	81472	108179	97111	60960	93908
Yield per 1 hectare of harvested area, tons	15.6	18.8	18.5	18.9	19.8	23.8	22.7	18.3	22.4

Source: SovEcon.

In 2011 as compared with 2010 the yields of grains and grain legumes grew in all the grain producing federal districts of the Russian Federation. 2011 was the third high-yield year in the preceding 11 years after 2008 and 2009.

Table 2

OUTPUT OF GRAIN IN MAJOR PRODUCING FEDERAL DISTRICTS (WEIGHT AFTER PRIMARY PROCESSING, ALL TYPES OF FARMS, MILLION TONS)

	Central federal district	Southern federal district	Volga federal district	Urals federal district	Siberian federal district
2009	21.6	28.9	21.7	5.3	18.3
2010	9.7	27.3	6.6	3.3	13.4
2011	17	32.6	21.2	7.3	14.6

Source: SovEcon.

Because of the applied grain export restrictions Russian grain exporters have “fallen out of the market” for actually the whole 2010/2011 MY. After their lifting Russia has managed to re-occupy its niche among the major exporting countries on the world market. In 2011/2012 MY export of grain proceeds at a high rate and record volumes of export shipments are expected: 26.5m tons according to estimates of SovEcon and 30m tons according to estimates of the RF Ministry of Agriculture. From the start of marketing year (i.e. July 2011) till January 2012 Russia exported 20.05m tons of grain including 16.4m tons of wheat and 2.25m tons of barley (Table 3).

Egypt, Turkey and Saudi Arabia continued to be major buyers of Russian grain. These markets are important for Russia and after the lifting of export restrictions domestic suppliers started active operations thereon. Meantime, a new export direction is actively developing – Israel.

Table 3

MONTHLY INDICATORS OF GRAIN, WHEAT AND BARLEY EXPORTS IN JULY 2009 – JANUARY 2012
(1,000 TONS)

	Grain*			Wheat			Barley		
	2009/10	2010/11	2011/12	2009/10	2010/11	2011/12	2009/10	2010/11	2011/12
July	1363	1960	2582	871.3	1717.8	2399	434.1	166.7	100
August	2224	1701	3336	1875.5	1584.4	2871	308.2	99.7	385
September	2395	7	3797	2117.6	2.5	3211	233.8	-	510
October	2324	37	2915	2015.2	5.0	2310	245.9	-	355
November	1909	42	2788	1601.4	12.3	2117	182.6	-	317
December	1579	69	2920	1291.6	11.2	2221	117.9	-	392
January	1567	33	1700***	1361.5	-	1300**	170.0	-	200***
July-January	13361	3848	20050***	11134.1	3333	16430	1693	267	2250
February	1120	59		1031.6 (1213.4)**	-		15.3 (95.8)**	-	
March	2044	100		1768.3 (1539.9)**	-		220.6 (140.1)**	-	
April	1944	124		1606.0	3.5		272.4	1.0	
May	1790	148		1372.8	10.0		345.4	-	
June	1631	159		1272.8	21.2		251.6	-	
July-June	21890	4439		18185.6	3369.2*		2797.9	267.4	

* including grain equivalent of flour but not including grain legumes;

** estimate of SovEcon;

*** forecast of SovEcon.

Source: SovEcon.

The bulk of export supplies of wheat to Egypt were effected under contracts signed in the framework of the earlier won GASC tenders. In July-December 2011 the share of Egypt in the geographic structure of Russian wheat exports amounted to 32% (4.8m tons). At the same time one should note the reduction of exports to the countries of East Africa and the Persian Gulf due to the stiffer competition from Australian grain suppliers in this region.

The growth of barley exports is due to larger supplies to Saudi Arabia. In July-December 2011 they amounted to 1.35m tons while during the whole 2010/2011 MY (July 2010 – June 2011) only 0.18m tons were exported there.

Corn is also actively exported. In October-December 2011 Russia supplied 666,560 tons of corn as compared with 49,640 tons in October-September 2010/2011. The major importers were Israel (15.8%), Turkey (13.5%), Italy (11.9%), Spain (11.0%) and Greece (7.9%).

In 2011/2012 MY pea became an important export item. In July-December 2011 its exports amounted to 431,480 tons. Russian pea was imported by Turkey (43.9%), India (23.2%) and Austria (16.0%).

According to estimates of SovEcon by the end of April 2012 exports of grain can reach 24-25m tons, i.e. the level when some export restrictions may come into effect¹. Market experts suppose that they may be enacted in March or April. The expected introduction of export restrictions forces exporters to speed up purchases in order to fulfill their commitments under the signed contracts before this time. Accordingly, the activity of exporters in December 2011 – January 2012 grew and the stocks of wheat in the Central and Southern regions of Russia (wherfrom major export flows originate) started to deplete. This resulted in the strengthening of domestic and export prices for Russian grain.

Rumors about possible restraining of grain export from Russia in the near future contributed to the strengthening of competitors' prices. In January 2012 FOB export quotations for French wheat grew from \$264 to \$270 per ton, for the US SRW wheat – from \$245 to \$260 per ton. At the end of January Russian wheat #4 (FOB, Novorossiysk) cost \$264 per ton². In other words, after a certain weakening the price competitiveness of Russian grain has restored. In this respect, the question

1 Prime Minister V.V. Putin declared that "this year the RF government will introduce protective duties on export of grain in case its volume exceeds 24-25m tons". <http://www.itar-tass.com/c1/256067.html>

2 Data of SovEcon.

arises whether market operators will manage to make the best of the current situation and sign contracts for the supply of Russian grain in April. This depends on the time when the government decision on introducing export restrictions will be taken.

The imposition of export restraints may be postponed in case export potential is enhanced by bringing intervention reserve grain to the market. The RF Ministry of Agriculture determined the minimum thresholds the falling of prices below which in 2012 will entail state interventional purchases of 2011 crop grain: depending on the region and type of grain they vary from Rb 3,900 to Rb 5,000 per ton¹. In particular, the minimum threshold price for milling wheat #3 in the Central, North-Western, Volga, North-Caucasian and Southern federal districts is set at Rb 5,000 per ton while in the Urals, Siberian and Far East federal districts – at Rb 4,700 per ton. The minimum thresholds for milling wheat #4 are Rb 4,650 per ton and Rb 4,450 per ton, respectively; for wheat #5 – Rb 4,300 and Rb 4,100 per ton, also depending on the region. For all regions the established minimum threshold price for milling rye group “A” is Rb 3,900 per ton, for feed barley - Rb 4,000 per ton, for corn #3 – Rb 4,400 per ton.

On January 18, 2012 the RF Ministry of Agriculture published a draft regulation determining the maximum thresholds the rising of prices over which may entail the sale of grain from state reserve in 2012. Wheat #3 of 2005 crop can be sold at Rb 5,000 per ton including VAT, wheat #4 – at Rb 4,500 per ton including VAT. For intervention reserve grain of 2008 crop the following maximum thresholds are set: for wheat #3 – Rb 7,550 per ton, wheat #4 – Rb 7,150 per ton including VAT, for milling rye – Rb 4,300 per ton including VAT, for feed barley – Rb 4,550 per ton. For grain purchased in 2009 the price limits are as follows: wheat #3 – Rb 6,050 and Rb 6,500 per ton including VAT depending on the region, for milling rye – Rb 4,300 per ton including VAT.

So, in case of marketing grain from the intervention reserve the period of unlimited export activity may be longer. However, the sale of grain from state reserve can destabilize the market and worsen marketing conditions for farm producers since the thresholds for barley, rye and wheat indicated by the Ministry of Agriculture are below the current market prices.

The major suppliers of grain in 2011/2012 MY (July-November) remained the same, i.e. companies that have strong positions on the export market: Glencore, Louis Dreyfus Vostok, Yug Rusi and some other companies.

Table 4

RATING OF RUSSIAN GRAIN EXPORTERS IN 2011/2012 MY (JULY-NOVEMBER)

No	Company-exporter	Volume, tons	Share of the market, %
1	International grain company (Glencore)	1949241	13.00
2	Louis Dreyfus Vostok	1265658	8.00
3	Yug Rusi	1176348	8.00
4	Aston	1167559	8.00
5	Bunge CIS	1120594	7.00
6	Cargill	941631	6.00
7	Open JSC Krasnodarzernoprodukt-Expo	851546	6.00
8	Open JSC OZK (United Grain Company)	561790	4.00
9	Vitalmar Agro	397656	3.00
10	Open JSC Bonel Resources	375529	2.00
11	Open JSC Artis-Agro Export	323592	2.00
12	Open JSC Outspan International	237463	2.00
13	Open JSC Grainstream	227975	1.00
14	Yuzhnaya syrievaya kompaniya	196043	1.00
15	Closed JSC Kubanexpo	173896	1.00
	Other	4270869	28.00
	Total	15237390	100.00

Source: APK-Inform No. 3(789) of January 23, 2012.

1 Regulation of the RF Ministry of Agriculture No. 463 of December 8, 2011 “On establishing minimum threshold prices for grain to be applied for state purchase interventions in 2012”.

The renewal of export shipments after lifting of restraints revealed the logistical problems of Russian grain market. The basic transportation means used for delivering grain from regions to ports are rail grain cars. As soon as massive shipments from ports began, there emerged the problem of their shortage. Among other problems encountered by exporters one should also mention poor development of port infrastructure, outdated fleet of grain cars and large commodity inventories due to the piling up of carryover stocks in companies. Each exporter had to solve the problem of delivering grain to ports only by his own efforts. Some of them signed agreements with small private transportation companies, others arranged deliveries by trucks or simply waited for the cars to be delivered. The least affected were the companies that had their own truck or rail car fleet and thanks to that managed to provide stable and timely deliveries to ports.

The expected introduction of export restrictions will lead to the reduction of exports and accordingly smaller work load in this sphere but it won't solve the basic problems of export process – shortage of cars and inability to store the required volumes of cargo in port silos. The solving of these problems will help to improve and accelerate performance of ports as well as to facilitate shipments of grain from Siberia, the Central Black-soil region and the Urals federal district with minimal losses in price and time. In the first half of 2011/2012 MY the demand for grain from these regions was sluggish since its deliveries were effected by trucks and thus unit costs were much higher. ●

A NEW ROUND OF RUSSIA'S CLUSTER INNOVATION POLICY

I.Dezhina

At present, a new impetus has been given on the government level to the process of elaborating Russia's cluster innovation policy, including the formation of innovation clusters. The strategic documents envisage a variety of support measures. In this connection, some measures have been selected whose effect is rather low, as demonstrated by the Russian Federation's previous experiences in that sphere. The afore-said Russian policy is largely based on foreign experience and pays insufficient attention to some newest trends. This results in Russia's falling behind the developed countries in the sphere of applying new innovation policy instruments.

The approval, in late 2011, of *The Strategy for the Innovation Development of the Russian Federation Until 2020*,¹ triggered a new round of cluster policy – including in the sphere of innovation cluster formation. The provisions and measures relating to the development of innovation clusters and systematized in The Strategy are based, to a certain extent, on those approaches that have been reflected in some previously adopted documents. That is why, in order to estimate the prospects of the measures that have been selected for implementation, it is essential to history of cluster formation.

It can be said with some confidence that the onset of cluster policy in the innovation sphere dates back to 2006 – the year when the project aiming at the creation of technology implementation zones (TIZ) was initiated, although at that time they had not yet been called 'clusters'. The project was developing at a slower pace than had been initially planned, which is also true of some other initiatives that can be placed in the category of clusters – revival of *science cities*, development of technoparks, and creation of a system for providing regional support to small-size innovation businesses. There existed different reasons for a slower and less effective development of all those projects. Thus, in particular, the mechanisms for implementing the suggested measures were not compatible with the then existing economic regulation norms, which were not specifically applicable to the innovation sphere.

The process of shaping up the cluster policy proper was also rather slow. In 2007, the RF Ministry of Economic Development elaborated *The Concept for Cluster Policy Development in the Russian Federation*, and after that it was only as late as March 2009 that the Ministry presented *The Methodological Recommendation for the Implementation of Cluster Policy in the Russian Federation* that envisaged, among other things, the creation of innovation clusters. In practical terms it was decided that pilot projects aiming at cluster formation were to be implemented on the basis of technology implementation zones (TIZ) and technoparks. It is also important to note that it was not intended to introduce any new instruments for developing clusters. Instead, some already existing instruments were to be applied – including also the potential of development institutions, which were beginning to actively function precisely at that time. The weakness of the selected approach was associated with the fact that at that time neither technoparks nor TIZ could serve as bases for cluster formation because the functioning of an innovation cluster implies that there should exist some very close connections between companies, their suppliers and their clients, as well as between research centers and educational, thus creating fertile grounds for innovations. No such system of connections had yet been developed in TIZ or technoparks – or even in many of the *science cities*.

The emergence, in 2009, of the project for developing the 'innovation city' of *Skolkovo* effectively 'froze' the idea of cluster development, because it is *Skolkovo* that became the prime target for allocating the bulk of resources and focusing the public (including political) attention. Cluster policy was narrowed, so that now support was channeled through the relevant programs of the RF

¹ *The Strategy for the Innovation Development of the Russian Federation Until 2020* is approved by Regulation of the RF Government of 8 December 2011, No 2227-r.

Ministry of Economic Development towards small companies that also included some innovation enterprises (which, however, were not singled out into a separate category to which special support regimes could be applied). In some regions their own cluster development programs were implemented, or some special organizational structures for promoting such development were established, but this sort of activity was only temporary and was conducted in a ‘political campaign’ mode¹. As a result, the plans for creating the previously broadly publicized clusters (for example, the ‘aviation cluster’ at the town of Zhukovsky²) were never actually implemented.

The idea of cluster development was revived in 2011 during the elaboration of the new strategic documents. In addition to *The Strategy for the Innovation Development of the Russian Federation Until 2020*, there emerged the draft of *The Concept for Long-term Socio-economic Development of Russia Until 2020*, which reproduced the basis provisions stipulated in the RF Ministry of Economic Development’s 2007 Concept.

The Strategy for the Innovation Development of the Russian Federation Until 2020 contains a separate section on innovation clusters. Although it offers no definition of innovation clusters, that term is used in the same context with special economic zones, technoparks, science cities, and *Skolkovo*. *The Strategy* mentions two types of clusters – territorial-industrial and hi-tech innovation. From the list of directions that have been selected by the government for promoting the development of innovation clusters it can be gleaned that, firstly, the State will be strongly interfering with this process (including the creation of a ‘specialized organizations for cluster development – cluster development centers’³); secondly, the regions will be receiving subsidies for creating their clusters; and thirdly, the main targets for such support will be small companies.

The Strategy envisages that a set of measures should be implemented in order to ensure the creation of favorable conditions for cluster development. These measures are important for creating an innovation-promoting environment, but are not, however, cluster-specific. In particular, they include ‘improving the efficiency of the system of professional education, developing cooperation between enterprises and educational organizations, making targeted investments in the development of innovation infrastructure objects ... [and] lowering administrative barriers’. All this is by no means contrary to the universally accepted measures aimed at cluster development as applied in the world practice, but the list anyway is worded too generally and so makes it impossible to understand which measures, for example, may help in lowering administrative barriers or in improving the efficiency of the professional education system when implemented in order to achieve the goal of developing clusters.

The issue of the efficiency of direct budget funding to clusters, which, in accordance with *The Strategy*’s provisions, will be allocated from the federal budget, is subject to disputes across the expert community. A number of specialists share the view that aid from the State may be useless or even harmful, because clusters are formed in a natural way. Those who believe that direct government support is necessary are arguing as to who and for what should be allocated these funds: the clusters *per se* as infrastructure objects; or the organizations operating inside clusters (for example, small-sized innovation companies); or the projects being implemented inside clusters – including cooperative ones. As can be judged from *The Strategy*’s text, financing will be provided to everybody and everything: the infrastructure, small-sized companies, and cooperative projects. However, the State has so far failed to precisely formulate its standpoint concerning this issue.

The initial approach that had implied a more active involvement of development institutions in the implementation of cluster policy appears to be the correct one – all the more so because in recent years development institutions began to support an increasingly versatile number of the types of projects. However, *The Strategy* does not offer any specific definition of the role

1 E.B. Lenchuk, G.A. Vlaskin. Klasternyi podhod v strategii innovacionnogo razvitiya Rossii [Cluster Approach in the Strategy for the Innovation Development of Russia]. See <http://oko-planet.su/politik/politikdiscussions/94396-klasternyy-podhod-v-strategii-innovacionnogo-razvitiya-rossii.html>

2 Zdes’ budet klaster zalozhen. Kriticheskaia massa intellektual’nogo potentsiala ne sozdaietsia po feodal’nym retseptam [Here a Cluster Will Be Founded. The Intellectual Potential’s Critical Mass Cannot Be Created on the Basis of Feudal Recipes]. // Nezavisimaia gezata [The Independent Newspaper], 26 February 2008. http://www.ng.ru/editorial/2008-02-26/2_red.html

3 See paragraph 2 (‘Development of Innovation Clusters’) of Section XI (Innovation Territories) of *The Strategy for the Innovation Development of the Russian Federation Until 2020*.

of development institutions in implementing cluster policy. At the same time, an emphasis on subsidies actually encourages the formation of the kind of mentality that has already become typical of the 'innovation community', which aims its aspirations in the main towards receiving some additional budget resources. As there exists no precise definition of 'innovation clusters', the initiation of any subsidies may result in a situation when any type of formation can be placed in the category of 'clusters'. This, in fact, has often happened before in response to the announcement of every new program designed to build an innovation-oriented infrastructure.

In spite of the rather eclectic description of the government's approach to cluster formation, *The Strategy for the Innovation Development* has put forth some quite specific parameters for estimating the achievement of the set goals. By 2016, RF subjects must establish 30 'full-fledged hi-tech innovation clusters' that will have been functioning for a period of more than two years. In this connection it is planned that by 2016 there will have emerged four, and by 2020 – as many as seven innovation clusters that will have been receiving federal support after 2010 and 'will have been capable of doubling their hi-tech export since the moment of receiving such support'.

It should be noted that the suggested directions and measures aimed at cluster development are largely based on generalized foreign experience. However, the borrowings actually applied in cluster policy fall somewhat behind the latest trends. During the last three years in foreign countries, and especially in the EU where much attention is paid to cluster policy, there has emerged a new idea that has given rise to some new trends – namely, *smart specialization* of regions. But this idea evidently has not been taken into account when Russia's new version of cluster policy was being elaborated. Smart specialization is understood as the selection, on the regional level, of those areas that can make the highest possible contribution to economic development through supporting research, development and innovation activity in the framework of their chosen specialization. At present, this approach¹ is the core of the cluster formation policy across Europe and is now gradually gaining its place at the level of EU policy making. Thus, it is planned that EU resources will be allocated to the support of only those regions that have already determined their specific smart specialization field.

Smart specialization should by no means be understood only in terms of hi-tech sectors or 'priority' research areas (such as biotechnologies or nanotechnologies). It can also involve some low-tech sectors or services spheres where investments in research and development can promote a region's industrial development and give an impetus to developing some other sectors of the economy. The choice of smart specialization areas is made on the basis of consensus achieved by experts representing science, education, business and industry at a regional level. In this connection, distinction is made between the procedures for determining a region's specialization and 'foresight'. The State, in accordance with that concept, should perform three functions: 1) create appropriate conditions for coordination and the choice of smart specialization; 2) monitor the process of cluster development from the point of view of a given region's selected specialization; 3) determine the needs arising in connection with that selected specialization (for example, the sphere of education) and introduce appropriate incentives and support measures.

Such an approach makes it possible to more flexibly apply various instruments, thereby enhancing their potential effects. Thus, for example, technological platforms as an instrument for coordinating the interests of different agents may be conducive to correctly identify areas that may be the most appropriate ones for each region's smart specialization.

Thus, Russia's approaches to implementing a cluster policy reproduce in part some previously elaborated ideas that have not yet been fully implemented. At the same time, the composition of the set of measures to be applied in supporting the process of cluster formation has been revised and expanded with due regard to foreign experience. However, some newer instruments designed to develop innovation clusters have been overlooked. Our borrowings actually fall behind the latest trends, thus making more cumbersome the way towards creating innovation clusters. ●

1 The smart specialization concept was put forth in 2009 by economists D. Foray, P.A. David, and B. Hall. Source: Foray, D., David, P.A., Hall, B. *Smart Specialization: The Concept // Knowledge for Growth. Prospects for Science, Technology, and Innovation. Selected papers from Research Commissioner Janez Potochnik's Expert Group. November 2009, p. 20-24.*

VIEW OF POLITICAL PARTIES ON MILITARY REFORM (BASED ON MATERIAL FROM THE LAST PARLAMENTARY ELECTION)

E.Trofimova

Election campaign to the sixth State Duma was held in September-December 2011. All parties participating in the elections paid attention to the implementation of military reform. Analysis of program documents showed that almost all parties argue the need for reform, but see it differently.

The future of the country will depend upon the provisions adopted by parties, which enter the newly elected State Duma. We can more or less precisely predict what expects our Armed Forces over the next five years if we analyze the views of parties on military reform that have been announced during the election campaign debates.

The views on *the need and the results of military reform* were divided. “United Russia”, Liberal Democratic Party and “Just Russia” noted the need to modernize the Armed Forces in the coming five years. Liberal Democratic Party believes that the Russian army needs reform. “The army, which Russia inherited 20 years ago from the Soviet Union cannot respond to the challenges of today”, – stated the leaflet. “Liberal Democratic Party. The order in the army – the order to the country!”¹ “Other countries’ experience showed that full implementation of military reform takes 15 to 20 years”, – said the leader of Just Russia, Sergei Mironov.² United Russia, naturally, supports the current reform.

The Communist Party and “Patriots of Russia” believe that the current reform is not needed and, moreover, comes at the expense of the army. “The Army is in fever for two decades, two decades it is being reformed and scaled down constantly. As a result, we have succeeded in dismantling the old military structure, nothing new is built, and the military security of the state is not increased, respectively,”- stated the leader of the party Patriots of Russia, Mr. Semigin.³

The most constructive, in our opinion, is the position of Yabloko party, which is supporting the reform but draws attention to system error of the military reforms over the last period – “in a long-term stagnation and profanation of military reform in Russia.”⁴

Since most of the parties which entered the new Duma agree that reform is needed, we can assume that the modernization of the army will continue. But that remains to be seen in what direction.

Considering *political and military situation*, five of the seven political parties, registered and eligible to participate in elections, urged their voters that “at any time, our country could be dragged into ethnic conflict or a local war” (for example, the Liberal Democratic Party), that “probability of retraction of the country in local conflicts has multiplied today” (Just Russia). But Yabloko sees the problem from different angle, paying attention to “serious differences within the ruling circles concerning the priorities of security and foreign policy.”

They did not deny the possibility of Russia being involved in local conflict, but members of the party state the existence of the dilemma: “Is the gradual integration with advanced democratic countries actually the long-term interest of Russia (with all the contradictions and difficulties on the way) – or whether it lies in opposing them in alliance with various exotic and extremist regimes of the world.”⁵ However, the elected parties do not pose the problem in this aspect, so we can expect that the bellicose spirits and rhetoric in reforming the RF Armed Forces will prevail.

1 “Liberal Democratic Party. The order in the army – the order to the country! « – Issued by Liberal Democratic Party. 2012 pp. 6-10. <http://www.ldpr.ru/#events/Read> the new edition of the Liberal Democratic Order in the army order to the country

2 S. Mironov’s speech at II All-Russian Congress of Veterans unions. October 25, 2011. http://www.spravedlivo.ru/news/first_face/406.php

3 «Patriots of Russia» support Russian Army and are ready to solve its problems. G.Semigin interview // Red star. November 12, 2011

4 On military reform in Russia // XVI Congress of YABLOKO party, September 27, 2011. http://www.yabloko.ru/postanovleniya_syezda/2011/09/27_2

5 See above

Within their *military and economic policies* parties United Russia and the Communist Party are in favor of huge defense budgets. United Russia suggest to invest in new, reformed Armed forces and military-industrial complex, and the Communist Party – wants them be restored in the “old form”, votes for reconstruction of many characteristics, proven in the past. Just Russia draws attention to the importance of efficiency, transparency and accountability of investments in the army.

Different point of view was adopted by parties Yabloko and Right Cause. The leader of Yabloko party questioned the need to spend huge sums on defense. “Military expenditures, why do we need them as high as 20 trillion rubles, this is just a waste of money. Of course we need to spend something on defense, that it was normal, but not 20 trillion. The best defense for the country is the domestic demand and a strong Russian economy”, – said Grigory Yavlinsky.¹ Right cause is proposing to increase funding for “education, health, science, environment and culture, tax incentives for innovation-driven industries, including improving the efficiency of public spending, cutting budget for the state security system.”²

Since the policy of huge defense funding is supported by the parliamentary majority is likely to continue. *The military-technical policy.* The provisions of United Russia and the Communist Party in this matter are similar: we should produce a lot of weapons and military equipment. Just Russia, Patriots of Russia and Yabloko pay attention to corruption and theft in the military administration, which devaluate all investments in defense.

The military personnel policy. Five of the seven parties in one way or another, stand for the preservation of military draft (on permanent or temporary basis). Communist Party proclaims³: “We must abandon the idea of a”professional” army. We should apply combined principle of recruitment.” “The Liberal Democratic Party believes that the protection of the Motherland is a sacred duty for all citizens of Russia before the final transfer to a professional army based on contract principles,”⁴ but says nothing about when the army will be moved to this principle. The position of the “Yabloko” party is more specific. “Yabloko” suggested to transfer the recruitment entirely on volunteer-contract basis during 2012-2014.⁵

By the end of the campaign on November 16, the Liberal Democratic Party submitted for public discussion a draft of the Federal law “On Amendments to Certain Legislative Acts of the Russian Federation in connection with the abolition of conscription in peacetime.”⁶ Apparently, this statement has been aimed at the presidential election. Perhaps the leader of the Liberal Democratic Party hoped that the promise to eliminate the military duty in Russia will help him in the presidential election on March 4, 2012

Based on the fact that all the parliamentary parties are in favor of retaining conscription, there is no reason to say that Russia will have a professional army.

Social status of military personnel. All parties agree in this regard: pay and allowances should be raised for those serving under contract, state should provide housing for military personnel and improve health care. This can only be welcomed. But do not forget about the financial situation of those who serve by conscription, and their families.

Thus, based on the provisions made in the documents of political parties and their leaders’ speeches, we can assume that in the foreseeable future: the reform of the Armed Forces will continue, huge funds will be allocated, despite the corruption and theft, the army will be recruiting for years to come; militaristic rhetoric in the political-military issues will strengthen. However, the social status of military personnel will be improved. ●

1 Online interview with Yabloko leader G.Yavlinsky. October 19, 2011 <http://www.gazeta.ru/interview/nm/s3798770.shtml>

2 «Right Cause» program. September 20, 2011 r. <http://www.pravodelo.ru/party/program>

3 V. Komodov. The Armed forces is not the object for experiments! // New Government – new policy – new life! // Pravda. October 2011

4 “Liberal Democratic Party. The order in the army – the order to the country! « – Issued by Liberal Democratic Party. 2012 pp. 6-10.

5 On military reform in Russia // XVI Congress of YABLOKO party, September 27, 2011. http://www.yabloko.ru/postanovleniya_syezda/2011/09/27_2

6 Draft Federal Law «On Amendments to Certain Legislative Acts of the Russian Federation in connection with the abolition of conscription in peacetime.” [http://www.ldpr.ru/#power/Bills/On Amendments to Certain Legislative Acts of the Russian Federation in connection with the abolition of conscription in peacetime](http://www.ldpr.ru/#power/Bills/On%20Amendments%20to%20Certain%20Legislative%20Acts%20of%20the%20Russian%20Federation%20in%20connection%20with%20the%20abolition%20of%20conscription%20in%20peacetime)

REVIEW OF THE MEETINGS OF THE GOVERNMENT OF THE RF IN JANUARY 2012

M.Goldin

In January 2011, at the meetings of the Presidium of the Government of the Russian Federation the following issues were discussed: draft resolution of the Government of the Russian Federation on the procedure for participation of representatives of the Russian Federation in governing bodies of an autonomous non-profit organization, draft resolution of the Government of the Russian Federation on the procedure for management of interests owned by the Russian Federation in limited liability companies established in the course of privatization and the draft law which changes the conditions of restoration of such amounts of expenditures on the profit tax as were taken into account as amortization premiums.

At the meeting of the Presidium of the Government of the Russian Federation which was held January 20, 2012, a draft resolution of the Government of the Russian Federation on the procedure for participation of representatives of the Russian federation in the governing bodies of an autonomous non-profit organization (hereinafter, the draft resolution) was considered. The need for approval of the procedure for participation of representatives of the Russian federation in governing bodies of an autonomous non-profit organization arises from Article 10 (5) of Federal Law No. 7-FZ of January 12, 1996 on Non-Profit Organizations. (It is to be reminded that Article 10 which is part of the above-stated Federal Law was supplemented with part 5 by Federal Law No. 220-FZ of July 18, 2011).

In accordance with the draft resolution, representatives of the Russian Federation are appointed by the Government of the Russian Federation on such presentation of the Ministry of Economic Development of the Russian Federation as prepared by Rosimushchestvo with the approval of the federal ministry or federal executive authority which are entrusted with powers to manage state property and whose management is carried out by the President or the Government of the Russian Federation.

Representatives of the Russian Federation can be persons who fill in for public offices of the Russian Federation and offices of the federal civil service, as well as other persons who act in accordance with the agreement on representation of interests of the Russian Federation in the governing bodies of the autonomous non-profit organization – professional attorneys. It is to be noted that such an agreement is of free of charge nature. In accordance with draft resolution, Rosimushchestvo will have to develop and approve the standard form of the agreement on representation of the interests of the Russian Federation in the governing bodies of the autonomous non-profit organization.

The draft resolution determines the list of obligations of representatives of the Russian Federation. The main obligation of representatives of the Russian Federation is voting on the issues brought to the meetings of the governing body of the autonomous non-profit organization; in doing so representatives of the Russian Federation are guided by instructions and orders of the President and the Government of the Russian Federation. In addition to the above, representatives have to submit on an annual basis a report on their activities at the governing body of the autonomous non-profit organization through placement of the report in an electronic format at the interdepartmental web site on state property management in the Internet. The form of the above report must be approved by the Ministry of Economic Development of the Russian Federation within three months from the effective date of the procedure for participation of representatives of the Russian Federation in governing bodies of the autonomous non-profit organization.

On that day, the draft resolution of the Government of the Russian Federation on the procedure for management of interests owned by the Russian Federation in limited liability companies established in the course of privatization was discussed as well (hereinafter the draft resolution).

Under the draft resolution, on behalf of the Russian Federation the rights of the participant in a limited liability company are to be exercised by Rosimushchestvo and the Ministry of Defense (in respect of limited liability companies established in the course of privatization and state unitary enterprises which are under the supervision of the Ministry of Defense). The above rights will be exercised by Rosimushchestvo on the basis of proposals of federal agencies which are under the supervision of federal ministries or federal executive authorities which are entrusted with powers to manage state property and whose management is carried out by the President or the Government of the Russian Federation.

On January 26, 2012, at the meeting of the Presidium of the Government of the Russian Federation the draft Federal Law on Amendment of Article 258 (2) of the Tax Code of the Russian Federation (hereinafter, the draft law) submitted by the Ministry of Finance of the Russian Federation was considered.

The draft law liberalizes the terms of application of amortization premiums for the purpose of profit taxation of entities. In compliance with the existing rules of application of amortization premiums in case of realization within five years from the date of commissioning of the capital assets, costs of which have been accounted for maximum in the amount of 10%, while in respect of capital assets attributed to the 3rd to 7th amortization groups – maximum in the amount of 30% of their initial value in the composition of the expenditures of the regular reporting (fiscal) period, such costs are subject to restoration and inclusion into the profit tax base.

In accordance with the draft law, the above costs included in the composition of the expenditures of the regular reporting (fiscal) period are subject to restoration and inclusion in the profit tax base of entities only in case the capital assets have been realized within five years from the date of commissioning to a person who is *interdependent* in respect of the taxpayer. ●

REVIEW OF THE ECONOMIC LEGISLATION

I.Tolmacheva

Late in December and January, the following amendments were introduced in the legislation: a person in respect of whom measures of control are applied is to be notified of the inspection at least three business days before it starts; planned inspections of compliance of the activities of non-profit entities with charter purposes and objectives can be carried out by the Ministry of Justice not often than once in three years.

I. Instructions, Letters and Orders

1. Letter No. d09-3425 of December 30, 2011 of the Ministry of Economic Development of the Russian Federation ON APPLICATION OF NORMS OF THE FEDERAL LAW ON PROTECTION OF THE RIGHTS OF LEGAL ENTITIES AND INDIVIDUAL ENTREPRENEURS IN EFFECTING OF STATE CONTROL (SUPERVISION)

A person in respect of whom measures of control are applied is to be notified of the inspection at least three business days before it starts. According to the opinion of the Ministry of Economic Development of the Russian Federation which is based on the analysis of the norms of the legislation and judicial practice, it is the way how one should understand the requirement of the Federal Law on Protection of the Rights of Legal Entities and Individual Entrepreneurs in Effecting of State Control (Supervision) as regards mandatory notification of a legal entity or individual entrepreneur of the planned inspection “at least three business days before it starts”.

2. Order No. 456 of December 30, 2011 of the Ministry of Justice of the Russian Federation ON APPROVAL OF THE ADMINISTRATIVE RULES FOR FULFILLMENT BY THE MINISTRY OF JUSTICE OF THE RUSSIAN FEDERATION OF THE STATE FUNCTION AS REGARDS CONTROL OVER COMPLIANCE OF THE ACTIVITIES OF THE NON-PROFIT ORGANIZATIONS WITH CHARTER PURPOSES AND OBJECTIVES AND THOSE OF BRANCHES AND REPRESENTATIVE OFFICES OF INTERNATIONAL ORGANIZATIONS AND FOREIGN NON-PROFIT NONGOVERNMENTAL ORGANIZATIONS WITH THE DECLARED PURPOSES AND OBJECTIVES, AS WELL AS THE LEGISLATION OF THE RUSSIAN FEDERATION

Registered under No. 22975 on January 19, 2012 with the Ministry of Justice of the Russian Federation.

Under Article 32 (5) of Federal Law No. 7-FZ of January 12, 1996 on Non-Profit Organizations, in respect of the non-profit organization the authorized body and its officials have the right in accordance with the procedure set by the legislation of the Russian Federation to check among other things compliance of the activities of the non-profit organization, including the activities related to spending of the funds and use other property with objectives provided for by its founding documents.

It is determined in the Administrative Rules that the planned checks of compliance of the activities of non-profit organizations with charter purposes and goals can be carried out by the Ministry of Justice of the Russian Federation not often than once in three years.

Also, determined in the Administrative Rules are the following: the target of the state control (supervision); the rights and obligations of officials and persons who are subject to measures of control (supervision); requirements to the procedure for fulfillment of the state function; composition, order and terms of fulfillment of administrative procedures; the form of control over fulfillment of the state function and pre-trial (extrajudicial) procedure for appeal against decisions and actions of officials. The annex to the Administrative Rules includes the contact information of the Ministry of Justice of the Russian Federation. Administrative Rules No.90 of March 31, 2009 which were applied before become null and void. ●

THE REVIEW OF REGULATORY DOCUMENTS IN TAXATION ISSUES IN THE DECEMBER 2011–2012 PERIOD

L.Anisimova

In January 2012, the main site for presentation of the position of the leadership of this country and experts as regards Russia's economic issues was undoubtedly the Gaidar Forum "Russia and the World: 2012–2020" which was held by RANEP, The Gaidar Institute for Economic Policy and the Gaidar Fund in Moscow on January 18–21, 2012.

1. At the Forum, the issues of taxation and formation of state extrabudgetary funds were touched upon. I. Shuvalov, First Vice Premier pointed out that such proposals in the field of taxation prepared within the frameworks of upgrading of the Strategy-2020 as provide for reduction in the rates of VAT, profit tax and insurance contributions to public extrabudgetary funds with simultaneous increase of the burden on the oil and gas sector which does not conform the ideas of diversification of the economy, tobacco and alcohol products which are harmful to people's health and the undertaxed real property cannot be supported by the Government of the Russian Federation so far as the guidelines for changing of the tax system. The First Vice premier noted that those proposals are not new to the Government and "are patterned after the former proposals of Delovaya Rossia" (Delovaya Rossia (Business Russia) public organization), which proposals they unsuccessfully put forward through the All-Russian People's Front¹.

As early as December 2011, doubts were expressed at the very high level as regards уже в acceptability of the "15-15-15" scheme (that is, the rates of VAT, profit tax and insurance contributions) proposed by the business community. In particular, Vedomosti Moskvyy daily published the opinion of Premier V.V. Putin that "the funds which we will receive from the [planned] raising of excise duties on alcohol products and tobacco are not sufficient enough for making for the business a considerable reduction of allocations to social funds". He considered it impossible to close eyes to "multiple" price rises on vodka and cigarettes for the sake of reduction of insurance contributions. In addition to that, the above newspaper published the opinion of T. Ilyushnikova, Deputy Head of the Department of the Ministry of Economic Development and Trade who explained that raising of excise duties may result in a situation where the rates in member-states of the Customs Union will be different and, as a consequence, "smuggling from Belarus and Kazakhstan will oust Russian products. The two industries alone cannot pay to resolve all the problems of the Pension Fund and it is a negative signal to investors"². The solution proposed by the experts was not supported by the Ministry of Finance, either. A. Siluanov, Minister of Finance of the Russian Federation pointed out that it would be correct to raise VAT rates and indirect taxes, and, in no event, social payments and profit tax, but according to Mr. A. Siluanov before tax rates are changed it would be expedient to the Government to solve the issue of decentralization of powers of authority, determine the fate of insurance contributions and deal with reduction of the share of the shadow economy (which is estimated by Rosstat at 30% of the GDP) by means of imposing additional limitations on payments in cash. According to Mr. A. Siluanov, with turning of payments and settlements into a non-cash form the economy will become more transparent and, as a result, collectability of taxes will be largely improved³.

Summing up at the Forum the situation with development of tax proposals, Mr. I. Shuvalov pointed out that within the frameworks of the Strategy-2020 all the debates on the taxes were planned to be held in the spring so that those tax laws which were passed in 2012 would remain unchanged within the next five-six years and the tax system was absolutely stable and transparent

1 D. Butrin, V. Visloguzov. The Strategy-2020 is Delayed Again. Implementation of the Plan of Early Prevention of Discontent will be Started After the Elections, Kommersant (Moscow), No. 8, January 19, 2012.

2 D. Kazmin. The Policy of Cheap Smoke, Vedomosti (Moscow), No. 233, December 09, 2011.

3 V. Visloguzov. Tax Maneuvers with Cash, Kommersant-Online, January 19, 2012; The Ministry of Finance is Seeking to Impose Bank Cards on Russians, Web-site BFM.RU (site: news.rambler.ru), 20.01.2012.

for businessmen. Mr. I. Shuvalov explained that the key decisions which were to be found in that period should deal with the sphere of taxation, search for the sources of further economic growth, attraction of investments, pension security issues and liberalization of the labor market¹.

2. Another serious issue which a significant attention was attached to at the Forum was social security and formation of public social funds.

Within the frameworks of the third day of the Forum which was dedicated to social problems, two diametrically opposite positions of experts on the issue of the pensions system reform were clearly determined. Some experts proceeding from the fact that there is a mammoth deficit of the Pension Fund of Russia (Rb 1 trillion both in 2010 and 2011)² believe it would be expedient to switch over to a simple redistribution scheme of social security which existed prior to 2002 (the working generation supports pensioners), while the others (mostly representatives of the banking and finance community) think that it is necessary to go ahead with implementation of the funded scheme of pension funds formation (it is worth mentioning that a portion of insurance contributions which amounts to 6% of the salary fund is transferred to specialized asset managers for market management) because such a scheme contributes to creation of the long-term money which is an important condition for commercial investments.

It seems that as there is such a variety of views on the ways of reform of the system of mandatory social payments that issue needs to be further understood in theoretical terms.

3. At the Collegium of the Investigation Committee, the issue related to mandatory payments was raised. A. Bastrykin, Head of the Investigation Committee spoke of the need to establish the financial police. It is to be reminded the fiscal police was once established in the Russian Federation to carry out interrogation, investigation and search as regards tax-related cases, but later it was transformed into Gosnarkokontrol (the Federal Drug Control Service of the Russian Federation). The reason for which the fiscal police failed to become an independent federal body was the fact that the legislators did not have the heart to entrust law enforcement officers with the authority to carrying out tax inspections.

According to the Kommersant daily, the real reason behind the proposal of the Investigation Committee of the Russian Federation to establish the financial police was the President's draft law under which the investigators of the Investigation Committee of the Russian Federation were denied the right to initiate criminal cases on tax dodging³. It was noted at the Investigation Committee of Russia that in the past few years the Federal Tax Service managed to reveal only 8% of tax-related crimes, while the Ministry of the Internal Affairs, the remaining 92%, and according to the Investigation Committee the larger portion of such crimes would be in the shadow. The proposed way out of that situation consists either in granting the tax authorities with the right to carry out investigative activities or establishment of the financial police which would be subordinate directly to the President⁴.

At present, within the frameworks of the Government Commission headed by V. Zubkov, the issues of organization of efficient forms of financial supervision are being studied. It only remains to hope that the Commission will manage to find the option of networking between the financial and law enforcement agencies without establishment of a "super ministry" which is entrusted to carry out tax and financial inspections with use of enforcement methods.

4. Letter No. OA-4-12/85@ of January 12, 2012 of the Federal Tax Service of the Russian Federation explains the mechanism of application of Chapter 14.6 of the Tax Code of the Russian Federation as regards conclusion of an agreement between large tax payers and tax authorities on the mechanism of control over application of prices by tax payers in respect of trans-border

1 Tax Decisions of 2012 will not be Changed Within the Next Five to Six Years – Shuvalov, MOSCOW, January 18, 2012, RIA Novosti.

2 Yu. Puschaev. What will Happen to the Pensions? Is It Possible to Increase the Future Pension and What Needs to Be Done For That Purpose? Web-site: money.ru.msn.com/reviews/calc/168197/ of September 16, 2011.

3 O. Rubnikovich. Alexander Bastrykin will Share with Taxes. The Head of the Investigation Committee of Russia has Lobbied for the Financial Police. Kommersant daily. No.7 (4792), January 18, 2012.

4 P. Netroba, V. Visloguzov and D. Butrin. Capital Outflow will not Be Left in Peace. Viktor Zubkov will Establish a Working Group to Fight the Suspicious Money, Kommersant daily, No.4 (4789), January 13, 2012.

transactions with related counterparties in order to prevent utilization of transfer pricing schemes. Taking into account the fact that the issues of tax supervision of pricing in most cases concern foreign trade deals, it is explained that with entering into an agreement between tax authorities and large tax payers the

Federal Tax Service of the Russian Federation will abide by the standard principles accepted in the international practice, in particular, those which are included in the OECD Transfer Pricing Guidelines for transnational companies and tax administrations. The very core of the principle is formulated in Article 105.3 (1) of the Tax Code of the Russian Federation: the price is recognized as a market price if it corresponds to the level of prices which would have been applied to such deals between non-related counterparties. It is specified directly in the Tax Code that: “If in deals between related persons commercial and financial terms are created or established and such terms are different from those which took place in deals recognized as comparable ones between non-related persons any income (profit and revenues) which might have been received by one of those persons, but due to the above difference was not received by that person is accounted for for taxation purposes with that person”. Such a wording in the Tax Code of the Russian Federation is rather tough and permits the tax authorities in case of existence of at least two similar deals between persons which under the Tax Code of the Russian Federation are not considered as related ones (or it is not established as of the day of court proceedings that they are related parties) to carry out adjustment of the tax base of the tax payer due to the fact that transfer pricing was identified. The above wording does not include the ambiguous term “the market price”, but it uses the mechanism of straight comparison of the terms of the deals.

As it is known, in case of trans-border deals both the quantity and the amount are specified in the customs declaration, that is, there is technically all the required data for the expertise to be carried out.

Due to the above, with entering into an agreement between the tax payers and tax authorities the former will be able prior to transacting the multi-million worth of deals to negotiate all the controversial issues as regards the prices used in determination of tax liabilities. Also, such a practice will permit large tax payers to evaluate in advance the amount of future tax liabilities and take into account the risks of possible sanctions.

The letter in question includes detailed references to the regulatory base of the deals between tax authorities and tax payers (information on the letters of the Ministry of Finance of the Russian Federation and the Federal Tax Service of the Russian Federation, the list of the documents and the procedure for execution of documents required for conclusion of an agreement between tax payers and tax authorities and standard forms of such documents). The Federal Tax Service notes that conclusion of such agreements with tax authorities is to be done on a voluntary basis and should meet both the parties' interests; the parties to the agreement cannot be forced to enter into it.

5. Late in 2011, in the Russian Federation a new scheme of taxation of the gambling business carried out beyond the borders of the special (gambling) zones was introduced. As it was introduced without a transition period, special explanations of the Federal Tax Service and the Ministry of Finance of the Russian Federation were required. The gambling business beyond the borders of special gambling zones was permitted by Federal Law No. 244-FZ of December 29, 2006 only in respect of bookmaker's offices and pari-mutuals. Under the above Law, the bookmaker's office is a gambling institution or a part of the gambling institution where the organizer of gambling makes bets with participants in gambling; pari-mutual is a gambling institution or a part of the gambling institution where the organizer of gambling makes arrangements for bets to be made between participants in the gambling. That is, in the first instance the bets are made by the organizer of the gambling and the participants (that is, a gaming contract under Article 1063 of the Civil Code of the Russian Federation), while in the other instance participants in gambling make bets between themselves (a mutual bets contract). Thus, the bookmaker's office and pari-mutual are both the type of gambling institutions where the gaming equipment is not used (at least, neither gambling tables, nor slot machines).

The net assets worth of the organizer of gambling has been required to be raised dramatically from Rb 100m to Rb 1bn and it is to be maintained within the entire period of the activities of

the bookmaker's office (pari-mutual), while the minimum sum of the registered capital paid up by means of the own funds alone should amount to at least Rb 100m. It is clear, that such a requirement will result in a situation where the number of bookmaker's offices and pari-mutuals is greatly reduced and their status is raised.

The new procedure for taxation of bookmaker's offices and pari-mutuals introduced into Chapter 29 of the Tax Code of the Russian Federation by Federal Law No. 319-FZ of November 16, 2011 was commented on in detail in Letter No. AC-4-3/22696@ of December 30, 2011 of the Federal Tax Service and Letter No. 03-05-05-05/12 of December 30, 2011 of the Ministry of Finance of the Russian Federation.

Another important factor of the new scheme of taxation became a change of the tax entities which are charged the gambling tax. If earlier they included cashier's offices of bookmaker's offices or pari-mutuals, from January 1, 2012 processing centers and betting shops of bookmaker's offices and pari-mutuals are recognized as tax entities which are subject to payment of the gambling tax. ●

CHANGES IN THE SPHERES OF BUDGET LEGISLATION

M. Goldin

By Order No. 2562 of October 27, 2011 of the Ministry of Education and Science of the Russian Federation, the new Standard Statute on a Pre-School Educational Establishment has been approved.

By Order No. 2562 of October 27, 2011 of the Ministry of Education and Science of the Russian Federation, a Standard Statute on a Pre-School Educational Establishment (hereinafter the Standard Statute) was approved. The Standard Statute regulates the activities of all the types of state and municipal pre-school educational establishments.

For non-state educational establishments the Standard Statute may serve as an example on which basis they can develop their own statutes.

Pre-school educational establishments may carry out the main educational programs of the pre-school education and take care of the children as well.

The age of pupils who receive training, education and development as well as tending, care and invigoration at pre-school establishments varies from two months to seven years old.

Pre-school educational establishments include the following types of educational establishments:

A kindergarten (carries out the main educational program of the pre-school education at groups of general development profile);

A kindergarten for early-age children (carries out the main educational program of the pre-school education at groups of general development profile for pupils at the age of two months to three years old and creates conditions for social adaptation and early socialization of pupils);

A kindergarten for children of pre-school (senior pre-school) age (carries out the main educational program of the pre-school education at groups of general development profile and, if necessary, in groups of the compensating and complex profiles for pupils at the age of five to seven years old with a priority to ensure equal start-up opportunities for training of the children at general educational establishments);

A kindergarten for care and invigoration (carries out the main educational program of the pre-school education at groups of the invigoration profile with a priority attached to fulfillment of sanitary, health-related and prophylactic activities and procedures);

A kindergarten of a compensating type (carries out the main educational program of the pre-school education at groups of the compensating profile with a priority to fulfill qualified correction of defects in physical and (or) psychological development of one or more categories of children with limited health abilities);

A kindergarten of a complex type (carries out the main educational program of the pre-school education at groups of general development, compensating, invigoration and complex profiles in a different combination);

A kindergarten of a general development type with a priority to fulfill activities by one of the lines of development of pupils (carries out the main educational program of the pre-school education at groups of the general development profile with a priority to fulfill development of pupils by one of the following lines: cognitive and speech development, social and personal development, artistic and aesthetic development and physical development);

A child development center -- kindergarten (carries out the main educational program of the pre-school education at groups of the general development profile and, if necessary, at groups of invigoration, compensating and complex profiles with a priority to carry out activities related to development of pupils by a few lines, such as cognitive and speech development, social and personal development, artistic and aesthetic development and physical development). At groups of invigoration, compensating and complex profiles, priority development of pupils is carried out

along those lines which contribute most to strengthening of pupils' health and correction of defects in their physical and (or) psychological development.

The Standard Statute includes a ban both on establishment and activities of organized structures of political parties and socio-political and religious movements and organizations (associations) at pre-school educational establishments. It is to be noted that it is emphasized in the Standard Statute that education at state and municipal pre-school educational establishments is of secular nature.

The right to carry out educational activities arises with the pre-school educational establishment from the day it was issued a license to carry out educational activities.

The content of the educational process at the pre-school educational establishment is determined by the main educational program of the pre-school education which program is developed and approved by the pre-school educational establishment individually. The main educational program of the pre-school education is developed in accordance with federal state requirements set to the structure of the main educational program and conditions of implementation thereof, as well as an exemplary base of the educational program of the pre-school education which determines the content of the mandatory portion of the educational program of the pre-school education.

In accordance with goals and purposes determined by the statute, a pre-school educational establishment may carry out additional educational programs and render additional educational services beyond the educational programs which determine its status with taking into account the requirements of the family and on the basis of the agreements concluded between the pre-school educational establishment and the parents (legal representatives).

Fee-based educational services cannot be rendered as a substitute for or within the frameworks of the main educational activities which are financed by the founder.

For the purpose of ensuring educational activities in compliance with the statute, the pre-school educational establishment is assigned by the founder the property (buildings, constructions, facilities and the equipment, as well as other necessary property of consumer, social, cultural and other use) which belongs to the founder on the basis of the legal title or leased by the founder from the third person (the owner).

Land plots are assigned to state and municipal pre-school educational establishments in accordance with the procedure set by the legislation of the Russian Federation. In other words, land plots on which pre-school educational establishments are situated are assigned to them for termless and free of charge use.

It is to be noted that at present the Standard Statute on a Pre-School Educational Establishment approved by Resolution No. 666 of September 12, 2008 of the Government of the Russian Federation is still in force. The new Standard Statute on a Pre-School Educational Establishment will come into effect from the effective day of the Resolution of the Government of the Russian Federation on recognition as null and void of the Resolution of the Government of the Russian Federation which approved the former Standard Statute on a Pre-School Educational Establishment. ●