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RUSSIAN ECONOMY: TRENDS AND PROSPECTS

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MONTHLY BULLETIN:

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THE RUSSIAN ECONOMY IN JULY 2012: PRELIMINARY DATA AND MAJOR TRENDS

Socio-political background in July was shaped by a catastrophic flood and the subsequent daunting death toll in Krymsky district of Krasnodar krai and the end of the “repressive” session of the State Duma. What caused the flood has remained murky: while the local administration insists on natural causes, the role of the flush from Neberdzhavsky reservoir, as well as its technical conditions, appears pretty much undiscerned. Quite characteristically, post-catastrophe, the authorities resumed an investigation into Mr. A. Ballo, Deputy Chairman of VEB, and JSC Evraziysky’s operations on acquiring water reservoir operators. The blame so far has been cast upon the local administrations of Krymsky district and the city of Krymsk for the failure to alert local residents in a timely manner. That said, it is evident that the much-needed set of measures to preclude such floods, which had been developed in the wake of similar disasters back in 2002, has remained unaccomplished.

On the eve of its summer recess, the Duma passed yet another repressive act. This time, it reinstated in the Criminal Code the Article on defamation, which MPs had abrogated just six months before. Like previously adopted acts (against rallies, NGO financing from overseas, “black-listed” web-sites), most observers consider the ruling party and the Kremlin’s move to be a counterstroke to the wave of rallies in the winter and spring 2012. A piquant nuance of the newly adopted act is that the maximum punishment was established for defamation against investigators and the court of law which the opposition and civil activists blame for having turned into a juggernaut rolling onto politically dissent citizens.

In July, an official announcement was that the state-owned Rosneft is going to acquire the BP’s stake in TNK-BP. If successful, the deal will increase the government’s share in the oil sector from 35% to 50%.

Macroeconomic background in July was driven by favorable trends on the oil market. Since the last week of June oil prices have resumed their rise, which accounted for 18% (ICE Brent) over the five weeks in question. That drove the stock market’s rally, albeit stock indexes proved far modest, and the forex market’s dynamic. With the Rb depreciating between May and June, it was for the first time since December 2012 that the Bank of Russia has made it back to the market as a net seller of forex (the sales accounted for \$ 2.02bln). In July, the Rb began to rise, and on 24 July the Bank of Russia expanded the operational interval from Rb 6 to Rb 7 and cut down the marginal intervention value from \$ 500mln to 450mln. July became the first month of the year which saw a slight (some \$5 bln) capital inflow. At the end of H1 the net capital outflow stood at \$ 43.4bln (vs. 31.2bln reported a year ago).

The July indexation of tariffs for natural monopolies’ services resulted in acceleration of inflation: at the end of the month consumer prices rose by 1.2%, while inflation between the beginning of the year and 23 July accounted for 4.4%, thus nearly having caught up with the last year’s figure of 5.1%

This year the economy, and the real sector in particular, exhibits a new peculiarity, that is, a “weakening” of the dynamics of macroeconomic indicators in Q2 on a year-on-year basis. By the RF Ministry of Economic Development’s estimates, the nation’s GDP posted a 4.0% growth in H1 2012, with its increase rates slowing down from 104.9% in Q1 to 103.9% in Q2 on a year-on-year basis.

An unusual for the economy drastic spike of investment demand in Q1 2012 (the investment increase rate in Q1 hit 16.3% on a year-on-year basis) was followed by a weaker dynamic (down to 7.7%) between April and May which further aggravated (down to 4.7%) in June. Thus the growth rate of investment in capital assets in Q2 2012 ultimately accounted for 6.5% vs. 5.0% reported a year ago. The slowdown of investment in capital assets was going hand-in-hand with deterioration of corporate performance indicators.

Residents’ monetary incomes in H1 2012 were in excess of their spending, while a year ago the ratio was an inverse one. The proportion of spending on current consumption in the structure of

residents' incomes soared to 77.4% and was up by 2.6 p.p. on a year-on-year basis. The savings ratio has been declining gradually over H1 2012 and by June stood at 6.6% vs. the last year's 12.9%.

A high level of household consumption is still bolstered by increasing lending. In June, the volume of consumer loans to the population was more than 1.5 times greater than in June 2011. According to the Bank of Russia, the increase rate of the volume of mortgages (measured on a year-on-year basis) slowed down from the January figure of 77.8% to 65.6% in April and further to 49.4% in May. It may well happen that the residents' investment behavior found itself affected by anticipation of changes in the inflation rate and Rb exchange rate in the second half of the year.

The banking sector posted greater growth rates of its assets. Russian banks continued to vigorously expand their retail lending portfolio and to boost lending to corporate customers. That said, the expansion of banking assets and, accordingly, the lending portfolio in June was fueled by external sources and the Bank of Russia's emission, rather than by expanding domestic savings. The increase in foreign and the Bank of Russia's loans accounted for over 80% of the June increase in assets.

The growth rates of the nation's foreign trade turnover between April and June 2012 were down on a year-on-year basis for the first time in the last three years. While the export dynamic strongly correlated with changes on global markets, the import one was driven by the dynamic and structure of domestic demand and the Rb exchange rate. It can be suggested that a slowdown of the manufacturing sector's dynamic and cautious investment activities on the one hand, and depreciating Rb, on the other, entailed a narrowing of demand for import in Q2 2012.

According to June surveys of industrial corporate executives, dynamics of main indicators (demand, output, employment, prices) retained their negative tendencies and it is more and more likely that the national industrial sector is drifting into a second wave of the crisis. Corporate plans and outlooks do not vouch the clouds are going to break away in the upcoming months. The manufacturing sector's mood has certainly begun to sour since May, and, notwithstanding Rosstat's optimistic data on output in that month, became clearly negative in June. Corporate plans and outlooks have been running out of optimism throughout Q2 2012 and do not allow hopes for the industrial sector's revival in months to come. Corporate pricing policies in Q2 emerged under influence of two polar factors. On the one hand, a regular phase of the annual tariff increase pushes producer prices and pricing plans upwards. On the other hand, a sluggish increase in demand, which, upon clearing from seasonality, turns into decline in sales and feeds dissatisfaction with their volumes, compels enterprises to contemplate price cuts in the hope to boost demand. Consequently, between May and June factory prices effectively discontinued to rise, while corporate pricing plans have already been in decline for four months in a row. ●

JULY 2012: POLITICAL AND ECONOMIC OUTCOMES

S.Zhavoronkov

In July, the focus was on the catastrophic night flood in Krymsk district of Krasnodar krai, which claimed more than 170 lives. It has already been established that the cause for the tragedy became, as a minimum, the absence of a PAGA system, though the local administration was aware of the calamity. Meanwhile, the Parliament passed yet another repressive act: this time, to return to the Criminal Code the article “Defamation” (which was abrogated just six months on initiative of the then President Mr. D. Medvedev (currently the nominal leader of United Russia, the majority parliamentary part). The novelty does not fundamentally change the situation, as there are other similar “politicized” articles in the national Criminal Code. But the reinstated article is a perfect illustration of the fact that decision making is beyond both Mr. Medvedev and United Russia’s respective mandates. Russia finally ratified the agreement on accession to WTO. Mr. I. Sechin, head of Rosneft, officially announced negotiations on buying from BP its share in TNK-BP, which should bolster nationalization and concentration in Russian economy.

It was a natural disaster in Krymsk district of Krasnodar krai that captured headlines in July 2012. The night flood of 6-7 July claimed over 170 lives, mostly seniors’, who failed to get out of their flooded houses at 3am, at the peak of the disaster. The death toll proved far greater than that of another catastrophic flood in the city of Novorossiysk 10 years ago. The local terrain, with numerous water reservoirs, lakes and torrents, makes this zone fairly dangerous; however, they were not a principal cause for such dire consequences. Nearly two weeks after the flood, speaking on behalf of Russian authorities Mr. A. Bastrykin, the head of the Investigative Committee, proved an obvious fact first voiced by local residents and then – by Governor A. Tkachev: while meteorologists had issued a storm alert to local authorities as early as at 8pm on the day before the flood, no public address and general alarm system was activated. Worse, the next day, there popped up falsified documents on a purportedly meeting of an emergency commission and there was an attempt to collect evidence in writing from local residents that they had been alerted of the disaster. It proved hard to verify another update which was released the next day after the flood – that is, the catastrophe was triggered by a possible flush from local reservoirs and artificial lakes: authorities deny it, but, still, it is hard to believe that tsunamis were caused solely by failure to complete cleansing of local river-beds in time, as this kind of work is nearly nowhere underway in the country. Ultimately, the authorities detained the mayor of the town of Krymsk and the district administration head on charges of negligence that caused grave consequences (part 2 Art. 293 of the Criminal Code of RF). Meanwhile, infamous for his “authorities-should-not-call-on-every-place” statement Governor A. Tkachev has retained his post, though the faux-pas does not add him political credit in the light of the upcoming regional elections to legislature and the fact that he is an appointed, rather than elected, Governor. After visiting the region twice, Mr. V. Putin announced an increase of indemnity up to Rb. 150,000 per person and up to Rb 2mn – to families of flood victims and vowed to have them move in new housing no later than November 2012.

Natural disasters may occur anywhere; however, the accident once again exposed the fact of an utter negligence by public administration of its non-profit-making duties. Specifically, it was back in 2002, after the first catastrophic flood in the region, that the need to cleanse the river-beds was articulated, yet nothing has been done to date. The functioning of the water reservoir system raised a lot of questions: it was found out that it is managed by JSC Evraziysky whose executives, together with Mr. A. Ballo, Deputy Chairman of VEB, have already been prosecuted for several months on charges of misappropriation of a VEB’s loan with regard to acquisition of water reservoir operators.

July 2012 saw a frantic (week-long(!)) passing of yet another repressive act: following the one on NGO with the status of “foreign agents”, which was also formally ultimately passed in the same

month, but considered in every detail in the previous months, the State Duma passed amendments which returned to the Criminal Code the article on defamation. Notably, it was just the United Russia faction which voted for the act. Yet more notable is the fact that it was just six months ago (!) that this particular article was abrogated on initiative of the-then Pres. D. Medvedev and with a unanimous support of the same faction. At the time, the move was publicly promoted as an evidence of liberalization of law. This time, the bill was formally initiated by several MPs representing United Russia and then – immediately and without an earlier promised internal discussion within United Russia – the faction leadership voiced their support of it and so later, albeit with some reservations, did Pres. V. Putin. After that, it became clear the bill would be signed into law. The nation saw that the ruling party has no ideology and is ready to vote for any text “from the top”. As well, it is now clear that United Russia’s structures, including Mr. D. Medvedev as its nominal head, who just six months before had solemnly submitted to the Parliament a directly opposite bill, have and will not have no say (after the December parliamentary election, there were talks about internal democracy, primaries in the party, etc.). This time, Mr. Medvedev kept silent – clearly, he has nothing to say. This is a very important fact, no less important than the adoption of the repressive act per se. Finally, the act in question has its analogues in the criminal law, including the notorious and not abolished to date Art. 282 of the Criminal Code on extremism.

The newly adopted act has the following construction: it provides for huge fines, up to Rb 5mn, or 10 times higher than the largest amount of fine currently foreseen by the Administrative Code. But, while currently the gravest offense (punishable by a fine of up to Rb 500,000 under aggravating circumstances) is defamation against corporation, the novelty establishes that main complainant are judges, prosecutors and investigators, as defamation against them is fined at maximum. The previous practice of enforcement of the Article “Defamation” evidenced that it practically was not used in Moscow – in the Russian capital, political figures would find themselves under the sword of Damocles of the aforementioned and more ominous Art. 282 of the Criminal Code. Rather, it was massively enforced in Russian regions, to crack down on local dissents. The matter of the fact is, this is the ultimate objective of its recent reinstatement. In all fairness, hundreds of Russians sentenced under the Article in question did not preclude the opposition to pursue an efficient campaign against the ruling party labeled as “the party of crooks and thieves”, nor this Article will stop the opposition now.

In July, Pres. V. Putin signed into law the ratification of the Agreement on Russia’s accession to WTO (with respective agreements having been signed in November 2011). The documents stirred a heated debate and ignited protests. This time, however, it was not the liberal part of the society which protested, but some national producers and the leftist part of the political spectrum (the Agreement likewise was passed thanks solely to United Russia’s vote). It was agrarian producers and machine-building manufacturers that proved most concerned about the document, as they are going to face a notable decrease of duties on imports. Addressing their concerns, Russian authorities claim that joining WTO should help the national metallurgical sector to cope with antidumping proceedings and bring more benefits to consumers. Plus, in the past decade the Government made everything it could for numerous sectors (such as the automobile industry) by imposing high import duties, allocating subsidies and encouraging construction of new plants in Russia. So, the one who is unable to compete after such a transitional period will not prove competitive ever after. Notwithstanding this, the opposition in the Parliament rightly argues that the ratification procedure was too hectic (with many documents not even having been translated to Russian) and the Government had not bothered to discuss its negotiation strategy. That said, some already exposed drawbacks can be remedied down the road through the negotiation procedure after joining WTO.

While in the past Mr. I. Sechin, the head of Rosneft, had been consistently dismissing any possibility to acquire a share in TNK-BP, in July he admitted that Rosneft was indeed considering the move. Having been forced away from managing TNK-BP’s operations back in 2008 and having failed to get back the control levers despite amicable agreements signed with Russian stockholders, BP had earlier announced its intent to sell its stake in the company. However, it remained unclear whether that was going to take place, or not. In terms of Russian logic, should Rosneft acquire the stake, it would gain operational control of the company. With account of the fact, as well as the TNK-BP’s size, the proportion of state-owned corporations in the oil sector should soar from

roughly 35% to 50%. So, the RF Government continues its course toward nationalization of the economy, though there has for long been no dearth of professional spokespersons in the Government vowing privatization the next day or shortly thereafter.

In July, the RF Government found itself divided on two challenging issues – that is, the educational and pension reforms. The Government ultimately failed to meet timelines of submission to the Parliament of a reworded bill “On education”, which had been released for public discussion a year ago. The cause behind the failure was Mr. Medvedev’s face-to-face meeting with Mr. G. Zyuganov, the leader of CPRF, and the meeting of the “Open government” with participation of the communists (represented by a renowned expert in education, Mr. O. Smolin, MP, their faction has long criticized the educational reform and enjoyed the teacher community’s broad grass-roots support). As far as one can judge their outcome, the meetings resulted in a certain compromise, with Mr. Medvedev having vowed to meet one of CPRF’s main proposals – namely, to tie the teachers’ average salaries to an average salary in a region (today, it proves to be at 20-30% lower than the average regional benchmark). The Ministry of Finance has not yet completed respective calculations, nor it is clear how the Ministry will feel about the initiative, for it requires extra federal spending, as many municipal budgets appear cash-strapped. The communists promised to contemplate a possibility to support the final variant of the bill and, in advance, supported the act on NGO. That is the way the Government tries to climb out of the internal isolation, with both the parliamentary and non-parliamentary opposition forces rejecting all its initiatives. In July, Mr. Medvedev announced that since 2015 the average amount of labor pension in Russia would be raised by no less than 45%. As in the earlier case of the vow not to raise social payments, the expert community was likewise perplexed by the novelty: the pension system deficit is expanding even under the present level of labor pensions and even the required by law its annual indexation by inflation rate has become a challenging task. The respective decision is set for adoption in 1 October 2012, and the new pension reform should kick-start since 1 January 2013. But it is not still clear what kind of reform it is going to be. The Government pleads not to increase the pension age, while other options are on the table, including confiscation of savings accumulated over the past decade in the savings system, abolition of their indexing, abrogation of preferential pensions, etc. Every option bears particular negative effects, including electoral ones, while it is becoming increasingly hard to postpone the decision. ●

INFLATION AND MONETARY POLICY

N.Luksha

Growth of prices in June was highest in the current year: CPI made 0.9% (against 0.5% in May 2012 and 0.2% in June 2011). This was contributed by the rise in prices for fruit and vegetable products because of the poor harvest in southern Russia (13.4%). In July, due to the indexation of tariffs of natural monopolies, inflation accelerated: within 16 days of the month the growth in consumer prices made 1%. As a result, cumulative inflation since the beginning of the year up to July 16 reached 4.2% (against 5.1% during the same period in 2011). In June, for the first time in the year, there was noted an insignificant inflow of capital about \$5bn. In the 1st half-year net outflow of capital from the country amounted to \$43.4bn (against \$31.2bn for a similar period of 2011) Due to the weakening ruble rate in May and June of this year, the Bank of Russia for the first time since December last year went to the market as a net seller of foreign currency (\$2.2bn was sold). In July, the ruble began to strengthen. On July 24 the Bank of Russia increased its operating range from Rb 6 to 7 and lowered the limit value of interventions from \$500m to \$450m.

In June consumer price index was the highest in the current year – 0.9%. It increased nearly twice as compared with May of this year (+0.5%) and significantly higher than in the same period of the last year (+0.2%). The main factor for the acceleration of consumer inflation was growth of food products from 0.6% in May to 1.6% in June. This is primarily contributed by the continuing increase in prices for fruit and vegetable products (+13.4%).

Such growth rate of prices for fruits and vegetables in recent months is associated, first, with unfavorable weather conditions in southern Russia, wherefore the harvest started later and was less than expected. Second, it is provoked by the low base effect of the last year, when the harvest was good and therefore, prices were low. And thirdly, the imported products, which replaced the delayed new crop and expiring old stocks was expensive due to the weakening ruble rate.

Note, that as per results of the first six months, the growth of prices for fruit and vegetable products was the highest among the monitored consumer goods (+28.8%). Sugar took the second place, which for the first six months rose by 11.2%. At the same time, the greatest price decline over the same period was observed in eggs, cereals and beans, which fell down by 15.8% and 11% respectively.

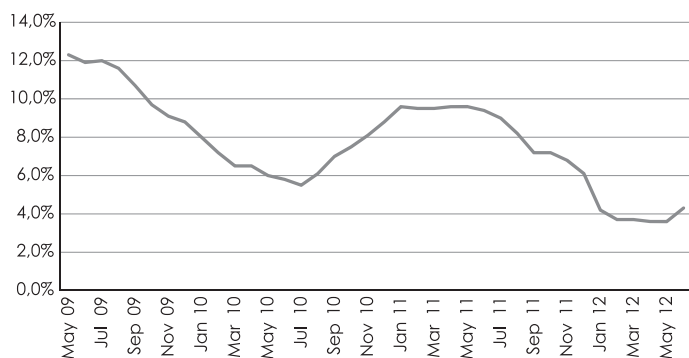
Due to a significant slowdown in the rate of increase in gasoline prices, non-food inflation in June slowed down by half as compared with May and June last year – up to 0.2%. Gasoline prices in June rose by 0.2% (against 1.4% in May). The only goods decreasing in price in June were audio-video items (-0.1%). Over the first half of 2012 the utmost price growth among the largest non-food goods was observed in tobacco – by 10.8%.

The growth rate of prices and tariffs for commercial services in June increased by 0.1 p.p. to 0.8%. In the summer holidays prices have grown for seasonal healthcare and recreational services (+3.6%), foreign tourism (+3.4%) and passenger transport (+2.8%). There was no decrease in prices for any type of commercial services in June. Since the beginning of the year to June, the highest rate of price growth for commercial services was observed on healthcare and recreation (+8.3%) and medical services (+5.8%).

Annual inflation (June 2012 against June 2011) at end of the month has increased to 4.3%. Within the relevant period of preceding year this indicator was twice higher, 9.4% (Fig. 1).

The basic consumer price index¹ decline in May was brief. In June, it has grown again, having returned to the indices of January–April of this year 0.4%

¹ The core consumer price index reflects the level of inflation in the consumer market after adjustment for the seasonal (prices of vegetable and fruit products) and administrative (regulated tariffs for certain types of services, etc.) factors. In Russia, it is calculated by the RF Statistical Service (Rosstat).



Source: Statistical Service.

Fig. 1. The Growth Rate of the CPI in 2009–2012 (% year to year)

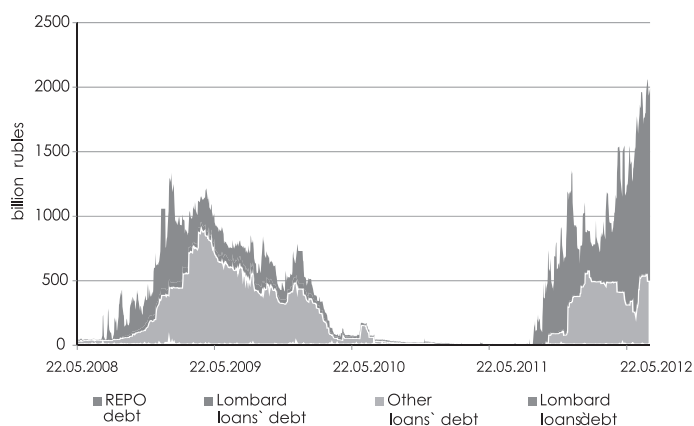


Fig. 2. Arrears of commercial banks with the Bank of Russia in 2008–2012

of which may occur in the second half of the year. Therefore, in our view, it seems doubtful to maintain annual inflation within the framework of official forecast at 5–6%.

In June, the volume of monetary base in broad definition increased by 5.2% to Rb 8.1293 trillion. All components of the broad monetary base were growing. After the May decline, in June, correspondent accounts of commercial banks with the Bank of Russia increased by 32.7% to Rb 790.7bn. Growth was also continued in deposits of credit institutions with the RF CB to Rb 135.8bn (+21%). As a result, excessive reserves of commercial banks¹ in June increased by nearly one-third, reaching by the end of the month Rb 926.5bn.

Nevertheless, the liquidity situation remains tense, which enforcing the banks to apply for refinancing with the RF Central Bank: in mid-July arrears banks on direct repo with the RF CB have exceeded the amount of Rb 1.5 trillion (Fig. 2). Another indicator of liquidity problems is the high rates on the interbank lending market: in July MosPrime 3M rate did not get below 7.2%.

Increase in cash in circulation and mandatory reserves in June has promoted the expansion of the monetary base in the narrow definition (cash plus reserve requirements) to Rb 8,522.4bn, or 21% (Fig. 3).

In June, for the first time since December last year, the Bank of Russia has suspended the purchase of foreign currency. As per the month results, foreign currency interventions amounted to \$2.2bn and EUR 173.11m (Fig. 4).

For two and a half months from the end of April, when international reserves reached their maximum in the current year (\$523.3bn), and till mid-July that volume fell to \$17.6bn. On July 13 reserves amounted to \$505.3bn having reduced within the month by 1.3%. However, the main reason for the reserves reduction was Euro decline against the U.S. dollar in global currency markets,

As expected, due to the increase in housing utility tariffs, index of consumer prices in the first half of July has jumped up: as of 16 days of July results, it reached 1% (against 0.1% during the same period in 2011). As a result, cumulative inflation since the beginning of the year on the same date increased to 4.2%, which reduced the gap with the inflation of the last year to 0.9 p.p. At the same time, the weekly increase in prices for fruits and vegetables slowed down to 4.2–4.4% in June to 1.3–2% in July. Gasoline prices in the first half of July did not grow.

If in the first five months of this year inflation was slowing down, then it began to accelerate starting from June. The main reasons for higher growth in prices of summer became the extinction of high base effect and indexation of tariffs for state monopolies, coming into effect from July. Gathering a new harvest in Russia in August–September can reduce the inflationary pressure on consumer prices in QIII. However, adverse weather conditions can lead to the low crop of fruits and vegetables this year, which will contribute to their price growth. In addition, at the end of the year, inflation is accelerating because of the traditional growth of budgetary expenditures. Do not forget also the weakening of the ruble, pending effect

¹ Under the excessive reserves of commercial banks with the Central Bank is understood the sum of correspondent accounts of commercial banks, their deposits with the RF CB and the RF CB bonds of commercial banks.

and consequently, a decrease in the dollar reserves denominated in Euro.

In June, the ongoing since June last year outflow of capital was replaced by a small inflow of about \$3bn. According to the RF CB tentative assessment, the outflow of capital from the country over the first half 2012 reached \$43.4bn. In QII of the current year, the outflow has decreased 3.5 times to \$9.5bn, being comparable with the level of outflow in QII 2011 (\$7.3bn).

We believe that the main cause of capital inflow in June is the decline in the surplus of the RF current account balance. In the situation of minimization of the Central Bank intervention in foreign exchange market, a reduced current account balance provokes concurrent reduction of the account balance of transactions with capital and financial instruments.

For the third consecutive month (since April this year) the ruble real effective exchange rate continues to decline. In June, it increased and reached 4.3%. As a result, the index of real effective exchange rate fell to 145.96¹ (Fig. 5). The higher monthly rate of decline in the real exchange rate were recorded only in January-February 2009, when the RF Central Bank carried out a smooth ruble weakening.

Starting from the fourth week of June, the trend of weakening of the ruble nominal exchange rate was replaced by its strengthening. After that, over four weeks, the Russian currency has grown against dollar by 4.7% to Rb 31.95 / dollar on July 21. During the same period the ruble rose against Euro by 6.8% to Rb 39.17 /Euro. As a result, the value of the two-currency basket has decreased by 2 rubles and 17 kopecks to Rb 35.2 (-5.8%).

The end of a downgrading trend of the Russian currency is primarily based on the renewed growth in oil prices. The weakening of the euro

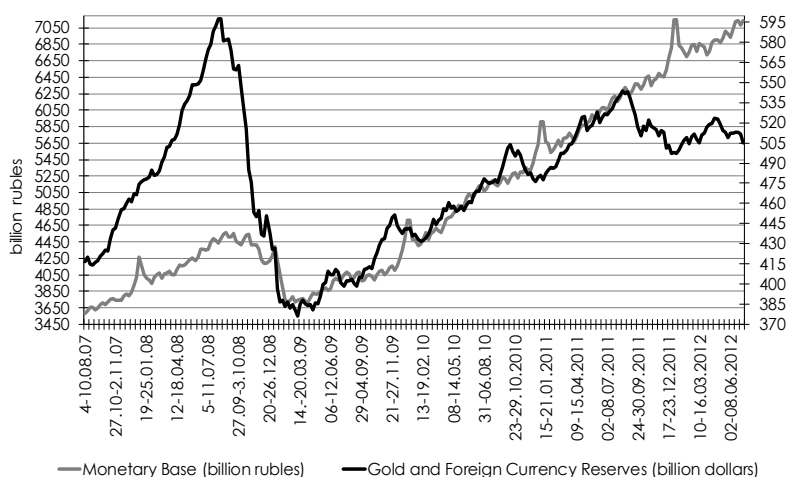
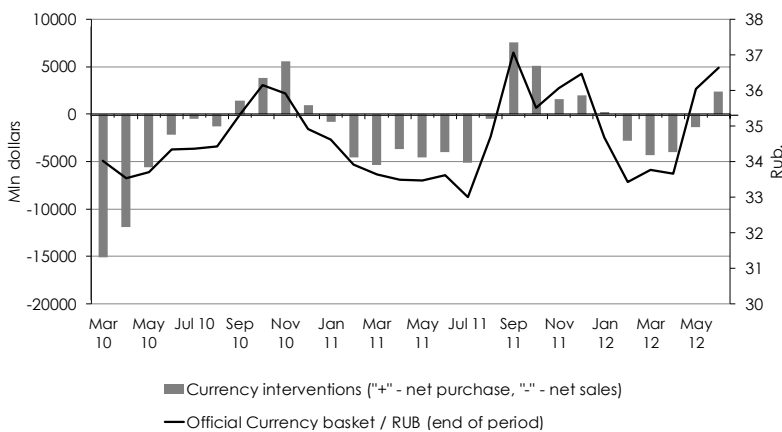
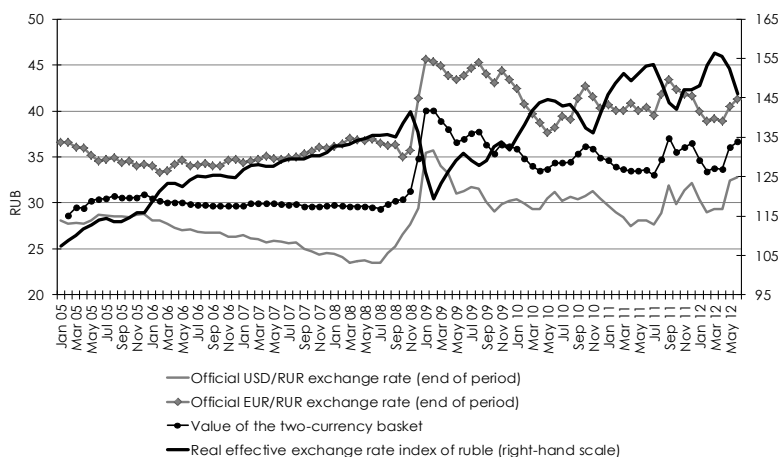


Fig. 3. Changes in the Monetary base (in narrow definition) and gold and foreign currency (international) reserves in 2007–2012.



Note: The level of January 2002 is accepted as 100%. Source: RF Central Bank, author's estimates.

Fig. 4. Bank of Russia currency interventions and ruble exchange rate to the currency basket in March 2010 – June 2012



Source: RF Central Bank, author's estimates.

Fig. 5. Indicators of ruble exchange rate dynamics in January 2005 – May 2012

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

against the ruble occurs at the background of the relevant dynamics of the euro-dollar at Forex: in July, the European currency has updated two-year minimum against the dollar, trading at Euro 1.215 / dollar on July 21.

On July 24 The Bank of Russia has informed on the expansion of the operating range of admissible ruble values of two-currency basket from Rb 6 to 7, as well as a decrease in the accumulated value of interventions, that lead to a change in the operating range by 5 kopecks, from \$500m to \$450m. Recall that from December 27, 2011 the operating range has been increased already from 5 to 6 rubles, and the limiting value of interventions was reduced from \$600m to 500m.

The statement on a decrease in the maximal accumulated interventions, which lead to a change in the operating range, suggests a further increased flexibility in exchange rate policy of the RF CB. In general, the Bank of Russia actions demonstrate a gradual abandoning of the exchange rate monitoring in the framework of transition to the inflationary targeting. Over a period of instability in the foreign exchange market in autumn 2011, as well as in spring 2012, the Bank of Russia demonstrated its readiness to minimize its interference in the foreign exchange market functions, allowing for significant variations of the ruble nominal exchange rate. Such policy allows reducing the amount of speculations in the currency market, as it reduces the predictability of exchange rate dynamics. ●

FINANCIAL MARKETS

N.Burkova, E.Khudko

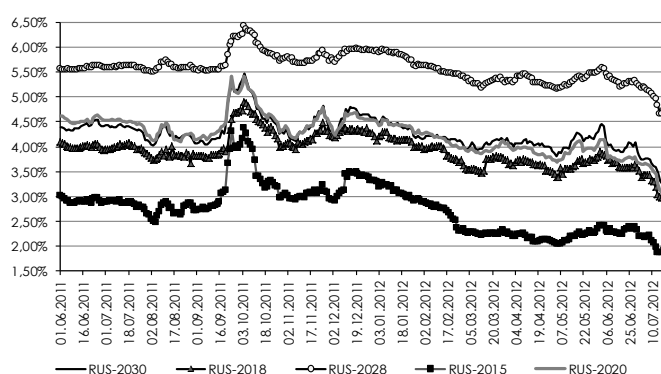
Investors' pessimistic mood due to the debt market's state in the eurozone and poor macroeconomic statistics from Japan and China, on the one hand, and oil prices soaring since mid-July and the European and US central banks' commitment to launch stimulating measures, on the other hand, resulted in considerable fluctuations on Russian financial market between 26 June and 22 July. The average monthly turnover of the market for government securities doubled over the period in question, while the equity and futures markets shrank by 21%. The domestic market for corporate bonds was contracting in July, with primary placement indicators remaining on a low level. Meantime, such critical market indicators as the market index, weighted average yields, secondary trading indexes were on the upsurge.

The Market for Government Securities

The flow of the domestic stock market participants from the equity market toward the public securities one, as well as the decline rate of yields to maturity on the market for government bonds (11–21%) accelerated vis-à-vis the June figures (Fig. 1).

Between 26 June and 22 July the aggregate turnover of the secondary OFZ market made up Rb 103.8bln, with the average daily turnover being at the level of Rb 5.5bln (vs. 59.3bln and 2.8bln, respectively, in the period between 24 May and 25 June 2012). When compared with the previous period, this corresponds to a nearly double increase in the average daily monthly turnover.

In the period between 26 June and 22 July there were held 7 auctions for placement of OFZ (34 auctions the month before) on the primary market (Table 1). The aggregate effective volume of placement hit 79% of the planned one (64% a month before). There were no auctions for a follow-on placement of OFZ issues on the secondary market.



Source: by data of Finmarket information agency.
Fig. 1. Yields to maturity of the Russian Eurobonds with maturity in 2015, 2018, 2020, 2028 and 2030

Table 1

PLACEMENTS ON THE PRIMARY MARKET FOR OFZ

Auction date	Issue	Volume of issue, as Rb mln	Volume of issue by face-value, as Rb mln.	Weighted average yields
27.06.2012	OFZ-25080- PD	35 000.00	13 852.58	8.28
04.07.2012	OFZ-25080- PD	15 000.00	14 985.00	7.82
04.07.2012	OFZ-26205- PD	17 000.00	16 749.00	8.24
11.07.2012	OFZ-25080- PD	20 000.00	18 120.00	7.85
11.07.2012	OFZ-26207- PD	15 000.00	11 437.00	8.65
18.07.2012	OFZ-26207- PD	15 000.00	14 540.00	8.30
18.07.2012	OFZ-26208- PD	15 000.00	14 615.00	7.75
Total:		132 000,00	104 298.58	

Source: RF MinFin.

Stock Market

Factors behind the Russian Stock Market's Dynamic

The decision by the EC summit to take measures to tackle the debt crisis in the eurozone and Standard&Poor's upgrading Russia's short-term forex-denominated rating up to A-2 kept the domestic

stock market buoyant between late June and early July 2012. But, while June 2012 witnessed an upward trend across all the sectors of Russia's stock market on the whole, mounting anticipations of the deepening global crisis resulted in a greater volatility on the market. Extra factors affecting Russia's stock market became the Federal Reserve lowering its economic growth forecasts and anticipations of a further plunge of the Rb through the coming autumn. A price rise for oil in mid-July, on the contrary, bolstered Russia's domestic stock market. In all, during the period in question, developed economies' markets posted a 2–8% growth, while emerging ones added 1–4%, except for Asia, where, for example, battered by a weak macroeconomic statistic, Japan, China and South Korea shrank by 1-2%. Meanwhile, main Russian indexes were up 6–10% (*Table 2 and Fig. 2*).

Table 2

DYNAMICS OF GLOBAL STOCK INDEXES

Index	Value (as of 22.07.2012)	Monthly change (%)*	Change since the start of the year (%)
MICEX (Russia)	1 415.38	6.41	-5.14
RTS (Russia)	1 391.55	10.28	-8.68
Dow Jones Industrial Average (USA)	12 822.57	2.56	2.33
NASDAQ Composite (USA)	2 925.30	3.14	8.87
S&P 500 (USA)	1 362.66	3.73	4.46
FTSE 100 (UK)	5 651.77	3.69	-2.18
DAX-30 (Germany)	6 630.02	8.11	3.97
CAC-40 (France)	3 193.89	5.70	-4.37
Swiss Market (Switzerland)	6 284.81	5.73	0.14
Nikkei-225 (Japan)	8 669.87	-0.74	3.30
Bovespa (Brazil)	54 194.79	0.72	-5.20
IPC (Mexico)	40 808.73	4.22	5.61
IPSA (Chile)	4 384.50	1.34	3.57
Straits Times (Singapore)	3 015.53	7.11	6.38
Seoul Composite (Korea)	1 822.93	-0.13	-0.02
ISE National-100 (Turkey)	61 792.16	3.89	16.02
BSE 30 (India)	17 158.44	1.64	9.23
Shanghai Composite (China)	2 168.64	-2.49	1.12
Morgan Stanley Emerging&Frontier Markets Index	740.04	3.57	-1.46

* Relative to the indexes' values as of 25 June 2012

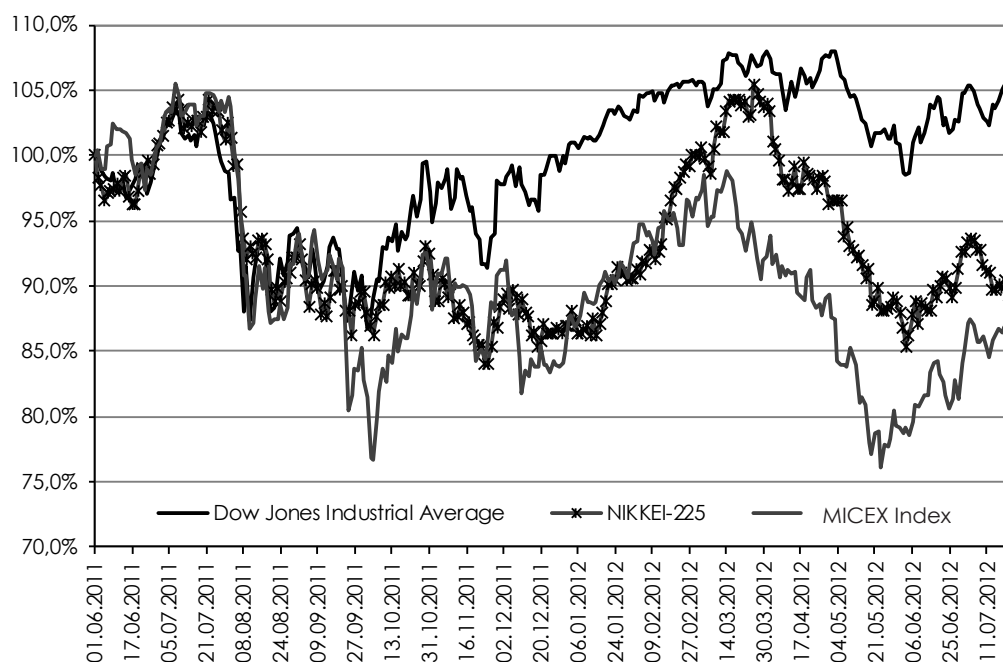


Fig. 2. Dynamics of the main USA, Japanese and Russian stock indices (in % to the date of June 1, 2012)

Stock Market Situation

The peak value of the MICEX index was registered on 4 July – 1,444 points (1,340 points the month before), while the minimum value was registered on 12 July – 1,394 points (1,297) (Fig. 3).

In all, between 26 June and 20 July 2012 the MICEX index climbed up by 6.4% (between 24 May 2012 and 25 June 2012 the MICEX index increased 5.9%), while the turnover of trading with stock forming the MICEX index hit Rb 591bln. The average daily level of investors' activity on the stock market in July plunged by 21% on a month-on-month basis (in June, this indicator rose by 3%).

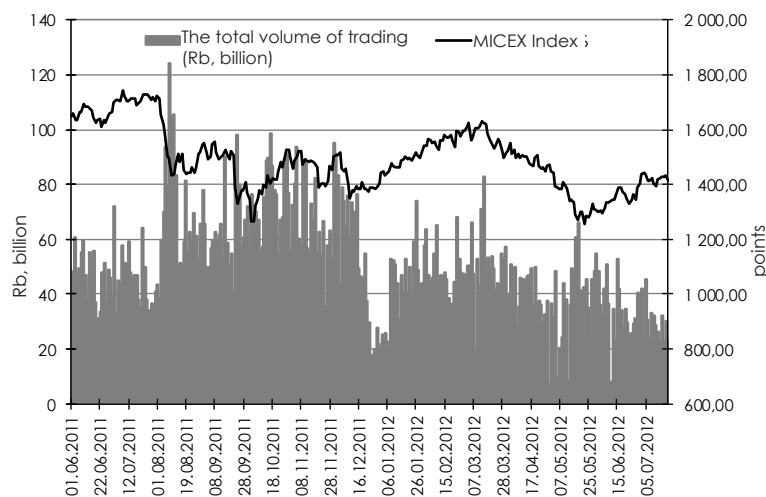
It was Tatneft and Sberbank's papers which were atop the list of the fastest growing blue chips between the beginning of the year and 22 July 2012 – they added 21 и 13.5% respectively, while the biggest losers were Rostelecom and Mosenergo's papers, which lost 23.1 и 22.8% of their values, respectively (Fig. 4).

According to JSC Moscow Exchange, as of 22 July, capitalization-wise, the top-five Russian corporations were: Gasprom – Rb 3,658bln (3,614bln as of 25 June 2012), Rosneft – 2,179bln. (2,140bln), Sberbank of Russia – 1,958bln (1,786bln), LUKOIL – 1,538bln (1,456bln) and Norilsky Nickel – 975bln (994bln).

Futures Market

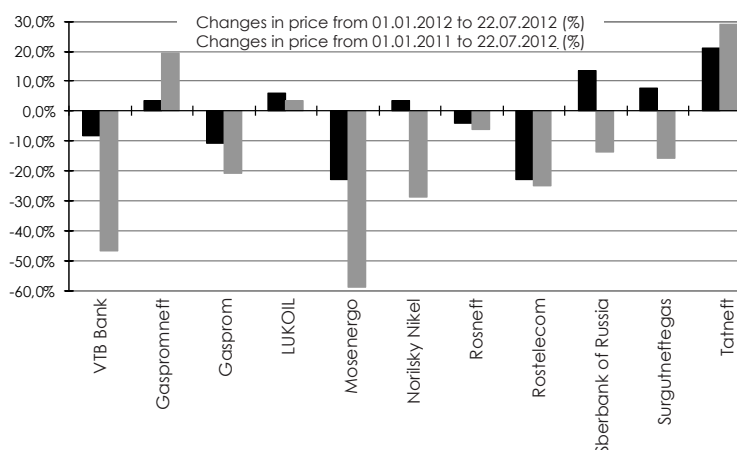
The investors' average daily activity on the futures market FORTS between 26 June and 22 July 2012 tumbled by 21% compared with the previous month (vs. a 32% rise in June). In terms of volume of trading with futures, atop the list were contracts for the RTS Index, followed, with a substantial gap, by contracts for Rb/\$, Sberbank of Russia's shares, €/\$, and refined platinum in bars. Values of the most recent deals on the Rb/\$ futures contracts with the exercise date of 15 September 2012 found themselves largely within a band of Rb 32.3–33.4/\$, ie. the Rb is anticipated to drop by 0.7–4.1% vs. 22 July 2012 (Rb 32.08/\$), while those with the exercise date of 15 December 2012 – within a band of Rb 32.8–34/\$. Values of the most recent deals on the Rb/€ futures with the exercise date of 15 September 2012 found themselves largely within a range of Rb 39.5–41.8/€, ie. the Rb is anticipated to drop by 0.2–6% vs. its value on 22 July 2012 (Rb 39.42/€), while those with the exercise date of 15 December 2012 – within a range of Rb 40.2–42.6/€.

The value of futures contracts for the RTS Index (on the basis of recently concluded deals) with the exercise date of 15 September was within a range of 1,280–1,400 points, ie. market agents anticipate its drop by 0–8% compared with its value on 22 July 2012, while for those with the exercise date of 15 December 2012 – 1,270–1,390 points. Values of the most recent deals concluded on futures contracts for the MICEX Index with the exercise date of 15 September 2012 were in the corridor of 1,360–1,450 points, ie. the index is expected to rise by 0–4% vs. its value on 22 July 2012.



Source: JSC Moscow Exchange.

Fig. 3. Dynamics of MICEX Index and trading volume



Source: JSC Moscow Exchange.

Fig. 4. Dynamics of the Russian Blue Chips

Options enjoyed a far lesser demand, with the respective turnover trading volume between 26 June and 22 July 2012 accounting for some Rb 223.2 bln (those with futures – Rb 3,357.5bln). Trading volume-wise, it was margins on RTS Index futures contracts that were most popular instruments during the period concerned.

In July 2012, the volume of trading with futures contracts on the MICEX's futures market accounted for Rb 91mln (Rb 2.2bln the month before), and all 7 deals fell on futures contracts for Rb/\$.

Corporate Bond Market

The volume of Russia's domestic market for corporate bonds (by face-value of Rb-denominated papers in circulation) was in decline in June. At the end of the month, it was on the level of Rb 3,691.9bln, or down just by 0.8% vs. the figure reported at the end of the previous month¹. A negligible contraction of the market's volume is associated with both reduction of the number of bonded loans (810 corporate bond issues registered in the national currency vs. 817 ones on a month-on-month basis) and fall in the number of issuers operating in the debt segment of the securities market (334 issuers against 339 corporations in June). In parallel with that, the array of forex-denominated bonds expanded, with already \$-denominated bond 2 issues (and still 1 issue of ¥-denominated bonds) in circulation.

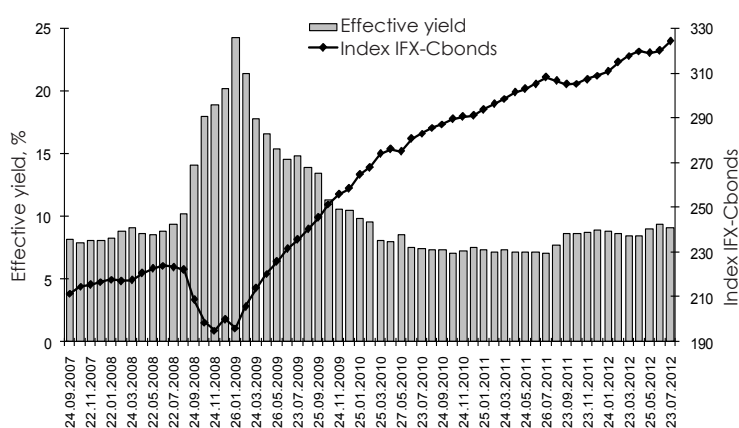
Investment activity on the secondary market for corporate bonds was on the rise in July, and after a seasonal decline, trading indicators bounced back practically to their March-April 2012 levels. The aggregate volume of transactions at MICEX between 26 June and 20 July accounted for Rb 111bln (for reference, in May-June, the volume of trading was at the level of some Rb 93bln), while the number of deals hit 24.200 (21.500)².

IFX-Cbonds, the Russian corporate bond market index, resumed its upward trend interrupted two months before. In late July its value was up 4 points (1.3%) against the late-June figure. Weighted average yields also exhibited a positive dynamic, with their values sliding from 9.43 to 9.10% over the past month, which is a fairly high indicator over the period since early 2010 nonetheless (*Fig. 5*). Such a moderately positive dynamic is likely to be determined by the fact that between late June and early July the international rating agencies confirmed and – in the number of cases – upgraded many large Russian issuers' ratings. As well, the financial markets were enthused by the news of ECB lowering its basic rate to all-times lows, notwithstanding quite a number of negative updates from the eurozone in July³.

The indicator of duration of the corporate bond portfolio plunged once again and accounted for

690 days as of late July, or down 24 days on a month-on-month basis. In this case, the tendency mirrors a high level of the current interest rate, rather than a contraction of bonded loan redemption timelines in the corporate segment of the market.

The most liquid issues exhibited a uniform tendency to lower yields rate. The exception was Mechel bonds which displayed a great volatility of yields rates across different issues which tended to roller coaster. It was bonds issued by financial corporations whose rates slid at most: JSC Gasprombank (series BO-04), Alfa-Bank (series 02), JSC Moscow Credit Bank (series BO-04)⁴.



Source: by data of Cbonds information agency.

Fig. 5. Russian corporate bonds index dynamics and average weighted yield

- 1 According to Rusbonds information agency.
- 2 According to Finmarket information agency.
- 3 According to Rusbonds information agency.
- 4 According to Finmarket information agency.

Interest rates on most papers issued by the financial sector tumbled by 0.5–0.9 p.p. A substantial plunge of the weighted average yields rates at the end of the month was noted with regard to hi-tech companies' bonds (including JSC AFK Systema, JSC Vypel-Communications, JSC Mobile TeleSystems). Yields rates on other issuers' liquid issues were down 0.2–0.3 p.p.

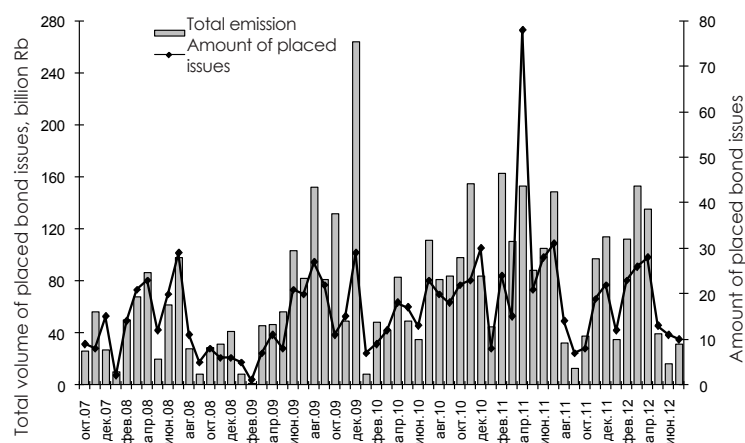
Despite high interest rates, issuers' activity in the debt segment proved to be record-breaking this year. More specifically, between 26 June and 23 July 16 issuers registered 67 bond series with an aggregate face-value of Rb 566.3bln (for reference, between 26 May and 25 June there were registered as many as 48 issues worth a total of Rb 287.2 bln). Such high registration indicators were determined by the fact that having faced the challenge of raising capital on external markets last month, large corporations registered 5-10 issues. More specifically, the largest bond issues were registered by JSC Bank (17 series worth a total of Rb 200bln), JSC Alfa-Bank (12 series, Rb 100bln), JSC Oil Company Rosneft (7 series, Rb 90bln), JSC Severstal (4 series, Rb 50bln)¹. Exchange bonds accounted for two-thirds of the registered issues.

But the investors' activity on the primary market in recent months has substantially trailed behind volumes of issue registration. Between 26 June and 23 July just 10 issuers placed 11 bond issues with the aggregate face-value value of Rb 31.7bln (16.3 bln between 26 May and 25 June) (Fig. 6), and yet another issuer – JSC VEB-Leasing – placed 4 series of \$-denominated bonds worth a total of \$ 400mln. The biggest bond offerings were placed by JSC Gasprombank (a series of bonds for a total of Rb 10bln), JSC Russian Railways (Rb 10bln) and JSC Mortgage Agent Uralsib 01 (2 bond issuances worth a total of Rb 5.4bln). The two latter issuers managed to attract financing for the term of 20 and 33 years, accordingly. It is also worthwhile noting such a positive development as a successful placement of several debut papers with a small face-value.

In July, FSFM cancelled JSC FSK UES's 4 bond issuances due to the failure to place a single paper (the financial regulator has lately canceled no more than 2 bond issues a month)². But in this case it may be suggested that in all likelihood the issuer has changed its plans with regard to external financing, rather than there was no demand for the company's papers.

Between 26 June and 23 July 10 issuers were set to redeem their loans for a total of Rb 32.3bln. However, 3 of them failed to meet the timelines and announced a technical default (there were 2 such issuers in June). Another 13 corporate bond issues worth a total of Rb 40.3bln are set for redemption in August³.

The situation with announcement of a real default (with the issuer not being able to pay income to securities owners even within a short period after the date due) somewhat deteriorated. Between 26 June and 23 July 1 issuer failed to honor its current obligations and another 2 issuers failed to redeem the face-value of their earlier placed bonds even in the frame of technical default. That said, like in the previous months, during the period in question, all issuers have completed an early securities redemption by the offer in time. Meanwhile, a compromise with bond holders on debt restructuring became possible only with respect to coupon income⁴. ●



Source: by data of Rusbonds company.

Fig. 6. Dynamics of primary placement of corporate bonds, denominated in national currency

1 According to Rusbonds information agency/

2 According to FSFM of Russia.

3 According to Rusbonds information agency.

4 According to Cbonds company.

REAL ECONOMY: TRENDS AND FACTORS

O.Izryadnova

The growth of the GDP in the 1st half of 2012 versus the corresponding period of the previous year made 4.0% (according to the preliminary estimation of the RF Ministry of Economy Development) was determined by the growth of the investment and consumer demand. However in the 2nd quarter 2012 as compared with the 2nd quarter 2011 both the investments in fixed assets and industrial production growth rates were observed to slow down, which was accompanied by the reduction of the import volumes.

In the 1st half of 2012 the macroeconomic situation was formed, on one hand, under the influence of the investment demand and internal trade volumes expansion and, on the other hand, dramatic decrease in the foreign trade turnover. In the 1st half of 2012 the growth of the investment in fixed assets made 110.2%, retail trade turnover – 107.1% versus the corresponding period of the previous year. The expansion of the internal consumer demand was supported by a considerable increase in real wages and real incomes of the population (Table 1). Over January–July of the current year the foreign trade turnover went up by 6.1% against 34.4% in the 1st half of 2011.

The 2nd quarter of 2012 was characterized by the slackening of the macroeconomic indices dynamics as compared with the corresponding period of the previous year. According to the preliminary estimation of the RF Ministry of Economic Development in the 1st half of 2012 the increase in the GDP made 4.0% the growth rates decrease 104.9% in the 1st quarter to 103.9% in the 2nd as compared with the corresponding period of the previous year.

Table 1

MAIN MACROECONOMIC INDICES IN 2010-2012, AS PERCENTAGE VERSUS THE CORRESPONDING PERIOD OF THE PREVIOUS YEAR

	1 st half 2010	Quarters 2010		1 st half 2011	Quarters 2011		1 st half 2012	Quarters 2012	
		I	II		I	II		I	II
Gross domestic product	104.3	103.8	104.9	103.7	104.0	103.4	104.0	104.9	103.9
Investments in fixed assets	101.3	95.2	105.6	102.7	99.2	105.1	110.2	116.3	106.5
Construction	93.7	88.9	96.7	100.9	101.2	101.0	105.4	105.2	105.4
Commissioning of residential floor area	99.4	91.1	107.3	96.3	97.6	95.2	101.9	105.7	98.7
Volume of industrial goods	110.2	109.5	110.9	105.3	105.9	104.8	103.1	104.0	102.3
Agriculture production	102.8	103.6	102.3	100.7	100.7	100.6	104.2	104.0	104.3
Freight transportation turnover	112.3	111.6	113.0	104.5	103.9	105.2	101.7	103.8	99.7
Retail trade turnover	104.6	102.2	106.9	105.4	105.0	105.7	107.1	107.6	106.7
Paid services rendered too the population	100.8	99.0	101.6	103.4	102.9	103.8	103.6	104.9	103.0
Foreign trade turnover	141.4	144.1	139.1	134.4	129.3	139.1	106.1*	114.9	98.9*
export	151.5	161.1	143.4	130.0	122.8	136.9	107.2*	116.5	99.3*
import	126.0	118.8	132.4	142.6	142.8	142.6	104.4*	112.1	98.3*
Real disposable incomes of the population	105.3	107.3	103.7	99.4	100.2	98.7	102.7	102.4	103.1
Real wages	104.6	103.1	106.1	102.1	101.6	102.7	111.3	110.3	110.2
Number of the unemployed	91.5	108.0	85.8	86.8	85.7	88.1	85.8	86.7	84.4

* preliminary data

Source: Federal State Statistics Service.

It is the investment and foreign trade component that had a prevailing influence on the economic growth dynamics slowdown in the 2nd quarter.

A sharp upsurge of the investment demand of 16.3% in the 1st quarter of the current year that is not typical to the Russian economy was succeeded by the weakening of the dynamics in April-May to 7.7% and in June – to 4.7%. As a result the growth of the investments in fixed assets in the 2nd quarter 2012 made 6.5% versus 5.0% a year ago.

The slowdown of the investment in fixed assets growth was accompanied by the worsening of the financial indices of enterprises and organizations' activities. Balanced financial result of enterprises and organizations' activity in January–May 2012 reduced by 5.2% as compared with the corresponding period of the previous year, the most intensive decrease occurring in April-May of the current year. The decrease in the incomes determined the change in the financial priorities for the enterprises: over January–May 2012 the deposits of the economic entities were observed to decrease by 1.4% versus the corresponding period of the previous year.

In the 1st half of 2012 the workload in construction went up by 5.4% versus the corresponding period of the previous year. It should be noted that the maintenance of a comparatively high level of provision with orders and backlog of unfinished construction at the end of 2011 – beginning of 2012 were the factors to accelerate the dynamics in the 2nd quarter 2012 up to 5.4% as compared with 5.2% in the 1st quarter versus the corresponding periods of the previous year.

The situation in the housing construction is ambiguous. The increase in the housing floor area commissioning in the 1st quarter 2012 made 5.7% versus the corresponding period of the previous year. Estimating the importance of this figure one should take into account the low base of 2010-2011 as well as the prolonged influence of the activity in the housing sector, which has been observed since September 2011. Unfortunately, these positive processes did not persist, and in the 2nd half 2012 the housing floor area commissioning rates were again observed to decrease by 1.3% versus the corresponding period of the previous year. Even though the proportion of housing floor area built at the expense of the funds of the population was registered to expand and the expenses of the population for the real estate purchase went up by 18% as compared with the previous year, the following specific features defining the investment behavior of the population should be noted. On the whole in the 1st half of 2012 the monetary expenses of the population exceeded the incomes, while the relation in the 1st half of 2011 was the opposite. The proportion of the expenses for the current consumption in the structure of the incomes of the population went up to 77.4% exceeding by 2.6% the figure of the corresponding period of the previous year. The savings ratio has been decreasing gradually over the 1st half of the year and made 6.6% in June 2012 as compared with 12.9% a year ago. The decrease in the savings ratio was not compensated by the increase of the expenses for the purchase of the foreign currency in the monetary incomes up to 4.9% in the 1st half of 2012 as compared with the 3.9% a year ago.

The same as earlier, high level of consumption are supported with the increase in the crediting of the population. In June 2012 the consumer credits expanded exceeding by more than 1.5 times the figure of 2011. The increment of the volume of the issued mortgages versus the level of the corresponding month of 2011 according to the data of the Bank of Russia diminished from 77.8% in January to 65.6% in April and 49.4% in May. It is possible that the investment behavior of the population is influenced by the expectations of the changes in the inflation rate and ruble exchange rate in the second half of the year.

In April–June 2012 for the first time in the last three years the rates of the foreign trade turnover were observed to decrease as compared with the corresponding period of the previous year. Whereas the export dynamics was determined by its dependence on the changes in the world market trends, the import depends on the dynamics and structure of the internal demand and efficiency of the import operations depending on the ruble exchange rate. It can be supposed that the slowdown of the manufacturing industries dynamics on one hand and unsteady investment activity on the other resulted in the contraction of the demand for import in the 2nd quarter 2012.

In the 1st half of 2012 the index of industrial production made 103.1% as compared with the 1st half of 2011, being 100.9% in minerals extraction, 104.5% in manufacturing industries, 101.9% in electricity, gas and water production and distribution. In the 2nd quarter the industry growth rates decreased to 102.3% versus the 2nd quarter 2011.

The dynamics of the manufacturing industries development was considerably influenced by the structural factors. The anticipating growth of the foodstuffs production (106.4% versus the 1st half of 2011) as compared with the aggregated index for the manufacturing industries is accounted for by the expansion of the domestic agriculture produce supply to the processing and development of the import substituting productions. In the 1st half of 2012 as compared with the corresponding period of 2011 the foodstuffs production was characterized by the positive trend for domestic meat, dairy and oil and fat production, whose competitive ability at the market was increased against the background of the existing prices dynamics at the internal consumption market. Besides, according to the data of the Federal State Statistics Service, in January–May 2012 foodstuffs and agriculture produce import reduced by 13.6% versus the corresponding period of the previous year, which was an additional stimulus to the expansion of the domestic foodstuffs production.

The situation in the production of non-food goods is different. In the 1st half of 2012 the production of leather, footwear, textile and sewing industry as well as household appliances and furniture production are characterized by the decrease in production. This is accounted for by the following factors: (1) change in the structure of the demand from the population and (2) exhaustion of the anti-crisis measures (2009-2010) effects aimed at supporting of these productions.

Table 2

PRODUCTION INDICES AS BROKEN BY TYPES OF ECONOMIC ACTIVITIES IN THE INDUSTRY
IN THE 1ST HALF OF 2010-2011, AS PERCENTAGE VERSUS THE CORRESPONDING PERIOD
OF THE PREVIOUS YEAR

	2010 1 st half	Quarters 2010		2011 1 st half	Quarters 2011		2012 1 st half	Quarters 2012	
		I	II		I	II		I	II
Industry	110.2	109.5	110.9	105.3	105.9	104.8	103.1	104.0	102.3
Minerals extraction	105.8	106.7	104.8	102.5	103.3	101.7	100.9	101.9	100.4
fossil fuels extraction	105.6	106.4	104.9	100.8	100.3	101.4	101.5	102.3	100.4
minerals extraction excluding fossil fuels	108.4	110.9	106.1	106.2	107.7	104.3	99.9	101.5	98.3
Manufacturing industries	114.3	112.1	116.3	108.0	110.6	105.8	104.5	104.4	104.7
foodstuffs production, including tobacco and beverages	105.2	103.8	106.8	101.2	101.7	100.5	106.4	106.4	106.0
textile and sewing industry	112.9	110.2	115.6	105.3	107.7	102.8	94.6	93.2	95.9
leather, leather goods and footwear production	122.8	126.1	120.0	110.3	112.8	107.8	87.8	89.8	85.8
timber and wooden goods production	111.9	111.1	112.6	106.6	106.9	106.2	102.5	100.7	103.3
pulp-and-paper industry, printing and publishing	109.3	106.7	111.7	100.0	99.5	100.5	106.0	107.3	103.9
coke and oil products production	105.0	104.7	105.3	103.9	104.6	104.8	102.2	102.3	103.8
chemistry industry	119.5	123.8	115.7	106.9	108.0	105.8	101.1	99.4	102.0
rubber and plastic goods production	120.7	122.8	119.2	118.0	120.6	115.4	103.2	102.8	104.4
other non-metal mineral goods production	110.3	104.9	114.2	111.0	112.7	109.3	108.5	112.7	106.6
metallurgy production and production of finished metal goods	119.2	118.8	119.6	103.0	109.1	96.5	106.0	104.8	107.2
machinery and equipment production	121.0	109.1	130.5	111.8	111.6	113.2	104.4	119.8	88.1

Table 2, cont'd

	2010 1 st half	Quarters 2010		2011 1 st half	Quarters 2011		2012 1 st half	Quarters 2012	
		I	II		I	II		I	II
electric, electronic and optical equipment production	128.8	130.4	127.5	106.5	106.3	107.8	106.1	110.6	101.2
production of transportation vehicles and equipment	128.1	113.3	141.2	134.9	159.6	115.1	121.0	122.7	129.5
Electricity, gas and water production and distribution	105.6	107.7	102.6	100.2	99.0	101.9	101.8	102.6	100.8

Source: Federal State Statistics Service.

The nature of the machine-building complex dynamics is considerably influenced by the limitation of the demand. The drop of the machinery and equipment production in the 2nd quarter 2012 by 11.9% as compared with the 2nd quarter 2011 determined slow growth in electric, electronic and optical equipment production, which supplies the components for the machine-building production of the final demand.

Production of transportation vehicles and equipment continues to demonstrate high growth rates. In the 1st half of 2012 the production index in this industrial sector was 121.0% as compared with the corresponding period of the previous year, the production of passenger cars having increased by 22.2% and of trucks – by 4.1%. This is mainly accounted for by the increase in the volumes of solvent demand from natural persons and enterprises, which in its turn is connected with the growth of households' monetary incomes, increase in crediting and slight weakening of import influence on the market of passenger cars.

Situation at the labor market has become practically normal. In the 2nd quarter 2012 the number of the employed in the economy made 71.7 m, having increased by 1m as compared with the 2nd quarter of the previous year. In June 2012 the total number of the unemployed diminished by 10.1% versus June 2012 and made 4.1m (5.4% of the economically active population). Since the beginning of the year a gradual improvement of the use of the workforce in the economy has been observed: part-time employment reduced by 85,000 or by 40%.

The number of the unemployed registered in the state employment agencies by the end of June 2012 made 1.1m (1.5% of the economically active population), and reduced by 159,000 since the beginning of the year. The demand for the employees declared to the state employment agencies by the employers went up by 593,000 vacant positions and made 1.75m of vacancies as at the end of June 2012. As a result the tension coefficient at the labor market per 100 of the declared vacant positions made 72 in June 2012 as compared with 101.4 a year ago.

The RF Ministry of Economic Development estimations for the GDP growth in 2012 lie in the range 3.4–4.0%. European Bank of Reconstruction and Development corrected the forecast for the Russian economy growth to the worse quite sharply at the end of July – 3.1% versus its estimation in May at the level of 4.2%. ●

RUSSIAN INDUSTRY IN JUNE 2012

S.Tsukhlo

According to the data of the Gaidar Institute¹, the dynamics of the main indices of the demand, output, employment and prices remained negative in June and that trend more definitely points to the fact that Russian industry may be involved into another wave of the crisis. The plans and forecasts of enterprises do not promise any improvement of the situation in the forthcoming months.

The Industrial Optimism Index

The sentiments of industrial enterprises started to get worse from May despite the Rosstat's optimistic output data in that month, while in June they became explicitly negative (Fig. 1).

Throughout the entire 2nd quarter of 2012, the plans and forecasts of enterprises were losing optimism and now have gained a great deal of pessimism (Fig. 2).

THE IEP INDUSTRIAL OPTIMISM INDEX, 2005-2012

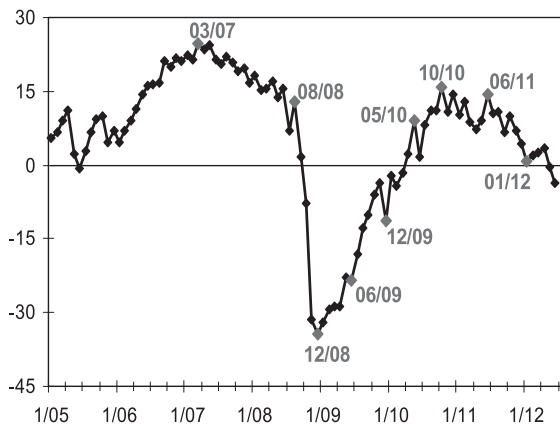


Fig. 1

INDUSTRY FORECASTS INDEX

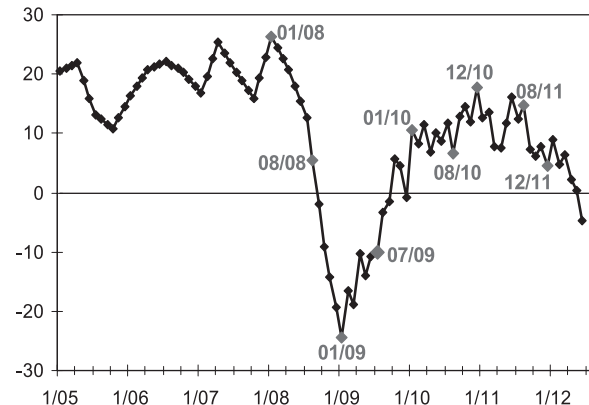


Fig. 2

Demand in Industrial Products

In June, the initial dynamics of the demand in industrial products underwent “positive” changes: a decrease in the demand was changed by stagnation in sales. However, with the seasonal factor cleared the June data was deprived of that positive aspect: the demand kept falling and slowdown rate increased by another two points (Fig. 3). Such sales dynamics was adequately apprehended by manufacturers. Within a month, the balance of estimates of the demand changed for the worse by 9 balance points and amounted only to +4 points, though as far back as October 2011 it was +31. The industry is ever less prepared to be content with falling sales volumes. The highest discontent with the demand is registered in light industry (72% of enterprises), chemical industry (63%), wood industry (56%) and iron and steel industry (52%). The largest number of normal estimates of the demand was received in food industry (78%), nonferrous industry (59%) and engineering (55%).

Judging by forecasts of enterprises, they do not expect the situation to change for the better in the near future. In the 2nd quarter, the initial data as regards that index improved by 22 points. Clearing of forecasts from the seasonal factor showed a drop of 12 points and produced a negative

¹ Surveys of managers of industrial enterprises are carried out by the Gaidar Institute in accordance with the European harmonized methods on a monthly basis from September 1992 and cover the entire territory of the Russian Federation. The size of the panel includes about 1,100 enterprises with workforce exceeding 15% of workers employed in industry. The panel is shifted towards large enterprises by each sub-industry. The return of queries amounts to 65–70%.

value of the June balance: in industry a decrease in sales is more likely than growth. Such pessimistic forecasts of the demand have not been registered by surveys since August 2009 (*Fig. 3*).

Stocks of Finished Products

In June, for the first time in five months the balance of estimates of stocks of finished products decreased (that is, improved) (*Fig. 4*). In May, that index reached its 33-month maximum level which factor pointed to formation of the largest bulk of excessive (in the current situation!) warehouse stocks since August 2009. Further growth in surpluses in a situation of the weak demand and diminishing expectations of its revival was regarded by enterprises as unreasonable and they started to clear warehouses. In June, a decrease in surpluses was registered in all the industries, except for iron and steel industry and engineering whose estimates remained at the same level. To solve that problem, enterprises had to both freeze growth in selling prices (that was particularly difficult in a situation where the second stage of tariffs growth is expected) and halt the output growth.

Output

In June, the output growth rates lost another 7 points, while in the 2nd quarter the aggregate losses of that index amounted to 24 points. As a result, at present the output growth rate is estimated by enterprises at +3 points, while in June 2011 and June 2010 it amounted to +25 and +19 points, respectively. Clearing of the seasonal factor diminished the value of losses of the output growth in the past three months, but made the result worse: the balance was equal to +1 point which means the output growth stopped in June. The obtained result turned out to be the worst since August 2009 (*Fig. 5*).

Enterprises' plans do not hold out hope that output growth will be revived in the forthcoming months. The initial data was getting worse for four months running and, as a result, in June reached the level which was neither registered in 2010, nor in 2011. With the seasonal factor cleared, the balance of output plans fell almost to the zero level (*Fig. 5*).

Prices of Enterprises

In the 2nd quarter, enterprises pricing policy was formed under the effect of the two opposite factors. On the one side, the next stage of the annual growth in tariffs pushed manufacturers' prices up, while on the other side sluggish growth in demand (which with the seasonal factor cleared resulted in a drop in sales and higher dissatisfaction with sales volumes) made enterprises think about cutting prices in

CHANGES IN THE SOLVANT DEMAND CLEARED OF THE SEASONAL FACTOR
(BALANCE=%GROWTH -%DECREASE)

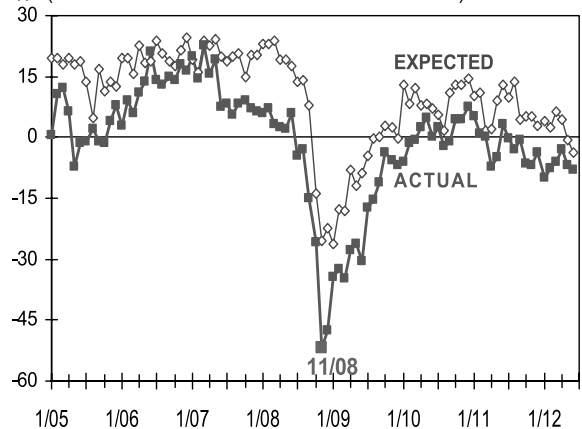


Fig. 3

BALANCE OF ESTIMATES OF STOCKS OF FINISHED PRODUCTS
(BALANCE=%ABOVE THE NORM -%BELOW THE NORM)

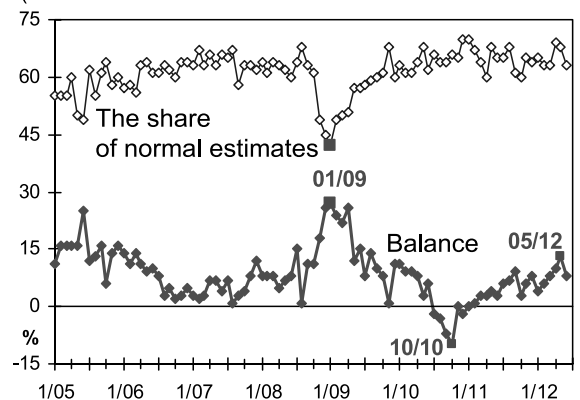


Fig. 4

CHANGES IN OUTPUT VOLUMES CLEARED OF THE SEASONAL FACTOR
(BALANCE=%GROWTH -%DECREASE)

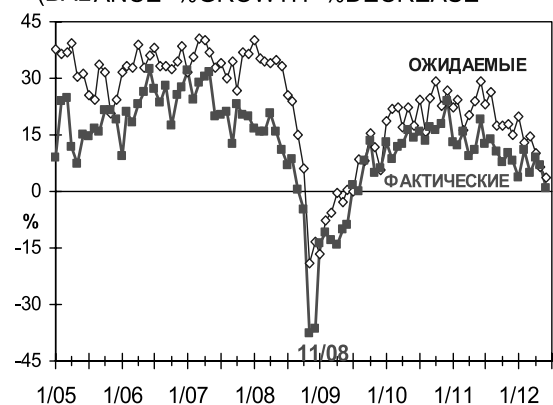


Fig. 5

order to stimulate growth. As a result, in May-June enterprises' selling prices virtually stopped growing, while price plans were revised downward for four months running (*Fig. 6*). In industry, a willingness to stimulate sales, rather than regain on growth in tariffs definitely prevailed. In May-June, intensive growth in prices was registered only in chemical industry and building industry. In other industries, prices were either stable (engineering, wood industry and light industry), or went down (iron and steel industry and food industry).

Actual Dynamics and Lay-Off Plans

In May-June, an approximate equilibrium between hiring of the personnel and lay-offs was maintained (*Fig. 7*). But the situation varied by the industry. Intensive hiring of workers took place only in building materials industry which fact can be explained by seasonal revival of production. Other industries dismissed workers at a rate varying from -3 points to -15 points. The employment plans in June lost that little optimism of the first months of the 2nd quarter and pointed to enterprises' willingness to preserve the existing number of workers in the forthcoming months.

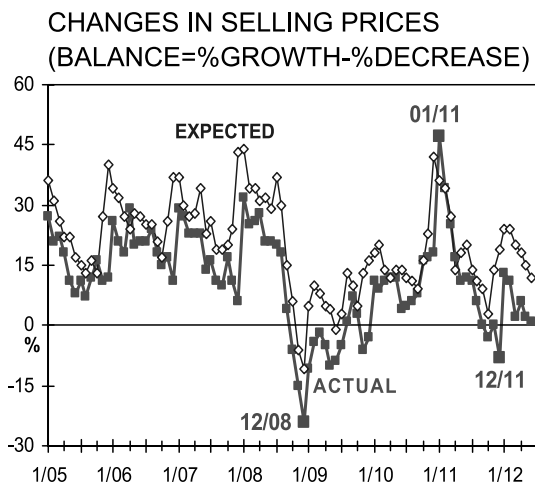


Fig. 6

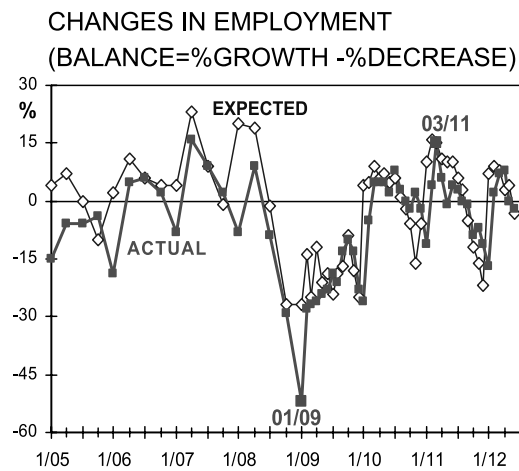


Fig. 7

FOREIGN TRADE

N.Volovik

Worsening of the global market situation in May 2012 resulted in a considerable reduction of growth rates of Russian foreign trade indices with a drop in the Russian import in absolute terms observed from April.

On July 23, 2012, the Secretariat of the WTO was submitted the document on ratification by the Russian Federation of the protocol on accession to the above organization.

In May 2012, the Russian foreign trade turnover calculated on the basis of methods of the balance of payments amounted to \$73bn which exceeded by the mere 1.6% the index of May 2011. The export increased by 3.5% to \$45.2bn, while the import decreased by 1.3% to \$27.8bn.

In May 2012, the Russian export volume in physical terms amounted to 98.8% on May 2011 with the average export price index amounting to 104.2%. In May 2012, the index of the import volume in physical terms fell to 99.6% as compared to May 2011 while the average import price index, to 96.2%.

In May 2012, trade conditions were favorable (the trade conditions index amounted to 108.3), but got much worse as compared to May 2011 when the index was equal to 120.8.

In May 2012, the foreign trade balance of the Russian Federation was a positive one and amounted to \$17.4bn which is 12.2% higher than the similar index of last year.

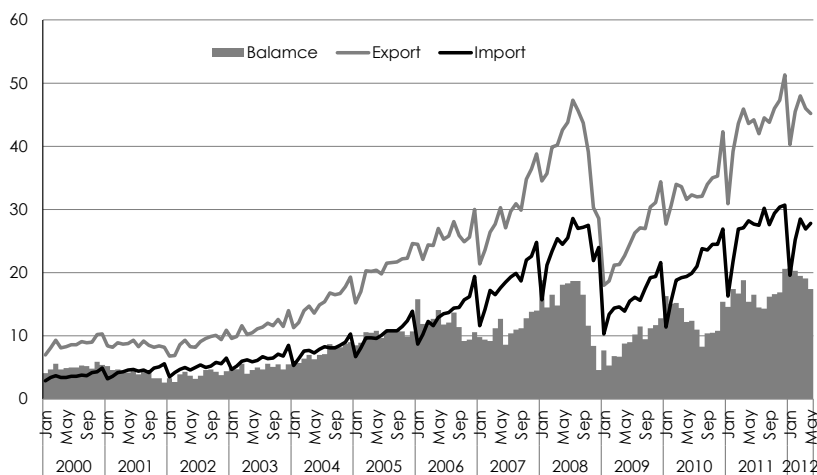
In May 2012, global market prices on primary commodities were going down. Late in May, in a situation of the financial crisis in the euro area which got worse both due to a failure of political parties in Greece to form the government and Spain's debt problems becoming more severe oil prices started to fall sharply. In May 2012, the average Urals oil price amounted to \$108.86 per barrel, having dropped by 2.3% as compared to the same month of 2011. It is to be noted that in May 2012 the price on oil decreased by 7% as compared to April 2012.

In the 1st half of June, prices on primary products were affected by the weak macroeconomic data from China, the US and Europe. So, on the basis of the trading results on June 1, the Brent oil price fell below the psychological level of \$100 per barrel, while on June 21, 2012 it dropped to \$89.48 per barrel, that is, the minimum level since December 2010.

After the government was formed in Greece, oil prices started to recover. An industrial action in Norway which lasted for over two weeks with 6,000 workers of the oil and gas sector demanding the right to early retirement contributed to growth in oil prices.

In the period of monitoring from June 15 till July 14, 2012, the average Urals oil price amounted to \$95.19 per barrel. On the basis of the above, according to the effective calculation formula, the export duty on crude oil will be reduced by \$32.7 from August 1 to amount to \$336.6 a ton.

In August, the unified export duty rate on oil products will fall by \$21.6 to \$222.1 a ton.



Source: Central Bank of the Russian Federation.

Fig. 1. The main indices of the Russian foreign trade (billion USD)

In May 2012, precious metals depreciated a great deal as compared to the previous month and the respective month of 2011. So, in May 2012 at the London Metal Exchange prices on aluminium, copper, nickel and steel feed fell by 2.3%, 4.1%, 4.9%, and 10.6%, respectively, against the level of April 2012. As compared to May 2011, prices on aluminium, copper and nickel dropped by 22.7%, 11.2% and 29.6%, respectively.

Gas prices were the only ones which showed positive dynamics. According to the IMF data, in May 2012 the average contractual prices on the Russian natural gas on the German border increased by 25.5% as compared to May 2011 and amounted to \$452.5 per thousand cubic meters; the natural gas prices remained unchanged as compared to April 2012.

Table 2

MONTHLY AVERAGE GLOBAL PRICES IN MAY OF THE RESPECTIVE YEAR

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Oil (Brent), USD per barrel	28.71	25.21	25.34	37.9	47.8	68.68	67.64	119.4	58.63	76.99	114.5	110.5
Natural gas*, USD/1 million BTU	4.36	2.83	4.04	3.95	5.89	8.28	7.98	12.38	8.09	7.27	10.3	11.64
Petrol, USD/a gallon	1,095	0.767	0.835	1,342	1.44	2,072	2,293	3.22	1.71	2,111	3.04	
Copper, USD/a ton	1708.2	1596.2	1667.5	2720.0	3254.0	8022.0	7682.2	83825	4568.6	6837.7	8927.05	7955.64
Aluminium, USD/a ton	1536.7	1344.3	1397.6	1615.7	1746.0	2852.0	2797.4	2902.9	1460.5	2040.53	2592.18	2007.63
Nickel, USD/a ton	7115.7	6764.0	8351.9	11068	16930.0	21038	52179.1	25735	12635	22008.2	24210	17068.2

* The European market, the average contractual price, franco border.

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

In May 2012, the average value of the food price index of the UN Food and Agricultural Organization amounted to 205 points, having decreased by 8 points as compared to the April index (213 points).

However, the latest data of the US Department of Agriculture points to the fact that the situation with this year harvest in the US has become much worse due to severe drought in the US (the last one was in 1988). Latin American countries – Brazil, Argentina, Uruguay and Paraguay which are the largest suppliers of grain and oil crops to the world market – face the same problem, too. As a result, in July 2012 global prices on maize and soya reached the historical maximum level; prices on wheat go sweepingly up, as well. In about six months, the above growth in prices will affect meat prices.

According to the data of the Central Bank of the Russian Federation, in January–May 2012 the Russian foreign trade turnover amounted to \$350.0bn which is 8.3% higher than the respective index of 2011. The export grew by 9.8% to \$222.6bn, while the import, by 5.9% to \$127.4bn. In January–May 2012, the positive trade balance of the Russian Federation amounted to \$95.2bn which is 15.5% more than in the respective period of 2011.

In January–May 2012, the main portion of the Russian export was still fuel and energy commodities whose unit weight in the commodity structure of the export remained at the level of 71.7% (in January–May 2011 it was 71.2%).

In January–May 2012, the share of metals and metal products in the monetary volume of the export fell by 0.4% to 9.1% as compared to the same period of 2011. With a drop in contractual prices, export volumes of copper, nickel and aluminium in physical terms rose by 45.8%, 48.5% and 28.5%, respectively. In January–May 2012, the share of the export of the chemical industry's products amounted to 5.8% (in January–May 2011 it was 6.2%). As compared to January–May 2011, the monetary volume of the above products increased by 7.7%, while that in physical terms, by 8.5%.

In January–May 2012, the share of machines and equipment fell to 3.2% against 3.6% in January–May 2011. As compared to the same period of 2011, the monetary volume of the export of machines and equipment rose by 6.9%.

In January–May 2012, the share of the export of food products and their primary products in the commodity pattern amounted to 2.9% (in January–May 2011 it was 1.6%). As compared to January–May 2011, monetary volumes of those supplies rose by 190%, while volumes in physical terms, by 570%. The export volumes of food products in physical terms increased mainly on account of export grain supplies which were absent in January–May 2011. The export volumes of sunflower seeds and vegetable oil in physical terms increased considerably.

In January–May 2012, the share of export of timber and pulp and paper products fell to 1.9% (in January–May 2011 it was 2.2%). The monetary volume of that commodity group decreased by 6.1% as compared to January–May 2011.

In January–May 2012, in the commodity pattern of the import the share of the import of food products and their primary products fell to 13.1% against 15.9% in January–May 2011. As compared to January–May 2011, the physical amount of food product supplies decreased by 22.2%, including fresh frozen meat (by 2.3%), butter (43.0%) and tea (10.7%); the volume of raw sugar supplies fell dramatically. The purchasing volumes of poultry meat grew by 33.5%, fish – by 11.3%, cheese and cottage cheese – 13.0%, cocoa products – 22.4%, cereals – 30.1%, including those of barley and maize, by 44.8% and 29.7%, respectively.

In January–May 2012, machines and equipment accounted for 50.4% of the total volume of the Russian import (in January–May 2011 their share amounted to 45.5%). As compared to January–May 2011, the monetary volume of the import of engineering products increased by 21.9%. The physical amount of the import of cars and trucks grew by 15.3% and 36.7%, respectively.

On July 23, 2012, the Secretariat of the WTO was submitted the document on ratification by the Russian Federation of the protocol on accession to that organization and in 30 days, that is, on August 23 the Russian Federation will become the WTO's 156th member.

On July 20, 2012, the Council of the Eurasian Economic Commission approved the new commodity nomenclature of foreign economic activities (CN FEA) and the updated unified customs tariff (UCT) which become effective in the member-states of the Customs Union from the day of Russia's accession to the WTO. The above documents are the baseline ones in calculation of import duties in respect of all the goods which are taken into the customs territory of the Union. The new editions of the UCT and CN FEA are based on the 2012 Harmonized Commodity Description and Coding System.

The rates of customs duties will be reduced in respect of about 1,000 commodity items, including food products, carpets, ready-made clothes, ferrous metal products and motor transport vehicles. As regards 25% of the total number of commodity items, the rate of the related tariff is currently higher than the existing one, so, the duty may be raised to the level of tariff obligations and, thus, unfavorable consequences associated with Russia's accession to the WTO can be additionally mitigated for individual industries and manufacturers. With a switchover to the new edition of the UCT, the weighted average rate of the import customs duty will be reduced from 9.6% to 7.5–7.8%.

The new tariff includes about 120 items in respect of which exemptions for Belarus and Kazakhstan (as non-members of the WTO) are fixed with the period of validity of such exemptions unspecified by the Commission. The list of exemptions includes, in particular, cars: Belarus and Kazakhstan will import them at the existing rates, while the UCT norms are applied only to cars imported to the Russian Federation. It is to be reminded that to compensate the difference in the level of the rates the Russian Federation will introduce a utilization tax on cars, while Belarus and Kazakhstan do not.

In June 2012, the European Commission's ninth report dedicated to potentially restrictive measures in trade¹ came out. It was stated in the above report that Russia is one of the three countries which were most active in taking protectionist measures in the past eight months. According to the European Commission, restrictive measures were most actively introduced by Argentina, the Russian Federation and Indonesia. The above three countries aggregately accounted for a half of all the restrictions. In addition to the above, it was stated by the European Commission that the latest

1 http://trade.ec.europa.eu/doclib/docs/2012/june/tradoc_149526.pdf

moves by the Russian Federation aimed at protection of its domestic market “may not comply with obligations the country takes as a new member of the World Trade Organization”.

According to the European Commission, measures which may limit trade between Russia and the EU include the Draft Technical Regulations on Safety of Alcohol Products, the ban on import of livestock from the EU introduced late in March, a priority given to Russian companies in state purchases, the plan to introduce an utilization tax on foreign-made cars, as well as some changes in duties, in particular, introduction of a temporary import duty on sugar and increased export duty on petrol. The European Commission is concerned about adoption of some sectorial programs providing for considerable public spending which may distort the competitive environment.

From the day of Russia’s accession to the WTO, other member-states will have an opportunity to dispute Russian measures which violate the norms of the WTO. ●

STATE BUDGET

T.Tishchenko

As of July 1, 2012 the federal budget was executed with a surplus in the amount of 0.9% of GDP. Federal budget revenues for the first half of this year amounted to Rb 6200bn, or 22.1% of GDP, while expenditures – Rb 5953bn, or 21.2% of GDP. Consolidated budget of the RF Subjects was also executed with a surplus of Rb 484.5bn.

At the same time, the execution of the budgets of the RF budgetary system with a surplus is mainly conjunctural and technical in nature, which implies a reduction of the budgets surplus volume at all levels in terms of budget execution intensity by the end of the year. The Head of the Ministry of Finance A. Siluanov announced that the RF budget deficit in 2012 may return to the original forecast of 1.5% of GDP (from an adjusted level of 0.1%) with an average oil price below \$100 per barrel.

Key indicators of the federal budget execution over the first six months of 2012

According to the tentative estimates the Russian Ministry of Finance, federal budget revenues in the first six months of 2012 reached Rb 6.200bn (Table 1), which is by 0.6 p.p. of GDP higher versus the relevant period in 2011, including oil and gas revenue, which growth made 0.8 p.p. of GDP. The volume of federal expenditures has increased in relative terms as compared with the first half of the previous year by 2.5 p.p. of GDP, whereas in absolute terms the increase in the expenditure growth amounted to Rb 1,349.6bn. As a result, the federal budget is executed with a surplus of Rb 402.0bn, which is by 2.0 p.p. of GDP lower than in the relevant period of 2011. The volume of non-oil deficit of the federal budget made – Rb 2,978.6bn (10.6% of GDP), i.e., by 3.1 p.p. of GDP higher than the level of the first half of the last year. Therefore, the federal budget surplus for January–June of this year is based on the accelerated growth of oil and gas revenues in the first three months of the year under favorable market prices for hydrocarbons.

Table 1

KEY INDICATORS OF THE RF FEDERAL BUDGET IN JANUARY–JUNE 2011–2012

	January–June 2012		January–June 2011			
	Rb bn	GDP%	Rb bn	GDP%	Rb bn	p.p. of GDP
Revenues, including:	6 200.0	22.1	5 306.4	21,5	893,6	0,6
Oil and gas revenue	3 226.1	11.5	2 540.3	10,3	685,8	0,8
Expenditures, including:	5 952.5	21.2	4 602.9	18,7	1 349,6	2,5
Percentage expenditures	155.5	0.6	108.4	0,5	47,1	0,1
Non-percentage expenditures	5 797.0	20.7	4 494.5	18,2	1 302,5	2,5
Federal budget surplus (deficit)	402.9	0.9	703.5	2,9	300,6	-2,0
Non-oil and gas deficit	-2 978.6	-10.6	-1836.8	-7,5	1 141,8	-3,1
GDP estimates	28 075		24 718			

Source: RF Ministry of Finance of Russia (tentative estimates), Gaidar Institute assessments.

Over the first half of 2012 federal budget revenues received taxes and payments on income tax, administered by the Federal Tax Service, in the amount of Rb 2,605.4bn, which is by Rb 431.4bn higher than in the same period of the last year. On taxes and payments administered by the Federal Customs Service, the amount of revenue to the federal budget amounted to Rb 3,475.2bn, which is by Rb 526.7bn exceeds the amount of revenues for the first half of 2011.

In terms of the federal budget lines (Table 2) the largest increase in expenses both, in absolute terms and in the GDP share, in January–June this year as compared to the same period of the last year is noted under the budget lines “National Defense” (+ 1.0 p.p. of GDP). Also, as compared with

the first half of the last year, in January-June of the current year there is an increased spending under the federal budget lines: “Social Policy” – by 0.7 p.p. of GDP, «Education» – by 0.4 p.p. of GDP, «Healthcare» – by 0.3 p.p. of GDP, “National debt servicing” – by 0.1 p.p. of GDP.

Under the budget lines “Housing and public utilities” and “Intergovernmental transfers” federal expenditures for the first half of 2012 decreased by 0.3 p.p. of GDP (for each budget line) as compared with the same period of the last year.

Table 2

FEDERAL BUDGET EXPENDITURES IN JANUARY–JUNE 2011–2012 IN RB BN AND GDP%

	January–June 2012		January–June 2011		Change, GDP %
	Rb bn	GDP %	Rb bn	GDP %	
Expenditures, total:	5 952.5	21.2	4 602.9	18.7	2.5
	Including				
Federal issues	346.9	1.3	307.9	1.3	0.0
National defense	989.4	3.6	625.7	2.6	1.0
National security and law enforcement	739.4	2.7	513.6	2.1	0.6
National Economy	685.5	2.5	603.8	2.5	0.0
Housing and public utilities	34.0	0.2	107.5	0.5	-0.3
Environmental protection	9.7	0.1	6.5	0.1	0.0
Education	355.5	1.3	215.0	0.9	0.4
Culture and cinematography	39.8	0.2	30.1	0.2	0.0
Healthcare	302.6	1.1	188.3	0.8	0.3
Social policy	1 934.3	6.9	1 513.0	6.2	0.7
Physical culture and sports	19.5	0.1	21.9	0.1	0.0
Mass media	37.6	0.2	30.7	0.2	0.0
National debt servicing	155.5	0.6	108.4	0.5	0.1
Interbudgetary transfers	302.6	1.1	330.0	1.4	-0.3

Source: the RF Ministry of Finance, RF Treasury, Gaidar Institute estimates.

There are no changes in the other sections of the federal budget in terms of GDP share over the same period of the last year.

As of 01.07.12, the amount of the Reserve Fund amounted to Rb 1,985.5bn, the National Welfare Fund – Rb 2,810.5bn, the government debt in June of this year has remained virtually unchanged and made on July 1 Rb 3,697.6bn for domestic debt and \$41.6bn for the external debt.

RF Subjects consolidated budget execution in January-May 2012

According to the Federal Treasury, in January–May 2012, the revenues of the RF Subjects consolidated budget received Rb 3,278.9bn, or 14.2% of GDP, which is by 1.2 p.p. of GDP lower than in the same period in 2011 (*Table 3*). Expenditures of the RF Subjects consolidated budget for the five months of this year rose against the same period of 2011 by 0.5 p.p. of GDP to 12.1% of GDP. In absolute terms revenues growth in January–May 2012 amounted to only 156,0 bn, while the amount of expenditures of the RF Subjects consolidated budget increased by Rb 448.7bn as compared with the five months of 2011. As of 5 months of 2012 results, the RF Subjects consolidated budget was executed with a surplus of 2.1% of GDP, which is by 1.8 p.p. of GDP lower than in January–May of the last year. The surplus of the RF Subjects consolidated budget execution in January–May of this year can be attributed to low rates of cash execution of budget expenditures, which for the first five months was only 32.4% of the annual volume of approved expenses (31.2 % as per 5 months of 2011). If cash execution of the RF Subjects consolidated budget in terms of expenditure was more regular and amounted to 40% over January–May of this year, while with the amount of income received during the same period in the amount of Rb 3,278.9bn, the budget of the RF Subjects would be executed with a deficit of Rb 200bn.

Table 3

KEY INDICATORS OF THE RF SUBJECTS CONSOLIDATED BUDGET IN JANUARY–MAY 2011–2012

	January–May 2012		January–May 2011		Change	
	Rb bn	GDP%	Rb bn	GDP%	Rb bn	p.p. of GDP
Revenue, including:	3 278.9	14.2	3 122.9	15.4	156.0	-1.2
– corporate profit tax	989.4	4.3	937.0	4.7	52.4	-0.4
– personal income tax	814.7	3.6	711.3	3.5	103.4	0.1
– domestic excise duties	168.2	0.8	138.6	0.7	25.5	0.1
– total revenue tax	134.7	0.6	99.5	0.5	35.2	0.1
– property tax	335.1	1.5	318.2	1.6	16.9	-0.1
– income from the use of the state and municipal property	92.6	0.4	100.7	0.5	-8.1	-0.1
– donations from other budgets of the RF budgetary system	625.3	2.7	683.2	3.4	-57.9	-0.7
Expenditures, including:	2 794.4	12.1	2 345.7	11.6	448.7	0.5
Surplus (Deficit) of the consolidated budget	484.5	2.1	777.2	3.9	-292.7	-1.8
GDP estimates	23 100		20 269			

Source: RF Federal Treasury, Gaidar Institute estimates.

Revenues of the RF Subjects consolidated budget as a percentage of GDP for the third consecutive month are declining as compared with the same periods of 2011. For five months of 2012 there was the largest decrease in income tax proceeds in terms of the GDP share – by 0.4 p.p. of GDP against five months of 2011.

Revenues of the of the RF Subjects consolidated budget in January–May of this year have somewhat decreased on property tax and tax on income from the use of property in the state and municipal property by 0.1 p.p. of GDP for each tax in the relevant period of the last year.

At the same time, in absolute terms revenue of the RF Subjects from the placement of temporarily free funds from the budgets of the RF Subjects have increased from Rb 4.9bn in January–May 2011 to Rb 10.4bn during the same period of 2012 due to an increase in balances of the RF Subjects budgets for the five months of this year by Rb 3.0bn implies that the regions have a policy of cost restriction, including those due to investment spending reduction in anticipation of a possible aggravation of the crisis in the economy. According to the Ministry of Economic Development of Russia, the share of budget funds in the structure of financing of capital investments in the QI 2012 was 11.0%, which is the lowest value for the QI over the monitoring history since 2005. Russian Statistical Service (Rosstat) data on investment structure in fixed capital by sources of funding shows that the share of funding from the budgets of the RF Subjects as of 2011 results made 7.9% of the total funding in the fixed capital, while it was only 5.6% in Q1 2012.

In regard to proceeds to the revenue part of the RF Subjects consolidated budget from personal income tax, excise tax and gross income tax from January to May 2012, there observed an insignificant increase of 0.1 p.p. of GDP (for each type of proceeds) against the same period of the last year.

In the expenditure part of the RF Subjects consolidated budget in January–May this year one can note the sustainability of major trends in changes in expenditures of individual sections, which appeared in the previous four months of the year (*Table 4*). An increase in expenditure was noted under budget lines “Education” (by 0.5 p.p. of GDP), “Public Health” (by 0.1 p.p. of GDP), “National Economy” (by 0.3 p.p. of GDP) and reduced expenditures under budget lines “National security and Law Enforcement” (by 0.3 p.p. of GDP), “Social Policy” (by 0.1 p.p. of GDP), “Physical Culture and Sports” (by 0.1 p.p. of GDP) as compared with January–May of the last year. Under other expenditure lines of the RF Subjects budgets over January–May 2012 as the GDP share remained unchanged against the relevant period of the last year.

Table 4

EXPENDITURES OF THE RF SUBJECTS CONSOLIDATED BUDGET IN JANUARY–MAY 2011–2012,
RB BN AND GDP%

	January–May 2012		January–May 2011		Change, p.p. of GDP
	Rb bn	GDP%	Rb bn	GDP%	
Expenditures, total:	2 794.4	12.1	2 345.7	11.6	0.5
Including					
Federal issues	176.4	0.8	165.6	0.8	0.0
National defense	1.2	0.0	1.0	0.0	0.0
National security and law enforcement	28.4	0.2	93.2	0.5	-0.3
National Economy	447.2	2.0	328.7	1.7	0.3
Housing and public utilities	243.4	1.1	218.6	1.1	0.0
Environmental protection	5.9	0.1	4.0	0.1	0.0
Education	770.8	3.4	573.0	2.9	0.5
Culture and cinematography	93.4	0.4	73.2	0.4	0.0
Healthcare	456.9	2.0	373.0	1.9	0.1
Social policy	481.8	2.1	435.0	2.2	-0.1
Physical culture and sports	47.5	0.2	42.6	0.3	-0.1
Mass media	13.1	0.1	10.7	0.1	0.0
National debt servicing	21.3	0.1	20.3	0.1	0.0
Interbudgetary transfers	7.0	0.1	6.8	0.1	0.0

Source: Federal Treasury, Gaidar Institute estimates.

One should be note an overall improvement of fiscal stability of the RF Subjects budget system in 2012 in comparison with the previous year. While in 2011 only in 28 regions the indicator “ratio of consolidated income and expenditures of the RF Subjects budgets” was above 100%, in 2012 it was noted already in 57 regions. The public debt of the RF Subjects in April has decreased nearly by Rb 2bn, and as of 01.05.12 made Rb 1,161.9bn.

Basic developments in budget policy

In the situation of a possible reduction in revenue of the budget system of Russia with the further decline in the global oil prices¹ and slowing economic growth rates, the RF Government started to form legal and financial framework for anti-crisis measures implementation. In particular, in the last ten days of June the RF government has submitted to the state Duma a package of draft laws on amendments to the Budget Code. One of such innovations refers to the authority of the RF Government without making any changes to the federal law on the federal budget to allocate funds from Reserve Fund, as well as funds to be transferred to the Reserve Fund for the measures to support the stability of the Russian economy, financial market, labor market social welfare and other measures of social policy, with a possibility of exceeded total expenditures of the federal budget in the amount not more than 5% of the total federal budget, approved by the federal law on the federal budget for the current fiscal year².

1 According to the Russian Ministry of Finance estimates, the federal budget in 2012 will be short of Rb 100bn, if the average annual oil price is \$100 per barrel instead of \$115, expected earlier and incorporated in the latest approved version of the federal budget for 2012.

2 Now there is a norm of a temporary nature (Article 6 of the Federal Law No. 245-FZ of September 30, 2010 “On Amendments to the Budget Code and other legislative acts of the Russian Federation”), which allows the RF Government without making any changes to the federal law on the federal budget make decisions about the use of the Reserve Fund to reduce the debt obligations, borrowings, balancing the federal budget and the state extra-budgetary funds, including a possibility of exceeding the total federal expenditures in the provision of inter-budgetary transfers to balance budgets of the state extra-budgetary funds of the Russian Federation, with the introduction of relevant amendments to the federal budget summary list.

It is proposed to use additional mechanisms to protect the budget against a long-term downgrading in oil prices. If the average oil price over the past 3 years (including the current fiscal year) was fixed at the level not exceeding the base price of oil, then in the budget formation the base price of oil is estimated as the average oil price for a specified period of three years. The normative value of the Reserve Fund is accepted as 7% of GDP (i.e., reduced in comparison with the standard value of 10% of GDP, set when the Reserve Fund was formed in 2008).

It is also expected to reduce expenditures of the federal budget approved by the Federal Law on the Budget for 2013 by Rb 343.3bn, and in 2014 – by Rb 486.7bn at the expense of conditionally approved expenses. ●

RUSSIAN BANKING SECTOR

M.Khromov

In June 2012, the growth rate of the banking sector assets has increased. An active increase of retail loan portfolio and loans to corporate borrowers was continued. However, the June growth of banks assets and, accordingly, the banks' loan portfolio is based not on the expansion of domestic savings, but rather on external sources and the emission of the Bank of Russia. The growth of foreign loans and credits of the Bank of Russia have ensured more than 80% of the June assets increase.

Over June 2012 the total assets of the banking sector increased by 2.5%¹ and reached the highest level since the beginning of the year. Annual growth rates have remained relatively stable since last autumn in the range of 20–22%. As of June results, they accounted for 21.4%, as well as by results of 2011. The highest growth rates of assets in June were recorded in the group of state-owned banks (3.9%), the lowest ones among the largest foreign banks (0.7%), where only Raiffeisenbank and Rosbank (a subsidiary of French banking group Societe Generale) have shown positive growth in assets

Equity capital of the banking sector² remained virtually unchanged within June; its growth rate was less than 0.1%. The assets indicator weighted by risk level (used for calculating the capital adequacy ratio) increased by 2.0% over the month. As a result, the capital adequacy of the banking sector declined to 13.8%. Reduction of capital occurs over the entire post-crisis period from the beginning of 2010. On the one hand, this reflects the growth of credit activity, resulting in operating (revenue rising) banking assets grow faster than the banks' own funds. On the other hand, since early May 2012 the capital adequacy of the banking sector remains at a level below the minimum of pre-crisis period (14.4% as of December 1, 2006), reached before made up a series of large-scale emissions of shares of state banks.

An additional factor that aggravates capital adequacy problems of Russian banks, is the entry into force a number of changes to the procedure for assessment of the own funds of banks and capital adequacy ratio (H1). Thus, when calculating the H1, there was introduced an additional component that takes into account an increased risk factor of lending to borrowers, who do not disclose their credit history. In the monthly reports these developments will be reflected only since 01.08.2012, which may further accelerate the reduction of the banks' capital adequacy.

Profits of the banking sector in June was Rb 91bn, which corresponds to the return on assets (ROA) at the level of 2.5% and return on equity (ROE) – 21,8% in annual terms. Overall, in the first half of 2012 figure of 2.4% ROA and ROE – 20,7% in annual terms. Some concern is caused by the fact that the June increase in bank profits is only associated with the reduction of allowance for possible losses. Thus, if in April and May increase in provisions amounted to Rb 30–35bn per month, in June, on the contrary, they were reduced to Rb 7bn. At the same time, the profit before provisions in June amounted to Rb 84bn, while in April and May it reached Rb 105–109bn.

Raised funds

Assets of individuals in bank accounts and deposits rose in June by 2.5%, the annual growth rates stabilized at the level of 18%. The renewed growth in deposits supports the hypothesis that their May decline was seasonal to a greater extent. Nevertheless, the inflow of individual deposits in the banks in the first half of 2012 remained at the level of the relevant period in 2011 (Rb 850bn vs. Rb 847bn). Herewith, the nominal income of individuals for the six months of 2012 increased by 7.2% over the same period in 2011. Thus, the savings rate in bank deposits declined from 5.3% in the first six months of the last year to 4.9%. In terms of currency structure of deposits of

¹ Hereinafter growth rates of balance sheet are already adjusted for exchange rate revaluation of foreign currency component, unless otherwise indicated.

² Estimated by reporting form No.0409135.

individuals, growth in June can be considered as a balanced one. Ruble accounts of the individuals increased by 2.6%, accounts in foreign currency – by 2.4% in dollar.

The volume of corporate customer's assets with the banks in June has reduced by 1.2%. From the beginning of the year, the outflow of corporate customers' funds amounted to 2.5% or Rb 269bn. It is markedly different from the situation in the first half of 2011, when the funds of enterprises and organizations in the banks were increasing (+0.5% or Rb 47bn). One of the factors of reducing the corporate accounts with the banks one can consider the increased outflow of capital from the non-banking sector. If in the first half of 2011 it amounted to \$18.7bn, in the first half of 2012 – already \$44.4bn.

Foreign liabilities of banks in June 2012 rose in dollar terms by \$7.8bn. In this month, Russian banks demonstrated activity in the Eurobond market. The total volume of new listings of Euroloans of the Russian banks amounted within the month to \$3.9bn, including the Eurobonds emitted by Sberbank (\$1.0bn with the maturity of 7 years), the Agricultural Bank (850m with the maturity of 5.5 years), Gazprombank (\$400m with the maturity of 1 year and Rb 13.5 with the maturity of 7 years). In addition, \$1bn for 10 years was raised by the Bank for Development and Foreign Economic Affairs (VEB)¹, which suggests the relative attractiveness of large Russian financial organizations, especially those affiliated with the state in the global capital market.

Table 1

STRUCTURE OF THE RUSSIAN BANKING SYSTEM LIABILITIES
(END OF MONTH), AS % OF TOTAL

	12.07	12.08	12.09	12.10	06.11	09.11	12.11	01.12	04.12	05.12	06.12
Liabilities, Rb bn	20125	28022	29430	33805	35237	38443	41628	41150	42151	43225	44266
Own assets	15.3	14.1	19.3	18.7	18.5	17.3	16.9	17.3	17.3	17.0	16.8
Loans of the Bank of Russia	0.2	12.0	4.8	1.0	0.9	1.3	2.9	3.3	4.4	3.9	5.1
Interbank operations	4.1	4.4	4.8	5.5	5.2	5.4	5.7	5.7	4.9	4.7	4.8
Foreign liabilities	18.1	16.4	12.1	11.8	10.9	11.4	11.1	10.6	10.4	11.0	11.3
Private deposits	26.2	21.5	25.9	29.6	30.4	29.0	29.1	28.7	29.6	29.4	29.4
Corporate deposits	25.8	23.6	25.9	25.7	24.3	24.4	26.0	25.9	24.8	24.9	24.0
Deposits and balances of state agencies and local authorities	1.5	1.0	1.0	1.5	3.5	4.9	2.3	1.8	1.4	1.7	1.5
Securities issued	5.8	4.1	4.1	4.0	4.0	3.8	3.7	3.8	4.6	4.6	4.5

Source: Bank of Russia, IEP estimates.

Investments

Retail lending in June 2012 continued rapid growth. Over the month arrears of individuals payable to the banks increased by 3.2%, while the annual growth rate was 42.5%.

Overdue debt on loans to individuals in June declined in nominal terms by Rb 7bn (2.1%); as a result, its share in total loans decreased to 4.7%. The value of provisions for losses on retail loans increased by Rb 7bn (1.5%), the ratio of reserves / loans decreased to 6.5%.

Lending is playing an increasing role in consumer demand satisfaction. During the first half of 2012, the newly issued loans to individuals amounted to about a quarter of household consumption expenditure. This is considerably more than in the previous year (19%) or a total for 2011 (21%). At the same time, the individuals address a growing share of their income to credit debt repayment (including early repayment). If in the first half of 2011 it took 11% of households' cash income, for the same period of 2012 it made already 13%.

¹ The aggregate data for the banking system VEB is not included as part of this review, however, in the Bank of Russia balance of payments it is accounted in the sector "Banks", which is one of the methodological reasons for the discrepancy in the values of this review and in the balance of payments statistics.

Corporate borrowers' debt to banks in June increased by 2.1%. Annual growth rates for several months remained stable in the range of 20-21% (20.2% at the end of June). Key indicators of the quality of corporate loan portfolio were improved in June. The share of overdue loans has decreased from 5.1% to 4.9% in the total amount of loans to corporate borrowers, the ratio of reserves to loans – from 8.2 to 8.0%. At the same time, in June both, the amount of outstanding debt and the value of reserves have reduced.

Renewal of the gradual growth in the medium-term bank loans to enterprises and organizations can be considered as a positive trend. Thus, over the past year (from 01.07.2011 to 07.01.2012) loans with the maturity of up to one year rose by 17%, and with the maturity of more than a year – by 28%. As a result, the share of credits granted for a term exceeding one year in the total debt has increased from 65 to 67%. This is the maximum percentage of “long” credit for the entire period of observation. For a long time in the loan portfolio short loans of up to one year was dominating, and only before the crisis of 2008 a parity was achieved. In 2009 the share of long loans increased at the expense of reducing the absolute volume (more than by one-third) of short ones, probably largely due to extension or refinancing short loans with the long ones. Now the growth in both market segments is observed, but the debt for long-term loans increased at higher rates.

Liquidity and state support

In June, the banks' borrowing from the Bank of Russia has sharply increased. Debt of banks to the RF Central Bank has increased by nearly a third at once (by Rb 555bn) and reached Rb 2.3 trillion. Larger amounts of refinancing volume were reached only in the midst of crisis, from 01.01.2009 to 01.05.2009. Since the beginning of the year, the volume of funds attracted by banks from the Bank of Russia has increased by more than Rb 1 trillion, including Rb 781bn in Q2 2012.

The greatest increase in loans from the Bank of Russia in June (over 90%) occurred among state-owned banks, which took a total of Rb 519bn. Indebtedness of large private banks has increased by another Rb 30bn.

A part of the Bank of Russia funds in June has promoted the increase in liquidity of the banking sector. The volume of liquid assets in the banking sector has grown by more than Rb 250bn, and their share in total assets came back from the minimum indicator of 4.1% to 4.7%, which is close to the average values over the last year.

Increased liquidity in June was of a general nature for all major groups of banks. Herewith, in the segment of small and medium banks in the normalization of liquidity level was carried out without refinancing on the part of the Bank of Russia. With an increase in the debt of small and medium banks to the RF CB Rb by 8bn the amount of liquid assets in these banks has increased nearly by Rb 70bn.

The banking sector own liquidity in general, i.e., the value of liquid assets less the loans of the Bank of Russia, on the basis of June 2012 was negative: -0.5% of total assets. The lowest values of this index has been reached by the state-owned banks, most actively borrowing with the Bank of Russia, including the Sberbank -2.6% and with other major state banks -1.9%.

Table 2

STRUCTURE OF THE RUSSIAN BANKING SYSTEM ASSETS (END OF MONTH), AS% OF TOTAL

	12.07	12.08	12.09	12.10	06.11	09.11	12.11	03.12	04.12	05.12	06.12
Assets, Rb bn	20125	28022	29430	33805	35237	38443	41628	41533	42151	43225	44266
Cash and precious metals	2.5	3.0	2.7	2.7	2.2	2.3	2.9	2.4	2.5	2.4	2.5
Deposits with the Bank of Russia	6.9	7.5	6.9	7.1	4.5	3.5	4.2	3.2	2.6	2.6	3.0
Interbank operations	5.4	5.2	5.4	6.5	6.4	6.2	6.4	6.2	6.0	5.7	5.8
Foreign assets	9.8	13.8	14.1	13.4	13.8	14.6	14.3	14.2	14.3	14.6	14.2
Individuals	16.1	15.5	13.1	13.0	14.0	14.2	14.4	15.3	15.6	15.8	16.0
Corporate sector	47.2	44.5	44.5	43.6	45.3	45.1	44.0	44.4	44.6	44.1	43.6
Government	4.1	2.0	4.2	5.1	5.8	6.0	5.0	4.9	4.1	4.5	3.8
Property	2.2	1.9	2.7	2.6	2.5	2.4	2.3	2.4	2.4	2.3	2.3

Source: Central Bank of Russia, IEP estimates.

MORTGAGE IN THE RUSSIAN FEDERATION

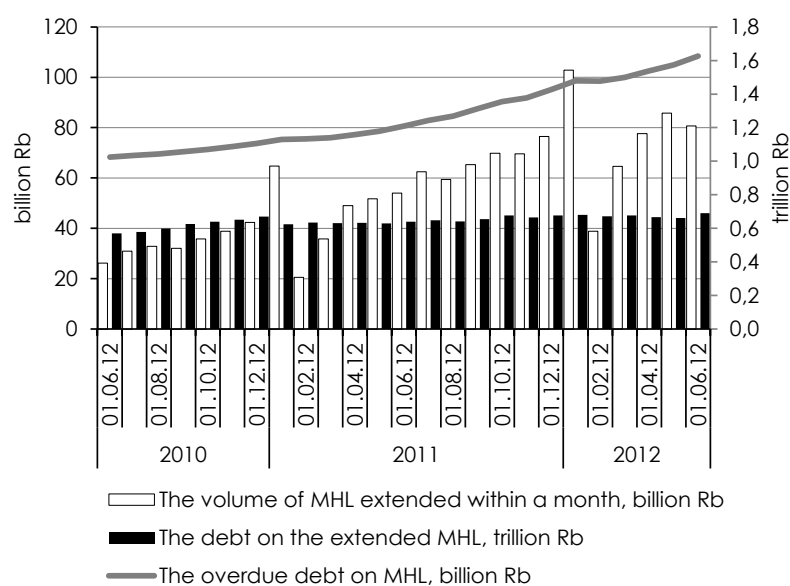
G.Zadonsky

In five months of 2012, 240,107 mortgage housing loans for the amount of Rb 347,478bn were extended which figure exceeds by over 50% the results of the respective period of 2011. The share of the overdue debt in the total debt on MHL keeps decreasing and amounted to 2.38% as of June 1, 2012. The share of the debt on defaulted MHL in the total debt increased by 0.15 p.p. In May 2012, growth in the weighted average rate on MHL in rubles continued.

According to the data of the Central Bank of the Russian Federation, in five months of 2012 240,107 mortgage housing loans for the amount of Rb 347,478bn were extended which is 57.05% and 64.67% more than in the respective period last year as regards the number of the extended loans and their monetary value, respectively. In May 2012, 55,285 mortgage housing loans for the amount of Rb 80,626bn were extended (Fig. 1). As of June 1, 2012, the outstanding debt on MHL rose by 34.54% as compared to that as of June 1, 2011 and amounted to Rb 1,627 trillion (Fig. 1).

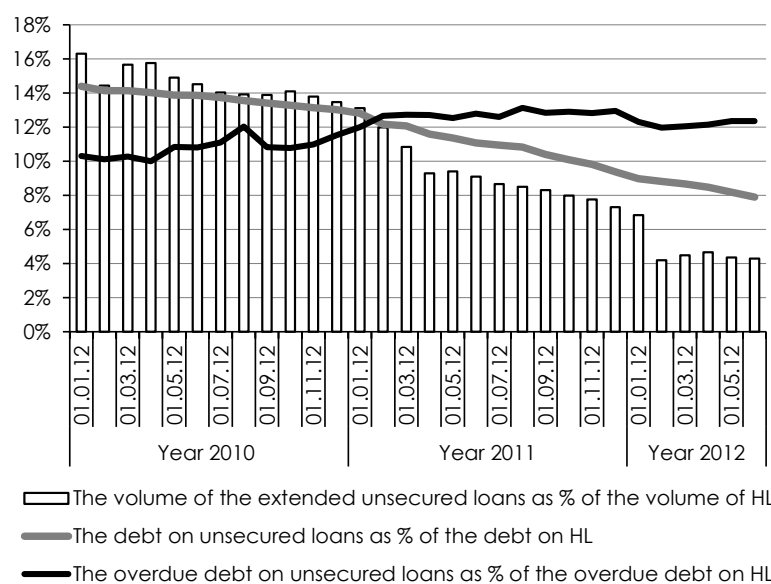
In five months of 2012, the volume of unsecured housing loans (the difference between the volumes of housing loans (HL) and MHL) amounted to 4.48% and 7.78% of the volume of HL extended within that period in monetary terms (Fig. 2) and in quantitative terms, respectively, while the shares decreased by 5.52 p.p. and 12.5 p.p. in monetary terms and quantitative terms, respectively, as compared to the same period of 2011. As of June 1, 2012, the outstanding debt on unsecured HL amounted to Rb 139,365bn or 8.56% of the debt on HL, having decreased by 3.89 p.p. as compared to the data as of June 1, 2011 (Fig. 2).

Before January 2011, the share of the overdue debt on unsecured HL in the overdue debt on HL in general was lower than the respective share of the outstanding debt on unsecured HL in the debt on HL in general (Fig. 2). After January 2011, the ratio



Source: on the basis of the data of the Central Bank of the Russian Federation.

Fig. 1. Dynamics of provision of mortgage housing loans



Source: on the basis of the data of the Central Bank of the Russian Federation.

Fig. 2. Dynamics of unsecured housing lending relative to housing lending in general

of the above shares changed: the first one became larger than the second one. The above points to the fact that the credit risk of unsecured HL before January 2011 was lower and, thus, the quality was higher than that of mortgage housing loans. It was sooner the result of a scrupulous selection of borrowers of unsecured HL. However, after January 2011, the quality of MHL happened to be higher, while the share of unsecured HL both in the volume of the extended HL and the debt on HL kept decreasing (*Fig. 2*).

As of June 1, 2012, the overdue debt (*Fig. 1*) on MHL (Rb 46,003bn) exceeded by Rb 3.392bn or 7.96% and Rb 1,903bn or 4.32% the overdue debt as of June 1, 2011 and May 2012, respectively. As of June 1, 2012, the share of the overdue debt in the total debt on MHL amounted to 2.83% or was 0.7 p.p. lower than that as of June 1, 2011. As regards MHL in rubles, the share of the overdue debt keeps decreasing, while that on loans in foreign currency, growing. The share of the debt on MHL with payments overdue for over 180 days in the total debt increased by 0.15 p.p. to 3.40% (*Table 1*).

Table 1

GROUPING OF THE DEBT ON MORTGAGE HOUSING LOANS BY THE PERIOD OF DELAY
IN PAYMENTS IN 2012

	The total amount of the debt on MHL, million Rb	Without overdue payments		With overdue payments					
				from 1 to 90 days		from 91 to 180 days		over 180 days	
		Million Rb	%	Million Rb	%	Million Rb	%	Million Rb	%
01 Jan.	1 478 982	1 391 130	94.06	27 805	1.88	5 916	0.40	54 131	3.66
01 Feb.	1 477 179	1 377 470	93.25	40 327	2.73	6 647	0.45	52 735	3.57
01 Mar.	1 499 585	1 398 514	93.26	42 138	2.81	5 698	0.38	53 235	3.55
01 Apr.	1 538 189	1 449 128	94.21	32 148	2.09	5 845	0.38	51 068	3.32
01 May	1 574 058	1 488 900	94.59	28 334	1.80	5 667	0.36	51 157	3.25
01 Jun	1 627 167	1 526 934	93.84	39 377	2.42	5 532	0.34	55 324	3.40

Source: the data of the Central Bank of the Russian Federation.

In the 1st quarter of 2012, as regards distribution of regions by the number of MHL per thousand persons the leaders were still the Khanty-Mansiisk Autonomous Region, the Yamal-Nenetsk Autonomous Region, the Tyumen Region and the Republic of Tatarstan with the Nenetsk Autonomous Regions being number one among the leaders (*Table 2*). With a larger number of mortgage loans extended per thousand persons, the leaders still have a lower share of the overdue debt in the outstanding debt. On the contrary, regions with high monetary volumes of MHL, such as Moscow, the Moscow Region and St. Petersburg have a larger share of the overdue debt in the outstanding debt with a smaller number of loans per thousand persons (*Table 2*).

As regards the share of the overdue in the total debt, as of April 1, 2012 the leader was the Republic of North Osetia-Alania (13.75% against 17.82% as of April 1, 2011) followed by the Chechen Republic (11.97%), the Kaliningrad Region (6.76%), Moscow (6.04%) and the Moscow Region (5.88%) (*Table 2*).

According to the data of the Central Bank of the Russian Federation, in May 2012 the volume of MHL in foreign currency extended from the beginning of the year as a percentage of the total volume of MHL increased by 0.1 p.p. to 1.35% as compared to April 2012, while the share of the debt on MHL in foreign currency in the total debt grew by 0.37 p.p. to 8.73% as of June 1, 2012.

In May 2012, the weighted average period of lending as regards MHL in rubles extended within a month amounted to 14.94 years which is 0.72% lower than that in April. As regards MHL in foreign currency extended from the beginning of the year, as of June 1, 2012 the weighted average period of lending amounted to 13.35 years having increased by 1.84% as compared to May 1, 2012.

In May 2012, the weighted average rate on MHL in rubles extended within a month kept growing and as compared to April 2012 gained on average 0.1 p.p. to amount to 12.2%. The weighted average rate on MHL in foreign currency extended from the beginning of the year remained unchanged (9.6%) within the same period.

Table 2

DISTRIBUTION OF REGIONS BY THE NUMBER OF MORTGAGE HOUSING LOANS EXTENDED PER THOUSAND PERSONS AS OF APRIL 1, 2012

Region, Federal Region	01.04.2012					01.04.2011
	Number of MHL, units	Volume of MHL, million Rb	Debt on MHL, million Rb	Overdue debt, million Rb	Overdue debt as % of the outstanding debt	Number of MHL, units
The Russian Federation	0.895	1,276	10,838	0.313	2.89	0.531
Netetsk Autonomous Region	2,175	4,422	48,779	0.024	0.05	0.591
Khanty-Mansiisk Autonomous Region	1,993	3,848	47,040	0.166	0.35	1,923
Yamal-Nenetsk Autonomous Region	1,841	3,914	37,288	0.097	0.26	1,524
Tyumen Region	1,805	3,316	36,093	0.219	0.61	1,548
Republic of Tatarstan	1,529	1,344	8,196	0.082	1.00	1,083
Republic of Udmurtia	1,458	1,337	9,495	0.195	2.06	0.672
Tomsk Region	1,411	1,767	15,838	0.224	1.42	0.831
Vologda Region	1,358	1,376	10,880	0.197	1.81	0.702
St. Petersburg	0.891	2,055	17,972	0.495	2.75	0.494
Moscow Region	0.835	2,076	18,596	1,094	5.88	0.440
Moscow	0.622	2,139	19,888	1,202	6.04	0.353
Urals Federal District	1,332	1,896	18,479	0.276	1.49	0.937
Privolzhsky Federal District	1,120	1,134	8,565	0.186	2.17	0.648
Siberian Federal District	1,026	1,267	11,715	0.278	2.38	0.644
Far Eastern Federal District	0.904	1,454	10,921	0.105	0.96	0.531
North-Western Federal District	0.902	1,496	12,419	0.279	2.25	0.506
Central Federal District	0.764	1,500	12,704	0.600	4.72	0.407
Southern Federal District	0.552	0.750	6,542	0.172	2.63	0.360
North-Caucasian Federal District	0.317	0.373	2,770	0.107	3.86	0.157

Source: on the basis of the data of the Central Bank of the Russian Federation.

In January–May 2012, OAO AHML refinanced 15,972 mortgage loans for the amount of Rb 20,743bn which is 8.79% and 14.61% more in quantitative terms and monetary terms, respectively, as compared to the same period of 2011. The volume of the “Military Mortgage” amounted to Rb 5,711bn, while the “Maternity Capital” mortgage, to Rb 2,090bn. In May 2012, OAO AHML refinanced 3,955 mortgage loans for the amount of Rb 5,225bn.

From September 3, 2012, in granting by the lender of a standard mortgage loan OAO AHML suggests that a combined interest rate providing for the fixed and variable rates option should be used. At discretion of the borrower, the rate can be fixed for any period and upon expiry of that period it is recalculated depending on the rate of inflation. For protection of borrowers from a sharp increase in the amount of payment in case of a crisis situation, a limit of maximum 16% per annum is set on the interest rate. According to experts, such an innovation is fulfillment by OAO

AHML of Order No.600 of May 7, 2012 of the President of the Russian Federation under which the Government is to ensure reduction of the average mortgage rate to the level of “the inflation rate plus 2.2 percentage points” by the year 2018. Such a loan will be refinanced by OAO AHML provided that at least a 50% initial installment was made, personal insurance agreement signed and the rate was fixed for twelve months.

The President has approved amendments to the Law on Mortgage Securities passed by the State Duma on June 8, 2012, which law permits banks to issue mortgage-backed securities and, take no longer heed of Regulation H17 of the Central Bank of the Russian Federation (the requirement to the minimum ratio between the amount of the extended mortgage-backed loans and the own funds) and Regulation H19 (the requirement to the maximum ratio between the aggregate volume of liabilities of the mortgage-backed securities issuing bank to its creditors and the bank’s own funds). The above amendments are aimed at elimination of such conflicts of interests between the bank’s depositors and holders of its mortgage securities as used to arise after removal of mortgage in accordance with the effective legislation from bankruptcy assets of the bankrupt bank. ●

RUSSIAN EQUITY MARKET IN THE FIRST HALF OF 2012

A.Abramov

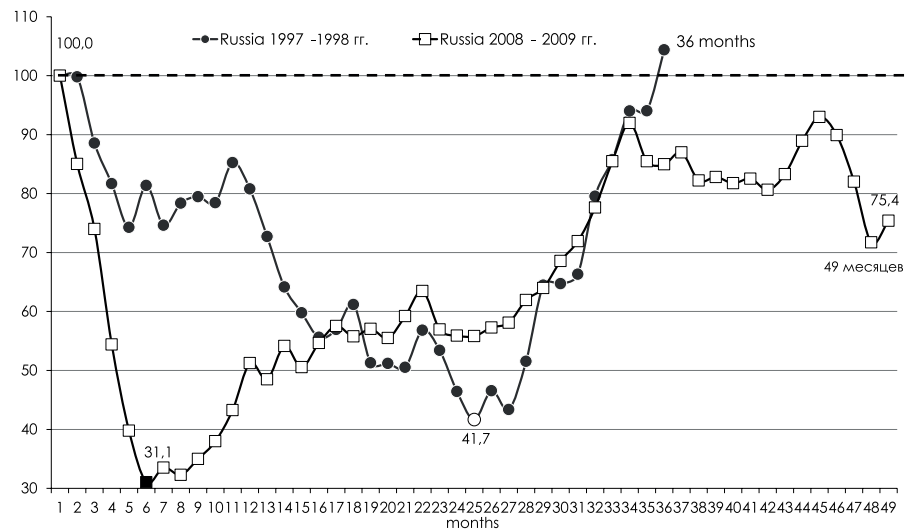
Changes in Russian equity market in H1 2012 allow judging vectors of its advancement and risks. The most significant factors and risks associated with its advancement lie in the dependence of its dynamic on the state of affairs of the global oil market in the first place and, second, in the outflow of foreign portfolio investors' funds from the national financial market. Both factors prove to exert equal influence on quotations of Russian equities. Meanwhile, one of the most significant risks facing the national financial market is absence of a strategy and expansion benchmarks.

1. Oil Dependence of Russian Equity Market

Despite a notable expansion of the equity market in the first months of 2012, because of a subsequent fall in stock quotations at the end of H1, Russia's main stock indices found themselves practically at their late-2011 levels. As of 20 July 2012, the MICEX index climbed up by a meager 2.0% vs. 30 December 2011, while the RTS one PTC tumbled by -0,7%. The MICEX index value hit just 73.5% of its peak figure of May 2008, while the RTS index value - 56.6%.

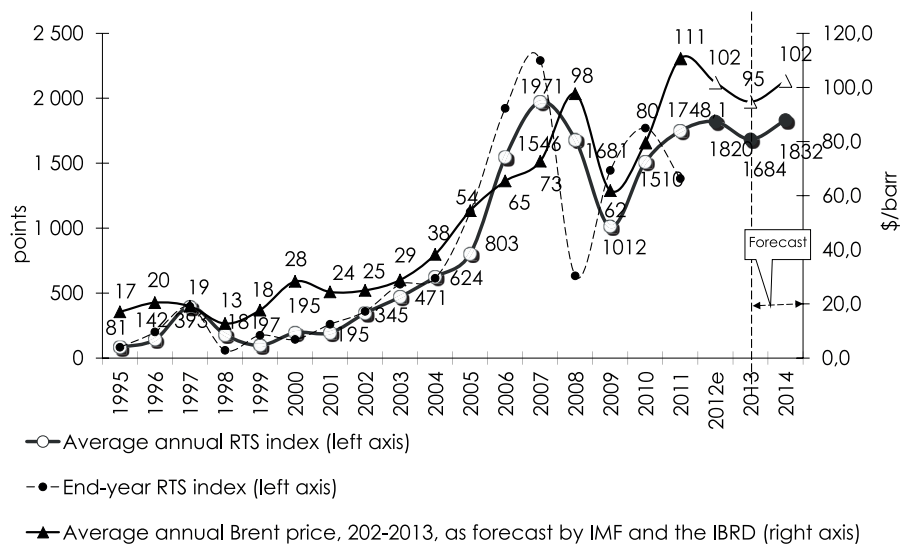
It was oil prices which have remained a major factor behind the dynamic of the Russian stock indices. In contrast to the 1997-98 crisis, when it took Brent prices 36 months to bounce back to their pre-crisis levels, these days, they were struggling to recover to their June-2008 peak values for 49 months in a row (Fig. 1). At the end of June, Brent prices still accounted for just 75.4% of their pre-crisis peak values nonetheless.

Having applied an equation of correlation between the oil price and the RTS index between September 1995 and June 2012 to the 2012-2014 oil price forecast by IMF and the World Bank (Fig. 2), the



Source: calculated by the IMF and Moscow Exchange data/

Fig.1. The Fall and Recovery of Brent Price during Financial Crises in Russia (price peak =100%)



Source: calculated by the IMF, the World Bank and the Moscow Exchange data.

Fig.2. Forecast of the RTS Index through 2014 on the basis of Oil Price Forecast by IMF and the World Bank

average annual value of the RTS index should be within the range of 1,684–1,832 points over two years and a half to come.

By our estimates, proceeding from historical data on the correlation between oil prices and the index value, the 2012 average annual value of the RTS index should surge from 1,748 to 1,820 points, or 4.1%. This is below our forecasts of early 2012¹, but above the average value of the RTS index in 2012 (1,503.8 points).

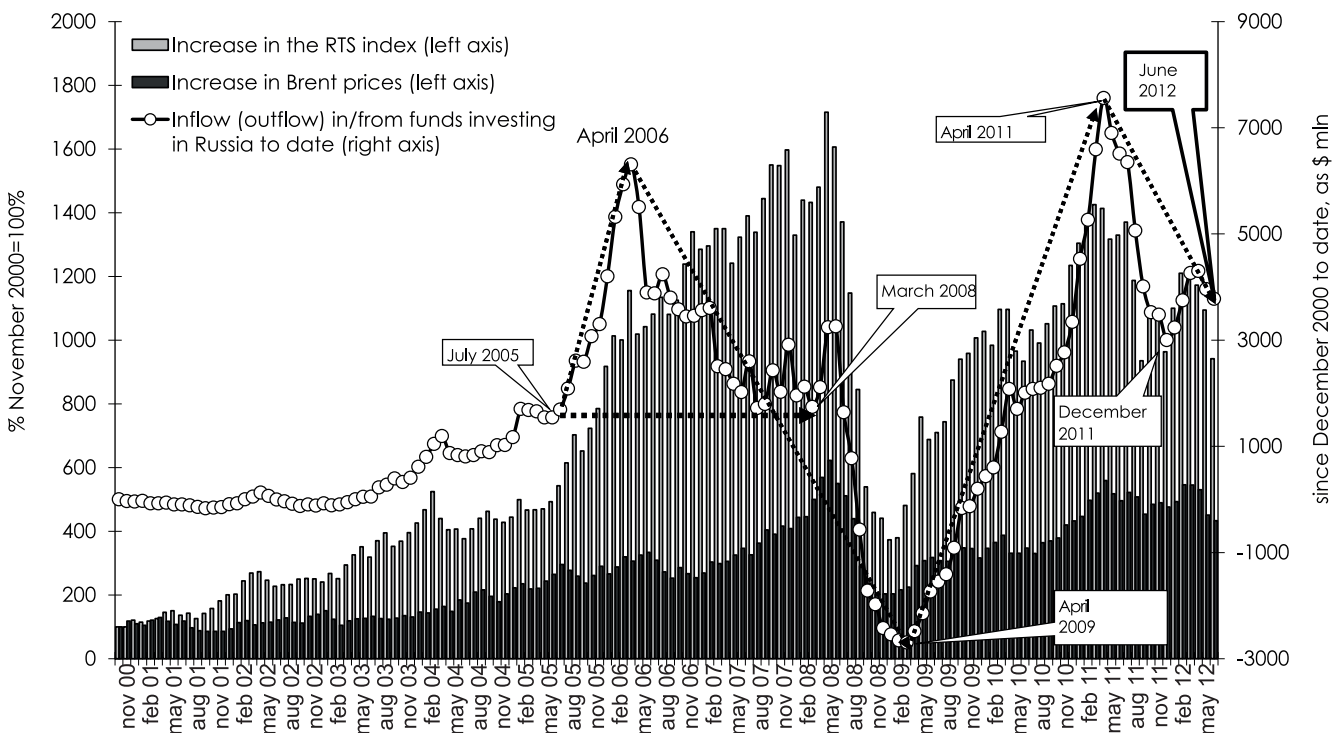
2. Transborder Foreign Portfolio Investment Migration

The cyclic nature of relative price changes of Russian corporate stock can be ascribed to the influence exerted on them by both oil prices and in- and outflow of foreign portfolio investors' moneys, as documented by the Emerging Portfolio Fund Research (EPFR). Both factors prove to exert equal influence on quotations of Russian equities, as evidenced by data presented in *Fig. 3*.

The post-crisis recovery of the Russian equity market since April 2009 through April 2011 should be ascribed to a \$ 10.3 bn-worth capital inflow in foreign funds specializing in investing in Russia. Assuming that the volume of assets under management of foreign funds with regional and global portfolios is several times greater than the size of funds whose portfolio focuses solely on Russian issuers' equities, the aggregate value of the inflow of portfolio investors' capital may account for several dozens of billions of dollars.

Since May 2011 the funds specializing in investment in Russia saw their investors pull capital out of the country. What drove foreign portfolio investors' negative sentiments towards Russian equity market can be understood from the IMF experts' findings². They believe that the documented by EPFR withdrawal of capital out of funds specializing in emerging markets is explained, as a rule, by reputable institutions' increasingly pessimistic projections with respect to growth in real GDP in developed and developing economies, a greater volatility of economic growth rate, exchange rates and equity prices.

In April 2011, MBΦ cut back its forecast of the 2011 GDP growth rates for US, UK and Japan, followed by Germany, China, Russia and the global economy on the whole. Small wonder EPFR



Source: calculated by data of IFS of IMF, the Moscow Exchange and EPFR.

Fig. 3. Increase in the RTS Index and Oil Price Rise, Capital Inflow (Outflow) into (out of) Funds Investing in Russia (November 2000 – June 2012)

1 Russian Economy in 2011. Trends and Perspectives (issue 33). M., the Gaidar Institute, 2012, p.142–144.

2 IMF. Financial Stability Report. September 2011, pp. 11–18, www.imf.org.

data suggested that in response to growing uncertainties in the global economy in May 2011 portfolio investments began to steadily pull out of the Russian equity market.

The length of the specialized funds' capital inflow/outflow cycles usually makes up 1.5–2 years. For example, capital had steadily been pouring into funds investing in Russia between late 2004 and April 2006. Between May 2006 and March 2009, investors were mostly pulling their moneys out of the funds; the trend to capital inflow reversed once again between April 2009 and April 2011. The said negative tendency was broken between January and April 2012, with new capital pouring into the funds in question throughout that intermezzo. We think that

underpinning the temporary discontinuation of capital outflow from the funds investing in Russia was a sudden dynamic of oil prices during the period in question, with Brent crudes having soared from \$ 112.1/b at the beginning of the year up to \$126.2/b as of 16 March 2012. With oil prices in decline since May 2012, the capital outflow was back. We suggest the capital outflow from the funds investing in Russia should remain in place through the end of the year, until international financial organizations begin to raise their GDP growth forecasts for next year or two.

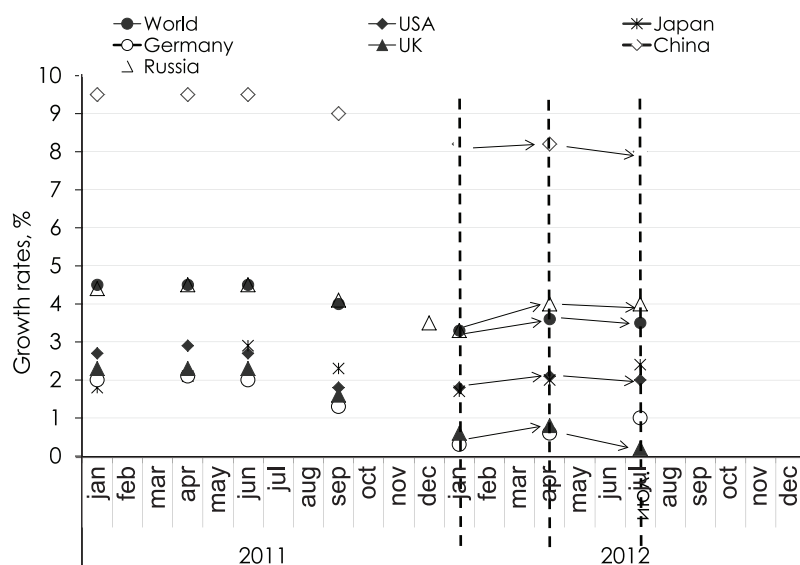
That said, international financial institutions' forecasts do not always prove accurate. For example, in April 2012, counter to the global investors' pessimistic mood fueled by challenges facing the Euro zone and the US and China's economies losing ground, the IMF projected greater growth rates for the leading economies in 2012 nonetheless (*Fig. 4*).

In January 2012 vs. September 2011 the Fund lowered its 2012 GDP growth forecast for the global economy by 0.7 percentage point, Japan – 0.6 p.p., Germany and UK – 1p.p., China 0.8 p.p., Russia – 0.6 p.p. However, in April 2012, without typical of such a move rationale, the 2013 economic growth forecast improved by 0.43 p.p. for the global economy and US, 0.2 p.p. – UK and 0.7 p.p. – for Russia.

The April 2012 forecast in many ways reflected Ms. C. Lagarde, the Fund's new Managing Director, hopes on getting the Eurozone out of trouble once the regular peak phase of the Greek crisis was over. Likewise, OECD put forward a super optimistic forecast in May 2012, with Russian economy projected to expand by 4.5% in 2012: the forecast was based on anticipation of the 2012 Brent crude prices averaging \$121/b.

In its regular global economy review in July 2012 the Fund was back to more conservative figures for this year: the global economy and the US are anticipated to expand by 0.1p.p., ie. slower than projected earlier, UK – 0.6 p.p., China – 0.2 p.p. Between April and July 2012 the forecast of the 2012 average oil price was cut back from \$ 114.7/b to 101.8/b.

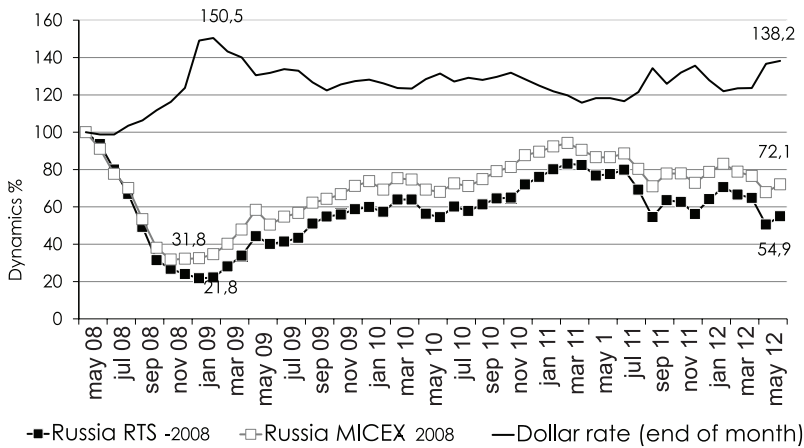
Interestingly, contrary to their usual behavioral pattern, international portfolio investors did not buy the IMF's April economic growth forecast. It seemed that an optimistic forecast of the global economy's growth in April vis-à-vis the January pessimistic one should have lifted the investors' spirit. However, it was May 2012 that saw renewal of withdrawal of capital from funds investing in Russia and other emerging markets. This is yet another proof of the international portfolio investors' rational behavior and adequacy of their judgment of the global economic outlook.



Source: calculated basing on data of quarterly WEO IMF in 2010-2012

Fig. 4. Day (month) of the IMF forecast

3. Risks of Depreciation of the National Currency



Source: by data of JSC RTS, MICEX and the Bank of Russia.
 Fig. 5. Dynamics of the US Dollar, RTS Index and MICEX INDEX Rates during the Crisis between May 2008 and June 2012 (May 2008=100%)

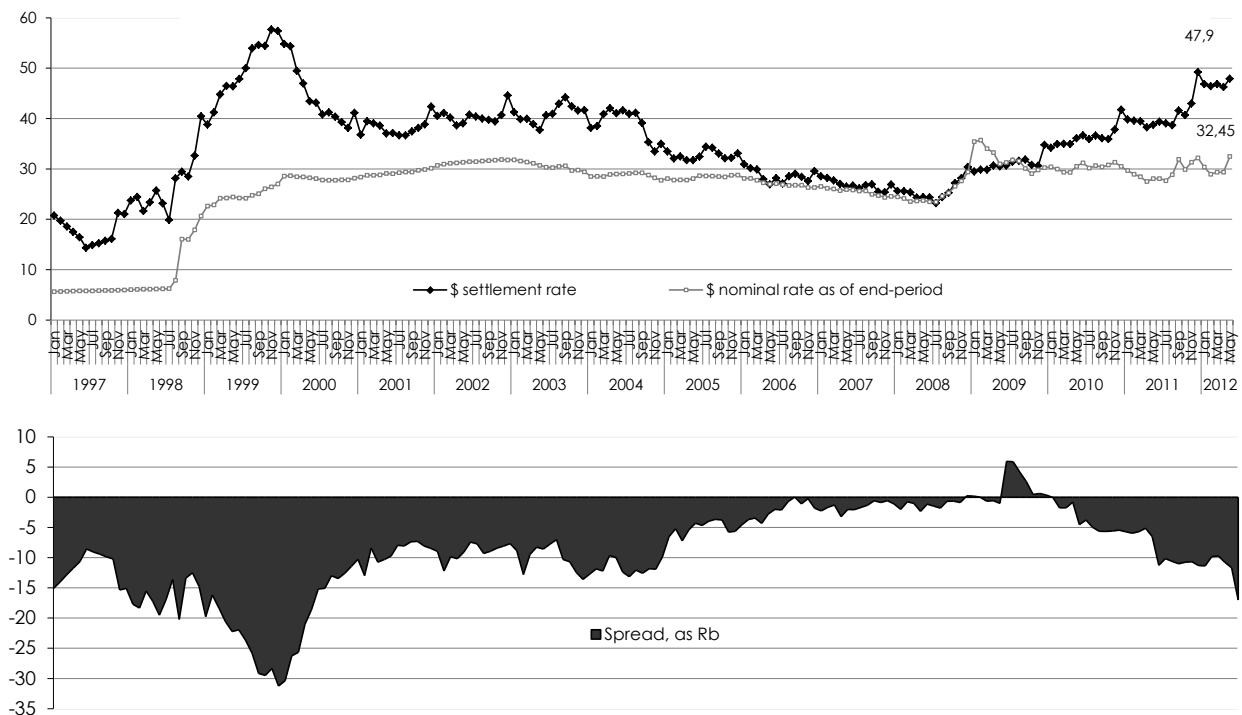
During the 2008-09 crisis, the peak level of the Rb depreciation was 50% (Fig. 5) followed by its subsequent appreciation. That is why the RTS and MICEX indexes have been bouncing back at a practically equal pace, with the latter index slightly outpacing the RTS's. In June 2012, the RTS index hit 54.9% and the MICEX index -72.1% of their respective peak values back in May 2008.

The trend to deceleration of the new forex revenue inflow in Russia due to the stabilization of prices on mineral markets and the foreign capital outflow for the fourth year in a row, transition to a freer formation of the Rb exchange rate entails a widening gap between the dynamic

of Rb-denominated money supply and the volume of forex reserves. This partly mirrors a positive process of fueling the national economy's expansion through its monetization. Meanwhile, the increase in money supply is largely backed by the budget and the Bank of Russia's resources.

As a result, the gap between the actual exchange rate of \$ and its estimated rate determined by dividing the Rb-denominated M2 into the \$-denominated equivalent of gold-and-forex reserves widens consistently (Fig. 6). The current gap between these two rates (Rb15.5/1\$) is catching up with the pre-1998 crisis one.

With the Bank of Russia in the functioning of the exchange market, a negative external shock, eg. a sharp downfall of energy prices, may trigger a fast and considerable depreciation of the Rb.

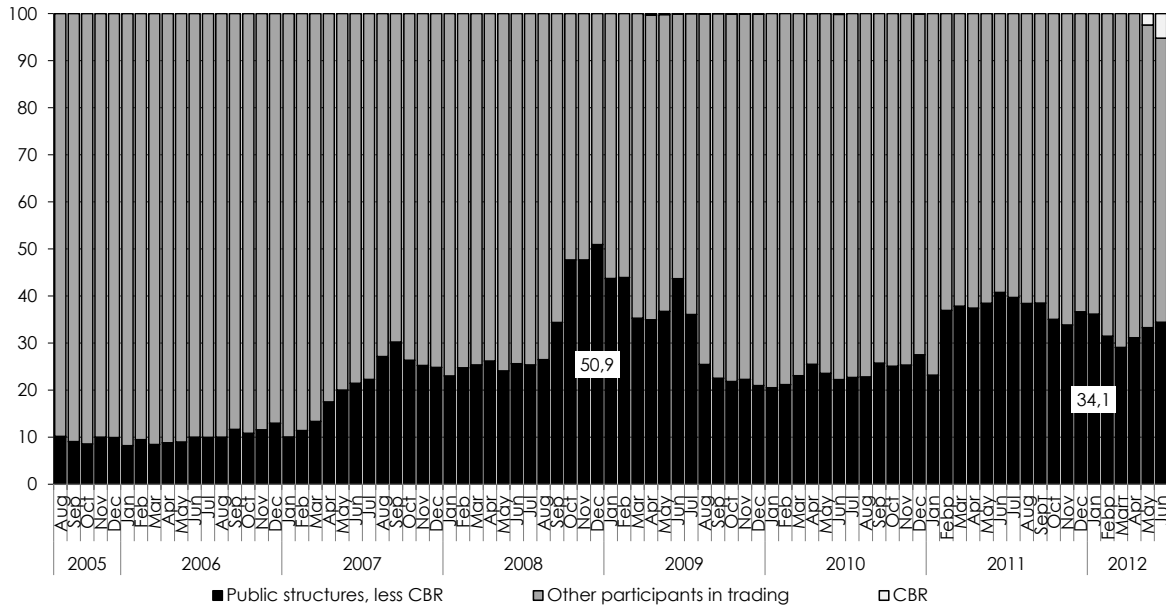


Source: calculated by data of the Bank of Russia and the RF Ministry of Finance.
 Fig. 6. Correlation between the Nominal Exchange Rate of \$ in Rb Equivalent and the Settlement Exchange Rate in Jan 1997 – May 2012

4. Greater Role of the State as a Participant in the Equity Market

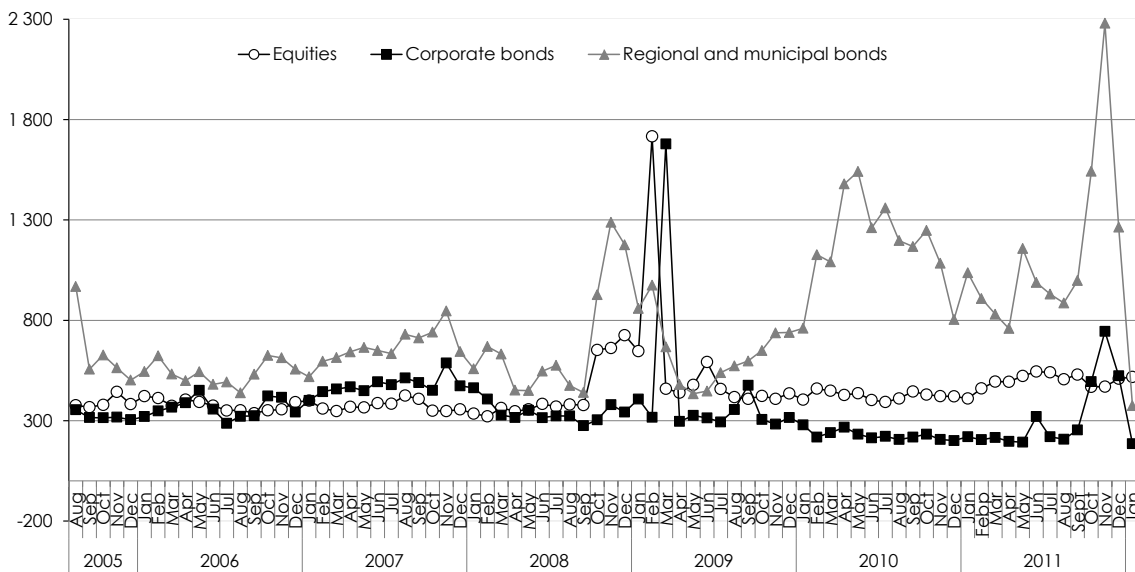
With the problem of attracting long-term domestic investors remaining unsolved, the year of 2012 saw a notable increase in the public corporations' influence on the stock market. Fig. 7 presents results of stock transactions on the Moscow Exchange's main market with participation of Bank of Russia, state-owned banks and their affiliated structures¹. Between March and June 2012 the proportion of public structures in the stock trading volume surged from 29.9% up to 34.4%. In June, the Bank of Russia's share in stock transactions accounted for 5.3%.

Furthermore, the Moscow Exchange's stock market witnesses a notable increase in concentration of deals, which is proved by data presented in Fig. 8 – dynamic of the Herfindahl-Hirschman Index (HHI) with regard to turnover on the Moscow Exchange stock market between



Source: the author's calculations on the basis of the Moscow exchange's data.

Fig. 7. Private and Public Brokerages' Proportions in the Volume of Trading with Equities at MICEX and RTS, %



Source: the author's calculations basing on the MICEX-RTS index.

Fig. 8. The Herfindahl-Hirschmann Index with Regard to the Volume of Secondary Exchange Trading on the Main MICEX-RTS-Market (All the Regimes), August 2005 – June 2012

1 VEB, VTB, VTB Capital, VTB24, Gasprombank, Sberbank, KIT Finance, Svyaz-Bank, Bank of Moscow, Transcreditbank, investment company Troika-Dialogue (since 2011).

January 2005 and June 2012. By FAS's estimates, the market appears low concentrated with an HHI value below 800, moderately concentrated under $800 < \text{HHI} < 1800$, and highly concentrated with HHI being above 1,800¹. In June 2012, the HHI rate with regard to deals on the main corporate bond market of the Exchange topped 1,000, thus having taken the market to the category of moderately concentrated ones. The equity market concentration level posted no substantial changes.

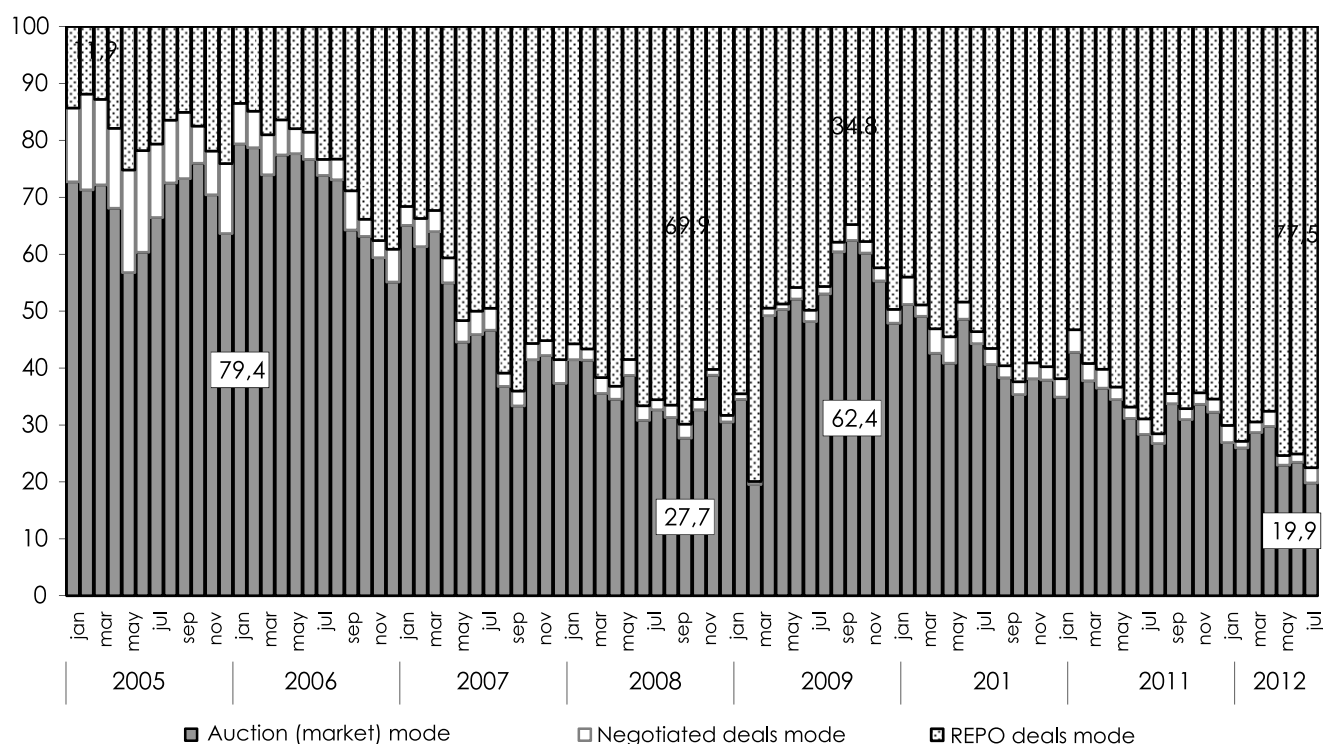
5. Risks Borne by REPO Deals with Equity

By virtue of REPO deals on the equity market brokerages, as a rule, attract short-term borrowed resources for a subsequent marginal lending to their clients. In 2008, the crisis on this market began with the crisis of settlements on REPO transactions. This segment of the market has seen numerous positive changes since then, yet critical risks have persisted there nonetheless.

Fig 9 displays data on the dynamic of the structure of equity transactions at the Moscow Exchange. Leaving aside data for February 2009, which appears not quite accurate due to a huge REPO deal later canceled by the court of law, June 2012 proved a record-breaking month in terms of the value of the share of REPO deals in the volume of equity trading at Moscow Exchange, which made 77.5%. The increase in the proportion of REPO transactions evidences recovery of the marginal lending of securities transactions. This, on the one hand, means the investors' growing appetite for the risky asset market and rising risks of speculative activity on the Russian equity market, on the other.

6. Absence of a Financial Market Development Strategy

Russia has remained one of very few countries with a relatively voluminous exchanging market with no long-term and updated strategy of its development at hand. Approved pre-crisis, the current Development Strategy has fallen short of becoming a credible benchmark,



Source: by MICEX-RTS data.

Fig. 9. Structure of Equity Transactions on the Main Market of MICEX-RTS, as %

¹ See p. 2.6.4. of Methodological recommendations on the procedure of conduct of analysis and assessment of the state of the competition environment on the market for financial services approved by Executive Order of the Ministry for Anti-Monopoly Policy of 31.03.2003 N 86.

while prognostic indicators of the financial market do not match today's realities. It is not accidental then that having completed a strategic audit of the financial market's development, the Accounting Chamber of the Russian Federation reckoned that with the current growth rates of indicators that characterize the dynamic of the financial market's development, "it is possible to attain only two benchmarks of the financial market's development out of twenty"¹. Sailing without a strategy and target indicators poses one of the biggest risks to the national financial market. ●

1 On 10.01.2012, the Accounting Chamber completed a strategic audit of development of the Russian financial market. Department of information of the Accounting Chamber of Russian Federation. Posted on the Accounting Chamber of Russian Federation's web-site at www.ach.gov.ru .

STATE PROGRAM FOR AGRICULTURAL DEVELOPMENT IN 2012–2020: BASIC DIRECTIONS OF SUPPORT AND PROBLEMS OF ADAPTATION TO WTO MEMBERSHIP

R.Yanbykh

The State program for agricultural development and regulation of agricultural and food markets in 2013–2020 that raised such a heated debate in the past two years has finally been adopted. In general it keeps to the support patterns of the previous program. Following Russia's accession to WTO an attempt is made to adjust the traditional support measures to the requirements of accession agreement. However, one failed to completely get rid of the most distorting measures.

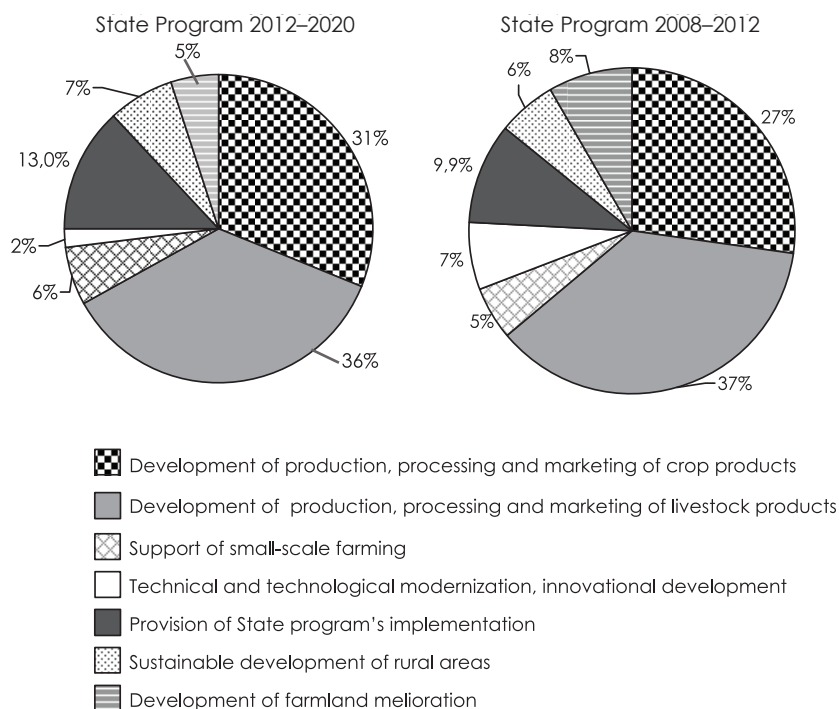
In 2006 following the adoption of Law “On agricultural development” (FZ No. 264 of December 29, 2006) the procedure of allocating funds to the development of agrarian sector changed. From then on budget support to farm producers could be rendered only in case it had been envisaged in the State program for agricultural development and regulation of agricultural and food markets (henceforth the State program). This practice has its undeniable merits since all the operators of agricultural market now can – theoretically – plan their activities for a 5-year period knowing in advance the basic rules of the game: the targets of agricultural policies, clearly defined measures of state support, amounts of subsidies they can apply for. The first State program for agricultural development in 2008–2012 was adopted without long hesitations and was abided by albeit with notable adjustments due to the emergency conditions following the 2009–2010 drought. The next State program was supposed to be elaborated at the beginning of 2012. The draft program for 2013–2020

that had been long discussed by key departments (partially due to the Russia's accession to WTO) was finally accepted on July 10, 2012.

What are the basic differences of the new State program from the previous one?

First, the amount of financing has notably increased. While the State program for 2008–2012 envisaged allocation of 551 billion rubles of budget funds to the development of domestic agrifood sector (i.e. on the average 110.2 billion rubles per annum), the implementation of the State program for 2013–2020 will cost 1509 billion rubles (188.7 billion rubles per annum). The structure of support by directions (sub-programs) changed and their number increased to 8 – up from 5 in the previous State program (Fig. 1).

The core of the two basic support directions – the deve-



Note: Directions of financing under the State program for 2008–2012 were split up into blocks corresponding to the sub-programs envisaged in the draft of the new State program for 2013–2020 in order to facilitate comparisons; the sub-program for development of meet cattle breeding was included in the general expenditures on livestock production.

Fig. 1. Basic directions and amounts of financing under the State program

lopment of priority agricultural subsectors (in the new State program – sub-programs for the development of crop and livestock production) and the sustainable development of rural areas – was preserved. Measures for regulation of agricultural and food markets (the former State program envisaged only the carrying out of purchase and commodity interventions on the grain market), granting of subsidies for compensation of interest rate on received credits and loans and insurance of farm output were transferred into the corresponding sub-programs according to sector profile. On the contrary, melioration of farmlands, technical and technological modernization of agriculture and support of small-scale farming were detached as separate sub-programs.

The emergence of sub-program “Development of meat cattle breeding” emphasizes new priorities of agricultural policies – the drop of beef production during the reform years was most dramatic and thus the restoration of cattle population became one of the main targets of the State program. Accordingly, new investment credits will be subsidized only for meat cattle producers while subsidizing of those for construction, reconstruction and modernization of poultry and pig breeding facilities will discontinue from January 1, 2015 and January 1, 2017, respectively.

Sub-programs for the development of crop and livestock production are designed according to a scheme including four block of basic measures: production of farm output of corresponding types; its processing; development of infrastructure and regulation of markets; crediting and insurance.

The Minister of agriculture Nickolay Fyodorov stressed that the government “gradually shifts from the former forms of direct subsidizing to the support of farm producers’ rates of return”¹. Indeed, 207 out of 467 billion rubles of state support will be allocated for subsidies to budgets of regions-subjects of the Russian Federation for granting non-bound support to crop producers. However, non-bound measures are so far envisaged only for crop production and it’s not yet quite clear how will this support be provided.

The measure “Creation of logistical centers” in the form of “wholesale distribution centers for marketing of output” is specified rather vaguely and the declaration of “forming of market price and excluding of numerous middlemen in the chain from farm producers to consumers” as one of the targets of agricultural policies seems to be no more than a pretentious declamation. It’s not clear who will actually receive these subsidies. Among other beneficiaries the State program names farm producers who by the profile of their operation will hardly engage in the construction of either logistical centers or ports for exporting Russia’s agricultural output.

The sub-program “Support of small-scale farming” implies the continuation and extension of government efforts in the field of small-scale entrepreneurship in rural areas including support of beginning farmers; development of family livestock farms on the basis of peasant (individual private) farms; subsidizing of interest rate on received credits; assistance to peasant (individual private) farms in registering titles to land plots. The latter measure leaves perplexed: first, why only peasant farms are eligible for subsidizing of land registration? Second, the area of lands the registration of which one supposes to subsidize is only 960,000 hectares, or less than 0.5% of the total farmland area in Russia, i.e. it won’t have any effect except for being a bonus for a small number of farmers. Third and most important, the problem of registering titles to land plots is not a financial one – it’s rather a problem of corruption of registering officials at the district level and poor involvement of available remote sensing data obtained at the cost of budget funds in the process of cadastral recording of earlier formed land plots. The development of land market in agriculture can be fostered primarily by the simplification of rules of registering new or certification of earlier obtained titles to agricultural land plots as well as by making the procedure of demarcating boundaries of land plots less expensive.

Regrettably, the measures for supporting the system of agricultural cooperation found no understanding in the RF Ministry for economic development. Meantime, such measures as granting of long-term budget loans for the replenishment of rural credit cooperatives’ working capital could help to tackle the problem of providing access to credits for small rural entrepreneurs that still produce one half of agricultural output in the country.

Till 2013 the sub-program “Sustainable development of rural areas” will be administered via the Federal target program (FTP) “Social development of rural communities till 2013” and afterwards – via the FTP “Sustainable development of rural areas in 2014-2017 and in the period till 2020”.

1 Rossijskaya gazeta No. 160, July 16, 2012.

Measures under the sub-program are divided in the following groups: provision of housing for rural residents, education, health care, culture, trade and consumer services, information and consultation services for rural residents, electrification, gasification, water supply, telecommunication, complex compact housing development, road construction. The program does not specify what exactly will be financed and on what terms. The previous program defined the measures more clearly:

- encouragement of non-agricultural activities in rural areas;
- amelioration of housing conditions for people living in rural areas including young families and young specialists;
- development of social and engineering infrastructure in rural areas;
- support of complex compact housing development and improvement of living environment in rural settlements in the framework of pilot projects;
- grant support of rural communities' initiatives on ameliorating living conditions.

However, their financing was cut due to the drought and the implementation of other priority support measures.

The general impression about the State program is that it was prepared in haste. Not in all cases one can observe a clear and logical inter-connection between targets, tasks and indicators of sub-programs, the measures under which often overlap and duplicate each other. The degrees of elaborating sub-programs' details are very different and it's not always clear what does this or that measure imply. For instance, it is mentioned in the sub-program for melioration of farmlands that the essentials of financing and the procedure of granting subsidies for application of mineral fertilizers will be specified in other sub-programs but we have failed to find them. The situation is similar with such a new support direction as the improvement of farm producers' rates of return¹. One can suggest that these will be such subsidies that will be granted to agricultural producers per hectare of arable land but it's not clear from the text of the State program.

One more bottleneck of the program that can be mentioned is the disregard of regional specifics of rural economies in regions-subjects of the Russian Federation. In 30% of them corporate agriculture with large agro-firms and agro-holdings is the prevailing form of farming. In approximately the same number of regions family farming is primarily developed and in 40% of them the structure is mixed². However, a unified set of measures is envisaged in the text of the new State program. For instance, most types of subsidies are fit only for regions with intensive agriculture and favourable social conditions for the development of rural areas.

A special program of social measures needs to be elaborated for regions with unfavourable conditions, affected by depopulation, for poorly developed areas with hard natural conditions. In such regions the amount of subsidies actually granted for the development of agriculture is traditionally below the allocated sums, budget funds remain under-used.

According to OECD data in 2008–2010 81% of the aggregate support to agriculture in the Russian Federation was provided in the form of most distorting measures³. In 2010 the aggregate support to agriculture in Russia amounted to 555.7 billion rubles including 279.4 billion rubles of price support to farm producers (or 59.3% of the total)⁴. For the sake of comparison: in the same year the share of price support in its total volume in the US was as low as 5.9%, in the EU – 15.3%. At the same time beginning from 1995 no support was provided in Russia to consumers of agricultural products. In the US the structure of aggregate support was absolutely different: over 50% of funds were used for general support measures (research, education and training, consulting

1 The new direction of state support implies payment of subsidies to farm producers without binding them to the purchase of a particular input. Such a binding would mean applying an “amber box” measure the financing of which is to be cut according to the WTO requirements. A subsidy to a farm producer is his additional income that can be used either for buying of mineral fertilizers or for other purposes. This measure is classified as a “blue box” one and is less rigidly regulated by the WTO rules.

2 See Uzun V.Ya., Saraykin V.A., Gataulina E.A. Classification of farm producers on the basis of data of All-Russian Agricultural Census of 2006. Moscow, VIAPI named after A.A. Nikonov, 2010, p. 229.

3 OECD (2011)/ Agricultural Policy Monitoring and Evaluation 2011: OECD Countries and Emerging Economies, OECD Publishing, P. 236.

4 V.Ya.Uzun. Russian policy of supporting agriculture and the need to adjust it after the accession to WTO/ Voprosy ekonomiki, 2012 (to be published).

services, etc.), about 30% – for the support of consumers and less than 20% – for the support of farm producers.

It has to be admitted that some measures envisaged in the new State program are the most distorting for the market. The spiral of paying subsidies for the compensation of expenditures on servicing long-term bank credits is still progressing. One can avoid this in case the policies of providing state support are revised: subsidies for the purchase of machinery and equipment should be granted directly to producers¹ instead of subsidizing interest rate; funds should be invested in the support of science, education, the system of information and consulting, construction of roads and other forms of improving rural infrastructure, development of agricultural cooperation; subsidies should be granted on a per-hectare or per-head basis instead of supporting selected products and inputs. ●

1 Without binding these purchases to the production of a selected product.

NEW MINISTER, NEW LAW IN THE HIGHER EDUCATION SECTOR

T.Klyachko

In an interview to Rossiyskaya Gazeta daily shortly before taking office Mr. D. Livanov, the new RF Minister of Education and Science, made a number of critical statements concerning the higher education sector that stirred quite a huge public outcry¹. While already in office, the Minister somewhat changed the tune. Specifically, he held that the critical task is to tighten requirements to future university enrollees, while the number of budget-sponsored tuition grants for them is a secondary task. The Minister's reform proposals are grounded but hard to implement.

In an interview to Rossiyskaya Gazeta daily shortly before taking office Mr. D. Livanov, the new RF Minister of Education and Science, made a number of critical statements. Specifically, he noted that:

- 1) Requirements to future university enrollees must be drastically tightened;
- 2) It is not the number of universities which should be cut (which has been debated lately), but the number of budget-sponsored tuition grants therein, which supposedly should be halved; without these Draconian measures, Russia is set to shortly face a transition to free tertiary education;
- 3) Upon slashing the budget-sponsored university tuition grants, there would arise a possibility to acutely (also roughly twofold) bolster budget spending per budget-sponsored student from the current Rb 125,000 a year up to Rb 250,000;
- 4) In addition to trimming the number of budget-sponsored tuition grants, it is imperative to modify the structure of tuition of students concerned to make sure the said structure is better suited to meet the economy's needs, e.g. to expand engineering enrollment opportunities.

Let us consider to what degree these measures appear realistic. To begin with, it is worth noting that once in office, in response to an impassioned public reaction Mr. D. Livanov somewhat changed the tune. Specifically, he held that that the critical task is to tighten requirements to future university enrollees, while the number of budget-sponsored tuition grants for them is a secondary task. The dust has not settled however. Thus, Mr. O. Smolin, Deputy Head of the State Duma Committee for Education has recently noted that cutting the number of budget-sponsored tuition grants for university students would result in Russia's failure to transit to innovation-based development, as a modern economy demands that 60% of employees should hold a university degree².

It is worthwhile noting that in compliance with the current federal act "On education"³ public and municipal universities combined should have no less than 170 budget-sponsored students per 100,000 residents of RF. This means that a minimum number of budget-sponsored students should hit some 2.4mln in a few years to come. Consequently, a minimum budget-sponsored admittance, which should ensure compliance with the said legislative provision, should be no less than 485,000 students under the 5 year-long term of apprenticeship and no less than 500,000 students in the event of transition to the two-degree (the Bachelor's program and the Master's one) tertiary education system, providing that some 30–35% of budget-sponsored undergraduates would enroll in the latter program. That said, the figure underwent substantial modifications in the bill "On education in Russian Federation": it is proposed to establish that that number of budget-sponsored university students should account for no less than 800 students per 10,000 citizens of the age cohort of 17–30-years⁴. In the conditions of a demographic slump that would lead to a substantial

1 Solid-state science. Rossiyskaya gazeta, 22.05.2012. The federal issue № 5787 (114).

2 "Place for debate" TV show (Should budget-sponsored university tuition be cut?) of 23 July 2012 on TV-Centre Channel.

3 Federal Act of Russian Federation of 10 July 1992 № 3266-1 «On education».

4 *Ibid.*

contraction of the number of the budget-sponsored contingent in Russia's tertiary education institutions (*Table 1*).

Table 1
MINIMUM NUMBER OF BUDGET-SPONSORED STUDENTS AT UNIVERSITIES IN ACCORDANCE WITH THE EFFECTIVE ACT "ON EDUCATION" AND THE BILL "ON EDUCATION IN RUSSIAN FEDERATION"

	2012	2013	2014	2015	2016	2017	2018	2019	2020
Populace – total, mln*	142.9	141.9	141.1	140.7	140.4	140.0	139.7	139.5	139.2
The minimum number of budget-sponsored students per the effective Act, as mln.	2.43	2.41	2.40	2.39	2.39	2.38	2.38	2.37	2.37
The minimum budget-sponsored admittance to comply with provisions of the effective Act, as Thos. students	485.9	482.5	479.4	478.2	477.4	475.9	475.1	474.3	473.4
The minimum number of budget-sponsored students per the bill, as mln.	2.45	2.38	2.29	2.18	2.09	1.99	1.89	1.80	1.72
The minimum budget-sponsored admittance to comply with provisions of the bill, as Thos. students.	489.4	475.2	457.2	436.4	417.2	398.4	378.6	359.2	344.2

* The calculations are made using the Rosstat's forecast of the populace of RF through 2031 (a median variant).

As displayed by *Table 1*, in 2015, the gap between the minimum anticipated number of budget-sponsored university students calculated on the basis of the effective Act "On education" and the figure calculated on the basis of the bill "On education in Russian Federation" accounts for 210,000 or 8.8%, while in 2020 it is set to widen to 650,000, or 27.4%. Meanwhile, the decrease in the number of budget-sponsored students between 2015 and 2020 in the former case accounts just for 20,000, while in the latter – 670,000. As for the budget-sponsored admittance, its 2012 parameters with regard to the said variants are practically the same and, furthermore, they match the approved control admittance figure (hereinafter referred to as CAF) at the expense of the 2012 budget funds, which makes up for 490,000 (with account of budget-sponsored admittance to regional and municipal universities it further rises up to 510,000). It should be noted that CAF has remained unchanged since last year. Meanwhile, under the former variant, the minimum budget-sponsored admittance in 2015 is projected to be at 41,800 above the respective figure under the latter variant, and by 2020 the gap is to widen to 129,200 (i.e. by 37,5%).

However, what the bill suggests appears substantially different from the new Minister's proposal of cutting down the number of students twofold, i.e. down to 1.35mln., as the budget-sponsored cohort at universities currently stands at some 2.7mln students.

If one abstracts from the above legislatively set caps, ensuring the result Mr. Livanov cites, for instance by 2020, is possible only by means of a drastic slashing of the budget-sponsored admittance, which already in 2012 should have made up some 390,000. This means it should immediately have been cut by 100,000 student vis-à-vis the 2012 CAF. This would not have been plausible from the perspective of social stability, notwithstanding the Minister's belief in rationality of such a move.

The fact of the matter is the number of 11th graders hit its peak (1.3mln) back in 2006 and has been in decline ever since: 800,000 – in 2009, 600,00 – in 2011, and as little as 570,000 – in 2012¹.

1 Most notably, there is a huge gap between the Rosstat's data (the number of high school graduates awarded the high school diplomas) and the data of Rosobrnadzor, the agency in charge of conduct of USE. For example, Rosstat claims that in 2011 the diplomas were awarded to 600,000 high-school graduates, while Rosobrnadzor reckons there were 790,000 high-school graduates taking USE, of whom 97% passed the exams successfully. In other words, according to Rosobrnadzor, as many as 766,300 11th graders were to receive their diplomas in 2011. The calculations are based on the Rosstat's official data.

Table 2
THE BUDGET-SPONSORED UNIVERSITY
ADMITTANCE TO THE NUMBER OF 11TH GRADERS
IN 2006–2012 RATIO, AS %

Год	The budget-sponsored university admittance to the number of 11th graders in 2006–2012 ratio, as %
2006	45
2007	47
2008	52
2009	69
2010	73
2011	85
2012	89

Note: 2006–2011 – actual figures, 2012 – preliminary estimates, including admittance sponsored by the federal, regional and municipal budgets combined.

200,000 and 350,000 in a given year), but the “stock” has practically “exhausted” by now. But EVE and SVE graduates do not practically compete with high school ones. They, as a rule, enroll in correspondence or evening departments, and their USE grades are lower than ex-11th graders’. Meanwhile, those in pursuit of the second degree pay tuition fees.

The conundrum of Russian higher vocational education system (HVE) lies in the fact that many children from poor and middle-class households (it is them who largely form the cohort of EVE and SVE graduates) either pay for public universities’ tuition fees (as a rule, at evening or correspondence departments, for their educational services are far cheaper than charges for a full-time course), or enroll in non-public universities (which chiefly charge less for tuition than public ones and are very lenient toward poorly performing students). Meanwhile, budget-sponsored opportunities concentrate mostly at full-time departments which are a prime target for fresh high school graduates. That is why the Minister does not play cunning by claiming that Russia faces a transition to the general free higher education, albeit this concerns solely the HVE full-time segment. It is the most prestigious universities which still retain a relatively small contingent of fee-paying full-time students. Accordingly, the fork the higher education system currently faces in its advancement is either to raise requirements to the quality of schooling (“quality” of enrollees), ie. to set a fairly high USE grade-wise cut-off threshold with regard to budget-sponsored admission, or to reduce the number of budget-sponsored opportunities, but that would result in shutting down underperforming public universities (at this point, the Minister is right in arguing that the primary task is to regulate the number of budget-sponsored opportunities at universities, rather than the number of universities per se). But, a closer look allows assumption that there exists just one option, for having set fairly high cut-off grades for budget-sponsored admission, it will remain underclaimed². This means that actually they are cut. An alternative is an increase in the number of budget-sponsored opportunities at the evening and correspondence forms of education, but that would necessitate individual cut-off thresholds with regard to USE grades for enrollees pretending for budget-sponsored tuition at full-time, correspondence and evening departments, respectively. But this conflicts with the set by the Minister task of tightening requirements to university enrollees.

As concerns change in the structure of budget-sponsored admission for the sake of progress toward innovation economy, the current actual processes have so far refuted the respective need: the turn-out of engineers in Russia has proved to be above respective indicators overseas. And, as the Minister noted, the country does not need poor-quality engineers.

¹ The 2012 enrollment process is not over as yet.

² Already last year some 3,000 budget-sponsored tuition opportunities remained unclaimed.

In general, it can be ascertained that the new Minister's proposals on reforming the tertiary education system are grounded, but appear hard to implement. That is why their outcome would be limited to shutting down a few public universities and innumerable subsidiaries, which will be triggered by an acute decline of the student cohort due to demographic reasons (the fall will continue through 2020) and a great number of non-state universities (which indeed have performed poorly), rather than by the government's concerted efforts. Plus, a sizeable faction of under- and moderately performing universities will be taken over by their more successful peers. It can be anticipated that in this event the problem of liquidation of "weak" universities will be formally resolved, but to the detriment of quality of tuition at "strong" ones, for as Prime Minister D. Medvedev enunciated it at a meeting of the Open Government on consideration of the bill "On education in Russian Federation" on 25 July 2012, "Carthage must be destroyed. Weak universities must be shut down!" ●

DEFENCE CAPACITY AND QUALITY OF PUBLIC STATISTICS: THE BAGGAGE OF LESSONS UNLEARNED

V.Zatsepin

The national military-industrial complex has lately added to the public discourse a few fairly tempting ideas that promise an effective remedy to Russia's primordial mission of catching-up development, at least, as far as the task of ensuring the nation's defense capacity and bolstering military technology is concerned.

One of them is establishment of a Foundation of Promising Research, a clone to the US's DARPA¹, a new system of evaluation and strategic planning with a 30–50 year-long planning horizon², and even a Skolkovo-type military innovation town in the vicinity of Moscow³. Meanwhile, Russia's leadership consistently reaffirm their confidence in our compatriots' ability to ensure “breakthroughs” and create a “stock” by “cutting corners”. That is to say, we are likely to be set to outpace our global rivals thanks to special intellectual and moral qualities either solely of our researchers and engineers, or the whole populace. Small wonder that while presenting the Foundation at the Parliament on 4 July, Mr. D. Rogozin, Vice Premier, tagged it as some mighty “scientific-technical predator”⁴ and, confusing with much confidence fundamental research with applied one and research failures with breakthrough scientific achievements, effectively dodged the question of nature of the said “corners” and ways to “cut” them. That said, even a superficial analysis would expose the fact that there is the Government behind all those “corners”.

One of such corners is the quality of public administration. Underpinning its concept is not only political system, but the quality of public statistics and the role of the national security information. Poor statistics and stringent secrecy are the Russian bureaucracy's trade marks, and they have for long determined a unique image of the Russian state.

The above cast serious doubt over feasibility of the aforementioned simple, universally acceptable and audacious ideas, even more so Russia's record in this regard appears negative, rather than positive.

More specifically, on 16 May the State Duma was given quite a telling example of a poor quality of the official statistics used to manage the national military-industrial complex (MIC). Engaged in a Qs&As session after presenting a bill “On the state defense order”⁵ to the MPs, Mr. Yu. Borisov, the First Deputy Chairman of the Military-Industrial Commission under the RF Government ascertained⁶ that currently, “The number of bankrupt corporations <in the defense sector> is down by one-third. It can be argued that the situation has stabilized in this respect, thanks to the very drastic increase in the volume of the defense order over the past three years. The outflow – the fall in the number of enterprises, which accounted for some 5-7% annually – has decelerated today, and the situation has stabilized”.

It is hard to understand what kind of statistics MIC operates while preparing for presentations at the Parliament and which time span is covered by the “stable today”. According to officials who bear a significant responsibility for the MIC's advancement, between March 2011 and April 2012 the number of corporations enumerated in the consolidated register of enterprises of the military

1 Bill № 88170-6 «On the Foundation of Promising Research» submitted to the State Duma by the RF President on 5 June 2012; but the concept was announced yet in September 2010 <<http://www.kremlin.ru/transcripts/8985>>.

2 Decree of the RF President № 603 of 7 May 2012 «On implementation of plans (programs) of build-up and development of the Armed Forces of Russian Federation, other armed forces, military formations and bodies, and modernization of the military-industrial complex».

3 A military Skolkovo is to emerge in Russia // *Izvestia*. 2012. 31 May. <<http://izvestia.ru/news/526051>>.

4 Transcript of the State Duma Session of 4 July 2012 <<http://transcript.duma.gov.ru/node/3671/>>.

5 Bill № 31990-6 «On the state defense order» submitted to the State Duma by the RF Government on 6 March 2012.

6 Transcript of the State Duma Session of 16 May 2012. <<http://transcript.duma.gov.ru/node/3633/>>.

industrial complex tumbled from 1,729¹ to 1,353², ie 21.7% over the two years in question, or by an average annual 11.5%, or nearly twice as much as the figures the high official reported to the MPs. It goes without saying, there might be several reasons, as well as several justifications, for such an opportunistic behavior and information asymmetry, of which the simplest one could be a normal human factor.

But unfortunately, the data collected by the RF Ministry of Industry and Trade in accordance with the Federal Plan of Statistical Works does not add much clarity either. As Mr. I. Karavaev, the Deputy Minister, claims³ there are over 1,300 MIC enterprises in the country employing over 1.3mln. Several days later⁴, one of his subordinates reckoned that the number of employees in MIC was about 2mln. Whether the word “aggregate” in the latter update is indeed meaningful it is impossible to judge without checking the RF Ministry of Industry and Trade’s statistical data tagged as classified; however, the 700,000-strong (54%) difference needs a further explanation

No questions would be asked, had the Ministry concerned, as well as Rosstat, with its Unified Interdepartmental Information-Statistics Database, been published aggregate data by all the federal statistical observation forms (including №№ 1-PO⁵, 1-SR⁶ and M-GOZ⁷). Alas, this is impossible at present juncture, as these data are locked from, and not available to, both outsiders and, given the situation with the aggregate register of enterprises and the number of their employees, to the leadership of Russian MIC. There is no conundrum about this, as the Ministry of Industry and Trade has no statistical division. No doubt, statistics are collected there, for data from classified aggregate registers of MIC enterprises can be purchased from affiliated JSCs, but statistics-wise, our MIC management bodies generally are a failure. There is nothing new about this, unfortunately – during WWI, the Special Commission on State Defense established the Statistical Bureau only “thanks to vigorous pressure on the part of our former allies who nearly mocked us for the absence of badly needed statistical data”⁸.

So, not surprisingly, when it comes to MIC, the decision making style *a-là russe* implies largely “debates”⁹, aka “discussions”¹⁰. To better discern its effects for a not-so-distant year of 2020 (until then it is planned to spend Rb 20 trln for the armament program and another 1.8 trln – on modernization of MIC), as well as for the recent crisis period of 2008-2009 which saw the injection of Rb 120bln (equivalent of 0.3% of the nation’s 2009 GDP), it appears appropriate to examine detailed statistics of national accounts published by Rosstat since 2010.

As shown by the dynamic of gross value-added deflators (*Fig. 1*), the extra aid the Government provided to the MIC in the form of subsidies, purchases of equity and enterprise bail-outs mysteriously concurred with a significant price rise: e.g. ship-builders increased their prices three-fold over the two crisis years, while aircraft and conventional arms manufacturers’ appetite proved more modest and their price tags mirrored a “meager” 150% price increase¹¹.

1 Vice Premier Mr. S. Ivanov at a meeting with Pres. Medvedev on 19 March 2010.: «1,729 enterprises, which according to the official register, fall under the military-industrial complex». <<http://kremlin.ru/news/7146>>.

2 Deputy RF Minister for Industry and Trade Mr. I. Karavaev at an enlarged meeting of heads of enterprises of the radio-electronics sector on 3 April 2012: «The consolidated register of MIC organizations comprises 1,353 ones». <<http://www.minpromtorg.gov.ru/industry/radioelectronic/63>>.

3 I. Karavaev, quoted a saying at a meeting in Ekaterinburg on 20 April 2012 r. NAKANUNE.RU <<http://www.nakanune.ru/news/2012/4/20/22271445/>>.

4 Mr. O. Ryazantsev, Deputy Director of Department for Development of the military industrial complex of the RF Ministry of Industry and Trade: «Currently, the aggregate number of MIC employees is circa 2 mln. » // Russian Business-Gazette. 2012. 24 April (№ 16). <<http://www.rg.ru/2012/04/24/opk.html>>.

5 Data on production and supply of military (defense) produce.

6 Data on production costs and profit margin of military (defense) produce.

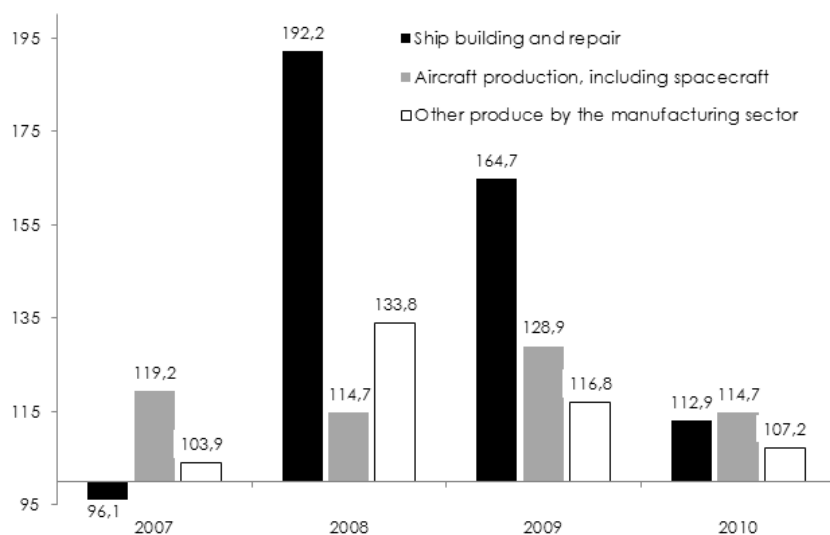
7 Data on contracts concluded, financing of the state defense order and arrears of public customers before organizations of the defense sector for defense supplies under the public contract, and on organizations’ wage arrears in the year under review.

8 The role of statistics in the area of supplies // The Russian state military archives. F. 46. Des. 10. F. 10. P. 110.

9 Putin V. Staying strong: national security warrants for Russia // Rossiyskaya gazeta. 2012. 20 February (№ 35). <<http://rg.ru/2012/02/20/putin-armiya.html>>.

10 <<http://kremlin.ru/news/7146>>.

11 In addition to weaponry and ammunition, nuclear materials and explosive substances, under the item “Other produce by the manufacturing sector”, Rosstat for some reason collects data on recycling of secondary raw materials.



Source: National accounts in Russia in 2003–2010: Collection of Statistics./ Rosstat. M., 2011. p. 210–211.

Fig. 1. Gross Value-Added Deflators across Kinds of Economic Activities (Detailed Development) in 2007–2010

After the aforementioned abnormal price rise for ship-builders' production during the crisis, the Joint Ship-Building Corporation's bold refusal to disclose the price structure of its produce to the Ministry of Defense may have a pretty banal explanation: it is just impossible to give a rationale for its prices (at least, without having investigative agencies involved).

The Russian leadership's confidence in massive financial injections in MIC being capable of starting the mechanism of innovation-based economic growth was hammered in the above debates and appears insufficiently grounded¹; plus,

not backed by credible statistics, it seems more like a parody of economic analysis.

In this connection, certain optimism is buoyed by Rosstat's efforts to develop new basic "cost-output" tables since 2011. By late 2015 the agency is going to publish such tables to cover 185 industries and 337 kinds of outputs². If successful, the undertaking will enable Russia to ultimately boast by 2020 a justified at the research level state armament program, providing the Interdepartmental Commission on Protection of Secrets of State, which once banned publication of the detailed 1995 tables, does not step in.

So, how one can cut the "corner" caused by a low quality of public statistics? The answer is, only by cutting the "corner" of secrets of the state first. That said, there is no better remedy to ultra-secrecy than statistics: annual public accounts by the Interdepartmental Commission on Protection of Secrets of State on the number of new classified and declassified documents, budget allocations on operations of agencies that protect secrets of state and on extra allowances to civil servants engaged in operations with classified data can become a first step of a long way.

At this point, an alarm bell is a total and utter absence of authorities' efforts in this respect: after the nation's leadership fairly shrewdly admitted the challenge in February³ and in April⁴, there have been no subsequent activities, while the May Decree on public administration simply omitted the matter⁵. But lost time is never found again, and it is not at all granted that the currently established Foundation for Promising Technologies would be able in principle to announce a tender competition for development of an automated disclosure technology, like DARPA⁶ did in September 2010, for the prevailing Russian mentality appears protective, rather than pioneer.

1 "Technological breakthroughs in individuals sectors related to the defense industry could not affect the general trend: because of closeness of this sphere, achievements were not used beyond it. This contrasts the US's practice of transferring solutions and ideas from MIC to the civil sector". Quoted by: Tsedilin L. Russian protectionism: the challenge of institutional legacy // *Voprosy Ekonomiki*. 2012. № 1. p. 110.

2 Mikheeva N. "Cost-output" tables: new possibilities for economic analysis // *Voprosy ekonomiki*. 2011. № 7. p. 143.

3 Putin V. *ibid*: "... the situation demands for a new attitude toward fundamentals of information exchange. Revision of obsolete approaches to protection of secrets".

4 D. Medvedev at a meeting of the Working Group on formation of the "Open Government" system of 10 April 2012: "... I receive all kinds of submissions to sign, <and they are> absolutely opaque. Indeed, it is not clear who will implement and how, and, naturally, they are all classified. One just has to hope for the responsible party's decency. It is time to clean house..." <<http://news.kremlin.ru/news/14995>>.

5 Decree of the RF President № 601 of 07 May 2012. "On main directions of improvement of the public administration system".

6 New Technologies to Support Declassification: Request for Information (RFI), Solicitation Number: DARPA-SN-10-73, Defense Advanced Research Projects Agency (DARPA), 9 September 2010.

Plus, the current domestic policy tendencies do not seem encouraging either, despite all the pep talk about transparency and open government.

It is just better statistics and a whole lot of transparency, which once again became a bugaboo, which would enable Russia to successfully close the gap with global leaders.

As for the aggressive, “breakthrough-stock-predator” rhetoric practiced by the national MIC establishment, it is just a proof of absence of an adequate appreciation of the challenges it currently faces, the prevalence of unprofessionalism in organization of public administration, and the authorities’ genetic propensity to Soviet-style *agitprop* methods. ●

INVESTMENT EXPANSION OF RUSSIAN CORPORATIONS AT THE PRESENT STAGE

A.Pakhomov

As of 2011 results, foreign direct investment (FDI) export from Russia has reached a record peak – \$67.3bn, surpassing the previous year indicator by 28%. In terms of the volume of FDI outflow, last year Russia took the 8th place in the world, and its specific share in the global outflows, the FDI made 4.0% as compared to the 27th position and the share of 0.3% in 2000¹.

Basic implications for export expansion of direct investments from Russia are general favorable macroeconomic situation and economic growth (at least before the fall of 2008), contributing to the development of Russian corporations, as well as a number of national legislative and administrative measures, including the liberalization of foreign exchange regulation and investment export².

In the post-crisis period, the basis of FDI exports from Russia is formed by export of venture capital by domestic companies, primarily through investments in overseas mergers and acquisitions (M&A), as well as implementation of new investment projects (greenfields) – over 40% of the Russian FDI. In addition, important export items are capital acquisitions of overseas real estate by legal entities and individuals (approximately 25%) and capital investments of equity funds owned by the Russians (about 20% of Russian FDI)³.

The milestone of domestic companies corporate policy in their approach to international capital markets is the desire to get a direct access to the strategic sources of raw materials, new sales markets, as well as to the modern technology and best management practices. The most effective ways to implement those objectives are the overseas M&A transactions, which are mainly used by Russian business in its investment expansion.

However, above all, such a massive FDI outflow is due to the lack of attractive investment opportunities in Russia in view of unfavorable business climate and challenges of the institutional environment in the country. In this context, from 2009, Russia is a net exporter of FDI, since due to the above problems, the level of foreign investment inflow is well below the outflow of Russian capital.

As a result, in early 2012 the accumulated capital investments of Russia abroad have reached \$362.1bn, which is 18-fold higher than the 2000 level⁴. Thus, a foreign segment of the Russian economy is in progress, the basis of which is the investment of 20–30 largest private and public non-financial corporations⁵.

In general, the official statistics in Russia gives a rather distorted picture of the scope and structure of domestic companies business activities abroad, primarily due to imperfect statistics and active use of offshore jurisdictions in the crossborder movement of capital. Therefore, for an adequate analysis of the sectoral and geographic distribution of the Russian investment abroad, it is necessary to use alternative sources of information and expert assessments.

Thus, as of mid-2012, according to the author's estimates, in terms of breakdown by industries, among the acquired foreign assets and projects oil and gas production and oil refining are still dominating (about 45% of the value of total assets of the Russian transnational companies (TNCs).

1 Indicators of FDI accumulated abroad (14th place in the world, 1.7% share) are insignificant as yet due to the relatively recent emergence of Russia in the world capital market as compared to the leading countries-investors. Calculated by the author on the basis of: World Investment Report 2012. Towards a New Generation of Investment Policies, UNCTAD, NY & Geneva, 2012, pp. 169–171.

2 For more details, see A.A.Pakhomov «Investment activity of Russian companies abroad: development trends, «Russian Presidential Academy of National Economy and Public Administration» “Delo”, M., 2011, p. 446.

3 A.V. Kuznetsov. Evolution of Russian TNC: from regional to global companies. Bulletin of the State Registration Chamber under the Ministry of Justice, 2011, No. 4, p. 7.

4 Central Bank data for the relevant years.

5 In view of the low competitiveness, the domestic financial sector (banks, insurance, stock market) is not represented in the global FDI markets with the exception of VTB and Sberbank (to some extent).

The second place is taken by transactions with ferrous and non-ferrous metals (30%), although the industry was seriously affected by the financial crisis and unfavorable situation in the global market, wherefore the sector's share is getting reduced.

Due to massive acquisitions, including those made by private funds of direct investments (PFDI), in the post-crisis period the third place was gained by telecommunications and IT companies (over 15%), which were the leaders in purchasing other businesses ahead of other sectors (about 15%), including production of mineral fertilizers, transport and logistics infrastructure.

A new and growing area of the Russian capital investment overseas in 2011-2012 was made in the development (construction and commercial activities in real estate market). In the high-tech area individual acquisitions were performed by Rusnano and a number of private funds of direct investments.

In particular, in the post-crisis period, a number of large transactions were foreign companies' mergers or acquisitions of their controlling interest, where the Russian party used to be a minority shareholder before the crisis, which reflects the extension of domestic business financial opportunities. Also a new phenomenon was the purchase of assets from foreign companies in the third countries, which indicates more flexible corporate policies in the area under review, including sectoral diversification of the overseas business.

At the same time, there was continued the practice of diversified by sectors acquisitions by the large domestic companies of the "second tier", as well as by small and medium companies, which due to their extensive character have already started to effect the total sectoral capital structure of domestic business abroad, including even the costs of those transactions.

In view of the sustained dominance of the Russian corporations engaged in energy resources and commodities sector overseas, it should be noted that the strengthening position of the companies, operating in other sectors of domestic economy, less dependent on the external cost factors, will lead to a large-scale and sustainable process of expansion of capital outflow from Russia, including in the field of M&A and greenfield projects.

In terms of geographic distribution, contrary to common understanding that business investment of domestic corporations abroad is mainly accumulated in the CIS countries (approximately 20%), statistical data and expert assessments demonstrate a further reduction of this region role in the Russian foreign assets allocation at the present stage¹.

Herewith, the share of European countries in foreign assets of domestic companies made about 50%, whereas in North America – 19%. At the same time, there was observed a trend of domestic business expansion in other markets, including the Tropical Africa (8%) and Asia (4%)². At the same time, in terms of sectoral breakdown of industries, regional deployment of the acquired assets can be significantly variable: for example, oil and gas assets of the Russian companies are primarily invested in the EU countries, and metallurgical industries are mainly based in the US and Canada.

According to the scope of available foreign assets (as of late 2010), the list of 100 largest non-financial TNCs from developing countries and transitional economies, compiled by UNCTAD, included 10 private Russian companies. The largest of them are LUKOIL, Evraz Severstal and Vimpelcom took the 9th, 39th, 42nd and the 50th place accordingly (*Table 1*).

In general, the leading Russian TNCs' positions are somewhat worsened as compared to the pre-crisis period. Thus, as per 2008 results, when for the first time UNCTAD included in its rating eight Russian companies, the top three of them, i.e., LUKOIL, Evraz and Severstal held the 8th, 23rd and 32th positions respectfully³. Traditionally, Gazprom is not included in the UNCTAD rating due to the lack of reliable data on the corporation foreign activities, although the scale of foreign assets of the gas monopoly, according to the Russian experts estimates, takes the second place, right after LUKOIL⁴.

1 Thus, the share of CIS countries in 2007-2009 in FDI exports from Russia made on average 7.5% and accumulated investments – 4.5%. Data for 2010-2011 demonstrate a downward trend in the share of the CIS countries' specific weight in the export of direct investment by Russian companies up to 4.5% and the accumulated investment – to 4.2%. Estimates on the basis of the Central Bank data for the respective years.

2 Investment from Russia stabilizes after the global crisis, M., IMEMO, 23 July 2011, p. 22.

3 See: World Investment Report 2010. Investing in a Low-carbon economy. UNCTAD, Geneva, 2010, pp. 18–19.

4 According to the in-house estimates of RAS Institute of International Economy and External Relations made in late 2009, foreign assets of LUKOIL were \$28.0bn, Gazprom – \$19.4bn, Evraz – \$10.4bn and Severstal – \$ 9.9bn. See: Investment from Russia stabilizes after the global crisis, M., IMEMO, 23 July 2011, p. 2.

Compared to the previous rating (2009), half of Russian companies (from the bottom of the list) have slightly improved their positions. Vimpelcom has made the most progress, which boosted their foreign assets by nearly \$5bn (due to the merger with the Ukrainian Kyivstar) and immediately took the 50th position in the UNCTAD rating.

Table 1

REPRESENTATION OF RUSSIAN COMPANIES IN THE TOP 100 NON-FINANCIAL TNCs FROM DEVELOPING COUNTRIES AND TRANSITIONAL ECONOMIES, RANKED BY FOREIGN ASSETS (OF LATE 2010)

Company	Industry	Position in the rating by foreign assets	Overseas business performance (\$ bn)		
			Assets	Sales	Number of employees
LUKOIL	Oil and Gas	9	23 317	71631	19607
EvrAZ	Metallurgy	39	9 356	8 702	24 251
Severstal	Metallurgy	42	8 701	7 370	14 100
Vimpelcom	Telecommunications	50	7 123	2 398	9 966
Sistema JSFC	Telecommunications	53	6 151	2 983	18 563
Mechel	Metallurgy	56	5 768	4 927	9 149
RUSAL	Metallurgy	70	4 483	8 696	8 932
Norilsk Nickel	Metallurgy	71	4 166	11 713	2 307
MTS	Telecommunications	83	3 120	1 906	6 385
TMC	Metallurgy	96	2 383	2 093	4 855

Source: UNCTAD. World investment Report 2012. Country Fact Sheet: Russian Federation, Presence in the top-100 non-financial TNCs from developing countries, ranked by foreign assets, 2012, p.2.

The greatest losses were incurred by the leading companies: Severstal has reduced its assets by \$2.3bn due to the sale of several plants in the US and as a result, lost at once 15 points in the rating, and Evraz lost over \$1bn due to write-offs of its assets and dropped down by 8 points. Similar problems were experienced by "Sistema" JSFC and MTS.

In sectoral terms, commodity sector corporations of Russia are dominating (six metallurgy holdings, three telecommunication businesses and one oil and gas company) in the UNCTAD effective rating, while in other developing countries, such as the BRICS group, the activities of the largest national companies are more diversified: they operate in the fields of telecommunications, finance, construction, customer service, transportation, etc.

According to the index of transnationalization (TNI)¹, which reflects the degree of globalization of corporate activities, the leading Russian companies Evraz and LUKOIL held only the 55th and 63rd positions in the rating, and the majority of domestic corporations were almost at the very end of the list, which indicates a low transnationalization of their activities against the international level.

In global terms, absolute performance indicators of the Russian corporations abroad are quite modest in general. For example, the threshold for inclusion in the key UNCTAD rating of the top 100 non-financial TNCs as per the scope of foreign assets, in 2011 made \$30bn². Consequently,

1 Transnationalization index is calculated as the average of three ratios: foreign assets vs total assets, foreign sales vs total sales and foreign employment vs total employment in a particular company.

2 UNCTAD. World investment Report 2012. The world's top 100 non-financial TNCs, ranked by foreign assets in 2011, p. 4.

according to the author's estimates, LUKOIL (\$24bn) and Gazprom (\$20bn) could theoretically be only at the beginning of the second hundred among global TNCs by this indicator, which demonstrates the low level of competition, even of the leading Russian companies, especially those of public sector in the world markets¹.

In general, an analysis of the Russian companies activities with foreign assets shows that meanwhile it is characterized by low efficiency and relatively low management quality, as well as poor feedback from the national economy. At the same time, for the time being, there is still no deliberate state policy in Russia in regard to domestic business overseas. Although the Government support to the Russian companies (state-owned corporations in particular) in the implementation of individual projects abroad has somewhat strengthened in recent years, there is still a lack of integrity and consistency of this policy².

However, domestic companies are enhancing their competitiveness, expanding and diversifying their business abroad by purchasing the missing production capacities and competencies, as well as by incorporating into global production networks or creating their own full-cycle chain.

In prospect, with available adequate public policies and a number of macroeconomic conditions (as demonstrated by experience of other countries), the implementation of such policy can promote the growth potential in the relevant sectors and the national economy in general. Thus, obtaining a direct access to the latest technologies and best practices is an important factor in the country transition to innovative development.

Therefore, at present, FDI exports and Russian business overseas are actually the relative advantages of the country, which should be addressed to real strengthening of Russia competitive position in the global investment market. In turn, this can boost a multiplier effect on the development of other forms of foreign activities and economic sectors. ●

1 In the FT-500 rating (the largest global companies by market capitalization) for 2011, Gazprom took the 33rd place, Rosneft – 79th, Sberbank – 86th and LUKOIL – only the 132nd position. <http://www.ft.com/reports/ft500-2011>

2 A.A.Pakhomov, "Foreign expansion of Russian companies: trends, volume, obstacles". «Current trends in the market of mergers and acquisitions», ed. By A.D. Radygin, "Delo", Moscow, 2010, pp. 315-316.

THE REVIEW OF THE ECONOMIC LEGISLATION

I.Tolmacheva

In July, amendments were introduced in some spheres of the legislation related to the activities of non-profit organizations which perform functions of a foreign agent.

1. Federal Law of the Russian Federation

1. Federal Law No. 121-FZ of July 20, 2012 of the Russian Federation on INTRODUCTION OF AMENDMENTS IN INDIVIDUAL STATUTORY ACTS OF THE RUSSIAN FEDERATION AS REGARDS REGULATION OF ACTIVITIES OF NON-PROFIT ORGANIZATIONS PERFORMING FUNCTIONS OF A FOREIGN AGENT.

In accordance with the adopted law, non-profit organizations which engage in political activities and receive financial aid and (or) other property from foreign sources ("foreign agents") will be put under special supervision. It is to be noted that a non-profit organization will be recognized as a participant in political activities in the territory of the Russian Federation if irrespective of the goals and objectives specified in its founding documents it participates (including by means of funding) in organization and holding of political actions in order to influence such decisions by public authorities as are aimed at changing of the state policy pursued by those authorities and formation of the public opinion for those purposes.

Non-profit organizations performing the functions of a foreign agent will be obligated, in particular, to do the following:

- submit an application to be included in the register[□] of non-profit organizations performing the functions of a foreign agent;
- specify in materials published and distributed by the mass media or the Internet that such materials have been published or distributed by a non-profit organization which performs functions of a foreign agent;
- submit audited financial reporting to the authorized body on an annual basis, a report on its activities and personnel of the managing bodies -- once in six months and documents on goals for which funds and other property were used -- on a quarterly basis;
- place information on its activities in the Internet once in six months.

For willful avoidance of obligations imposed on non-profit organizations performing functions of a foreign agent, an administrative and criminal responsibility up to a two-year imprisonment has been established.

Operations related to receipt by non-profit organizations of funds and (or) other property from foreign sources is subject to mandatory supervision if the sum of the operation is equal or exceeds Rb 200,000 or the equivalent of that amount in foreign currency. Rosfinmonitoring has been entrusted with that function.

The Law will come into effective on October 21, 2012. ●

REVIEW OF THE MEETINGS OF THE GOVERNMENT OF THE RUSSIAN FEDERATION IN JULY 2012

M. Goldin

In July 2012, the following issues were discussed at meetings of the Government of the Russian Federation: development of the institute of regulatory impact assessment in the Russian Federation; federal draft law on education in the Russian Federation.

On July 13, at the meeting of the Government of the Russian Federation the issue of development of the institute of regulatory impact assessment in the Russian Federation was discussed. The report on that subject was delivered by A.R. Belousov, Minister of Economic Development of the Russian Federation.

The institute of regulatory impact assessment (RIA) or regulatory impact analysis appeared in the second half of the 20th century in OECD countries when they tried to reform their system of public administration.

In an OECD document, the RIA is defined as “a mechanism of methodical identification and assessment of benefits and costs of proposed regulatory norms. The RIA represents the main instrument which ensures quality of regulation and, at present, it is utilized by almost all the OECD member-states, the European Commission and many countries with a transition economy[□]”. Within the frameworks of OECD activities, the RIA concept was developed as a list of 10 items enclosed to the Quality Regulation Guidelines of the OECD Council which came out in 1995. In addition to the above, in 1997 the OECD formulated and published the RIA advanced methods (OECD, 1997).

In the report by A.R. Belousov, general parameters of the RIA institute in Russia were presented. In particular, a definition of the RIA as a set of regulatory procedures permitting to assess primarily the possible effect of regulatory decisions was given. Also, it was stated that in carrying out assessment conclusions and costs of entities of regulation were analyzed and comprehensive evaluation of social and economic consequences was made.

It was also stated that the RIA institute under another name operated for a long time within the frameworks of the activities of the Ministry of Finance of the Russian Federation in order to prevent unjustified financial liabilities to be assumed by the Russian Federation.

In mid-2010, the second stage on implementation of the RIA institute began. The goal of that stage consisted in establishment of obstacles on the way of introduction of unjustified administrative limitations for business in the spheres of control and supervision, licensing, compliance assessment and establishment of requirements to products and related processes.

From mid-2012, the third stage of implementation of the RIA institute began; its goals and purposes were specified in Decree No. 601 of May 7, 2012 of the President of the Russian Federation on the Main Guidelines of Upgrading of the System of State Management.

The new third stage of the RIA implementation will be carried out by the following four lines:

- Switchover to the regulatory impact evaluation directly by federal executive authorities;
- Application of the RIA procedures in the sphere of tax and customs legislation;
- Application of the RIA procedures to draft laws prepared for the second reading;
- Promotion of the RIA institute to the level of constituent entities of the Russian Federation.

On July 26, at the meeting of the Government of the Russian Federation the draft Federal Law on Education in the Russian Federation was discussed. The new law is to replace the effective one – the Law of the Russian Federation on Education -- which was passed in 1992 because the above law cannot at present fully regulate relations in the sphere of education. The Law of the Russian Federation on Education entails problems and uncertainties in respect of many aspects of the system of education (for instance, as regards the status of approximate educational programs, electronic educational resources, activities of non-government educational establishments, a procedure for networking between educational establishments and other entities, credit and modular system of

provision of paid educational services and other); also such excessive administrative restrictions related to the typology of educational establishments as complicate their development still remain. The new draft law is meant to eliminate the above problems. In addition to the above, the draft law introduces novelty as regards:

- credit and modular system of organization of educational process and the system of scores (credits);
- networking in implementation of educational programs, including the mechanism of offsetting of results of education in individual parts of the educational program in outside entities;
- utilization of remote educational technologies in the educational process;
- education on the basis of integrated educational programs;
- educational and information resources in the education process and other. ●

AN OVERVIEW OF NORMATIVE DOCUMENTS ON TAXATION ISSUES IN JUNE–JULY 2012

L.Anisimova

In June – July 2012 special attention in the field of taxation attracts, of course, budget message of the RF President to the Russian Federal Assembly, “On the fiscal policy in 2013–2015”.

1. The priority tasks, outlined in the Budget message, are as follows. The Russian government is assigned to develop the directions of further formation of the RF pension system, to submit proposals on the indicators of its development by September 2012 at latest (P. 6). The RF President said that the indicators should be considered when designing a draft budget for 2013 and for the planning period of 2014 and 2015, as “the stability and predictability of economic and social development of the Russian Federation, and above all predictability of fiscal policy are largely dependent on the parameters of the pension system”. The required volume of transfers from the federal budget and the role of the National Welfare Fund to ensure sustainability of the pension system also depend on the selection of parameters for further development of the pension system. Investors’ confidence in the policies of macroeconomic stability would be enhanced, if they are well informed of the terms and funding of the pension system”. One cannot disagree with such a formulation of the problem. Indeed, the vision of the Russian government of the role and tasks of pension provision largely depend on the level of tax burden on business. There is much to discuss in this issue, but the criterion of correctness in outlining the objectives of economic policy will be addressing of investment financial flows to the real economy sector.

The RF President urges the Russian government to shift tax policy focus from the fiscal aspect to the economic one (p. 7). It is important to note the fact that a different approach to the role of fiscal policy, rather than the previously attributed to it incentive function (what is usually justified by the introduction of new benefits). The Budget message emphasizes the need to consider the interests of compliant taxpayers: “We need to take sustained measures to prevent attempts of tax evasion. The tax burden is painfully perceived by compliant taxpayers, while others businessmen engaged in the same economic conditions are evading taxes. This is not just the issue of budget revenue shortage, which could be used in the public interests, but also inequality in economic activity conditions”.

Another important task, which is highlighted by the RF President, is to create a comfortable environment for the taxpayer’s administration. Thus, we see fundamental changes in approaches to organization of the tax system in Russia, at least at the level of senior management; there is a clear understanding that businesses need comfortable and competitive environment, since only a growing business can really solve the problems faced by the Russian government in their daily activities. There is good reason for the President to stress that “the tax system of the Russian Federation should be competitive with the state tax systems of other countries struggling in the global market to attract investment in their national economy”.

Another important task is to restore own revenue base of regional and local budgets. Over the past decade, it became evident that the existing approach to refund losses incurred by the regional budgets from the federal budget due to the decisions taken at the federal level, does not prevent “washing out” of the financial resources from the regions. Basing on certain conjunctural reasons, benefits are often granted at the federal level on federal and regional taxes, forming the revenue base of the regions (income tax, tax on physical entities’ profit tax, land tax, tax on property of organizations, etc.). Replacement of lost revenue base of regional budgets by subsidies and subventions from the federal budget leads to their financial dependence on the center and threatens economic stability. As a result, there takes place a gradual restitution of the centralized financing of regions by artificial multiple-factor indices, developed by the ministries. Meanwhile, if the regional budgets had their own tax sources that would not be the objects of initiative decisions of higher authorities (whatever motivation is behind them), it would strengthen the economic

base in the regions. It is noted in p. 8 of the Budget message the RF President: "... it is necessary to implement a plan of gradual abolition of benefits, established at the federal level, which result in the revenue shortage of regional and local budgets. ...The heads of regions and municipalities should have complete information on crediting the relevant proceeds to regional and local budgets, to assess the effectiveness of measures taken to expand the revenue base. Therefore, it is necessary to establish cooperation between tax authorities and relevant bodies of executive power of the Subjects of the Russian Federation and local self-governments..."

We believe that all the above-mentioned objectives, outlined in the Budget Message of the RF President to the Federal Assembly, are the priorities for the development of the market tax system in Russia.

2. In connection with the Budget Message of the RF President one can raise a question about another legislative initiative to reform the economic area, which was earlier proposed by the previous President, and now – the Russian Prime Minister Dmitry Medvedev. We are talking about amendments to the Civil Code, submitted to the State Duma in spring 2012. Pursuant the draft Federal Law No. 47538-B, it is proposed to amend Parts one, two, three and four of the Civil Code. The amendments are aimed at further development and strengthening the institution of private law in the Russian Federation with regard to the decisions of higher courts for improvement the mechanisms for the protection property of individuals and legal entities in conformity with international law, impose the requirements of fairness on the part of managers and shareholders with respect to the corporate property (the burden of proof of their actions integrity in the courts lies with the management of organizations), simplify and unify the legal forms of business activity. However, the draft law involves a lot of innovations, which relevance is not obvious, and the adoption of which can significantly complicate the tax issues, including: a pledge of goods in circulation (maintenance of minimum balance of inventory) by the pledger, a pledge of management agreement, a pledge of obligations and rights, including rights under the guarantee of bank account (it is proposed to extend the rules on the pledge of rights under the account agreement to the guarantee of rights under the contract of bank deposit), etc. These special innovations, in our opinion, require further review of their adapting to current legal practice on taxation. Here are some examples.

The need for a special pledge of account, the pledger for which acts the bank itself is not entirely clear. The Bank provides loans to customers from the money, placed by other customers with interest. Before providing loans, the bank checks the pledge that ensures the credit. The rights for the account, to which in future the money could be deposited, cannot serve as a pledge. Banks cannot finance the deal secured by their own assets, since for them it's a violation of the Bank of Russia financial regulations, which entails license revocation. The transfer of a deposit as a means of bank guarantee does not require the opening of a special pledge account – the bank can simply withhold the money when transferring it to the depositor and claim losses through the court. Strictly speaking, the bank usually just lends to the client, who needs money. If the term "pledge account" will still be introduced, in the current system of bank accounts, it apparently could be one of the bank activities to manage customer accounts for a commission (the bank may on behalf of a client reflect the operations with this account and transfer the received funds to repay the debt of the client to the pledger account, opened with the same or another bank).

Additional investigation, in our opinion, requires the concept of an independent guarantee. The draft law (Art. 368) specifies that "under an independent guarantee the guarantor undertakes at the request of another person (the principal) the liability to pay to the specified third party (the beneficiary) a certain amount of money in accordance with the terms of the guarantee irrespective of the fact, if the guarantee obligations are effective". It seems, that according to the amendments, the basic commitment may be initially null and void (void deliberately?), but it does not affect the obligation of the guarantor.

In accordance with Art. 376, the guarantor has the right to suspend payment for not more than 7 days, if it has reasonable grounds to believe that any of the submitted documents are unreliable. After this deadline, if there are no grounds to reject the claim of the beneficiary, and the guarantor is obliged to make payment. With the consent of the principal, the guarantor shall

promptly make payment under the guarantee, even if there are grounds to reject payment. Losses from unreliability of documents the guarantor is likely to recover through the court (Art. 375.1).

Innovations reviewed in the proposed wording apparently will require to include judicial decisions in the tax practice. The pledge relationship is not business activity, regulated by banking license, but the amendments directly align it with the system of bank accounts. Guarantee provision is not an independent business, regulated by the bank license, but the amendments relating to the guarantee permit transactions under deliberately misleading primary documents that hinder the recognition of transfer of ownership for the goods (works, services) for tax purposes. It is also unclear, how to account losses for the tax purposes in case one of the parties terminates negotiations (Art. 434.1), as formally there were no business activities, etc.

It is clear that the urgency of the bill development was dictated by the expiration of the presidential powers and the need to complete the work on incorporation of legal practice in the legislation, including the decisions of the judicial system, but the draft law contains provisions of the special (sectoral) regulation, and probably it will be difficult to be adopted in one package. Unfortunately, Experts' opinion on those issues was not published. Lack of professional research will inevitably result in the delay of the document adoption. Apparently, it will be adopted by parts upon expert assessments. In our view, it is very important, that all innovations in general and sectoral legislation are accompanied with appropriate amendments and supplements to the text of the RF Tax Code. In the absence of such parallel collaboration, there is a potential threat of the budget system losses.

3. One cannot neglect other issues, that are not directly outlined in the Budget message and in the draft amendments to the RF Civil Code, but which, in our opinion, should also be addressed as soon as possible. Still, one of the major problems that hinder the economic development of the Russian Federation is the excessive centralization of government power, which makes almost impossible to solve pressing problems: the ministries and other agencies interact with each other only under the assignments of higher authorities (the RF President and the Government). Perhaps, the management hierarchy in Russia is excessively overloaded with such forms of governance as the ministries and agencies that carry out a detailed regulation of specific industries, but the market economy is very mobile, and regulatory documents are often generated by concerned structures, which control each other's activities through participation in self-organized associations.

To a lesser extent than to the ministries, bureaucratic shortcomings are inherent to the state companies, as they are directly operating in the market. Perhaps we should review more closely the state-owned companies as a form of economic regulation by indirect methods that can manage the economy "in the field" by allocation the budget funds on a returnable and paid basis. Despite the negative attitude to the public companies developed in the community, perhaps, under certain conditions they can ensure rapid economic development in various areas and regions, as they have financial and technical resources, and in addition, can make investment decisions on their own. To this end, we need to transform them into a kind of investment centers, through which the money on the returnable basis would be transferred from the budget to the economy (except for investments in resource industries, financial services, defense, trade, alcohol and tobacco production, import purchases, etc.)¹.

It is also advisable to consider the possibility of forming a consolidated group of taxpayers namely for such associations, since the purpose of the consolidated group is to create a consolidated pre-tax profit of some organizations to cover the losses of other ones.

Granting the right to form groups of consolidated taxpayers without any restrictions on the ownership and activities led in 2012 to a sharp reduction of the tax base for corporate income tax and losses to the regional budgets². As a result, unprofitable organizations were simply "trading" their losses, assisting profitable organizations to exclude profit from the taxation. If requirements for consolidation are tightened and it is allowed, for example, to state-owned companies to cooperate

1 Unlike private companies, the government can determine the organizational form, the goals and objectives of the statutory activities of public companies.

2 As per the RF Ministry of Finance estimates, up to 10% of relevant revenues of regional budgets.

with those organizations to which they granted a target loan for business development, and thus allow to reduce the amount of the tax base by the amount of the target loan (until repayment of this loan to the lender), then from an economic point of view it would be, we believe, more reasonable. In the event the investment project happens to be unprofitable, losses of the borrower would be consolidated with the amount of the loan issued by the lender (lender profit, temporarily excluded from taxation). Targeted nature of the loan would ensure its accountability to the lender. Assets of the lender have the budget origin and their safety is monitored by the state. With this approach, a public corporation would be interested to invest profits in targeted loans and track the return on such loans, because otherwise it would just lose money transferred to it. The difference between these loans from the bank loans is that they do not require a guarantee: these are the budget assets, rather than temporary free funds of private entities. Accordingly, the lender may, upon consent with the owner of funds, allocate them into risky and long-term investments. At the same time, the targeted nature of the loan allows the lender to monitor the use of loans, and if necessary, make the approved amendments to the loan agreement.

This proposal should be regarded only as one of the attempts to find an alternative to the rigid executive “vertical”, which is excessively bureaucratizing the process of economy management.

In June and July 2012 a number of regulations and documents on matters of taxation were adopted, which are of great practical importance for the taxation of small businesses.

4. By the Federal law No. 94-FZ of June 25, 2012, substantial amendments were made to the Tax Code, relating to the system of special tax regimes.

1) Russia is transferring to the priority of the patent system of tax for small businesses. The patent system was introduced as a special tax regime by Chapter 26.5 of the RF Tax Code. The patent system was introduced in the closed list of works and services. There are some restrictions in the application of patent system: the number of employees should not exceed 15 people, the potential revenue – not less than Rb 100,000 and not more than Rb 1m. The patent is not applicable, if the permitted patent activity is carried out under an agreement on simple partnership (joint venture) or the contract of property trust management. Subjects of the Russian Federation have the right to increase the criterion of return by 3–5 times on certain activities, and for certain types of activities – up to 10 times (lease, retail trade and catering). The patent system provides exemption from VAT (including imports), personal income tax and property tax for an individual (for businesses allowed to use the patent system).

The request for a patent is transferred by mail or by electronic communication means not later than 10 days prior to the application of the patent system by the taxpayer. A 5-day term is set for tax authorities for review and issuance of notice (in case of rejection – within 5 days after the decision). The rejection reasons are listed in the text of the RF Tax Code. With the loss of the grounds for the patent, the taxpayer should notify tax authority within 10 days. A patent is granted for a period of 1 calendar year (or a shorter term). The tax rate for the patent is set at 6% of income. Tax return is not required under the patent system. For each patent separate tax reporting is recorded in the account book of receipts and expenditures. Tax levied in the framework of the patent system at the rate of 100% is credited to the budgets of municipalities.

In connection with the patent status of a special tax regime, amendments were introduced to the Federal Law “On Mandatory Pension Insurance» No. 167-FZ of 15.12.2001. For individual entrepreneurs using the patent system, lower rates of insurance contributions to FIU for a transitional period are applied (except for a patent issued for the lease of property, retail trade and catering services).

Individual entrepreneurs, who plan to use the patent system from 01.01.2013, need to apply for a patent not later than 20.12.2012.

2) Agricultural producers (whose share of income from the sale of agricultural products is at least 70%), fisheries employing up to 300 people, agricultural consumer cooperatives (which are subject to 70% limit provided to agricultural producers) have transferred to the system of imputed

agricultural tax, which significantly reduces the administrative barriers for small businesses in these areas.

Organizations and individual entrepreneurs can still use both, unified tax on imputed income (UTII) for those activities that are regulated by the relevant Chapter of the RF Tax Code, and the agricultural tax (for agricultural and other activities, other than regulated under UTII). The limit of 70% is assessed on the basis of all these organizations and activities carried out by individual entrepreneurs.

Notice on transfer to agricultural tax shall be filed not later than 30 calendar days from the date of registration with the tax authority, and at the termination of such activity the taxpayer should submit a notification to the tax authorities within 15 days.

The text of the RF Tax Code Chapter includes a provision that in assessment of tax base for agricultural tax all taxes paid are excluded, except for the agricultural tax.

Provision on the agricultural tax to be paid through the accounts of the Federal Treasury departments is excluded from the RF Tax Code. But since according to the RF Budget Code the budget accounts are maintained through the system of Treasury, the exclusion of such provision from the Tax Code can be regarded as a technical version. The amendment to the RF Budget Code revises the standard of crediting agricultural tax to local budgets (the share is increased from 35% to 50%) to the budgets of municipal territories (from 60% to 70%) and to the inter-settlement areas (from 50% to 100%).

Restrictions set in the RF Tax Code for the taxpayers to transfer to STS (simplified tax system) are changed. It is allowed to apply STS to the taxpayers – individual entrepreneurs engaged in the manufacture of excisable goods, production and sale of minerals. Income criterion set by Art. 346.15 and 346.25 for the right to transfer to simplified tax system was increased from Rb 20m to Rb 60m. For organizations the criteria for switching to STS is adjusted: the limit of Rb 100m is sustained only to fixed assets, while intangible assets are excluded from this limitation. A 30-days term is established for filing a notice with tax authorities to transfer to STS and 15 days – from the date of termination of such activities

Patent regime as part UTII is excluded. Editorial error, allowing transition to UTII to individuals engaged in maintenance and other services (storage, parking) of cars only, are applicable also to motorcycles.

3) The text of the first Part of the RF Tax Code is supplemented with a general definition of the deflator coefficient used in the tax base assessment. The right to determine the deflator coefficient is delegated to the Ministry of Economic Development. It is specified in the amendments to Art. 11 of the RF Tax Code: “The coefficient set annually for each subsequent calendar year and calculated as the product of the deflator applicable for the purposes of the relevant chapters of the Code in the preceding calendar year and the coefficient that takes into account changes in consumer prices for the goods (works, services) in the Russian Federation in the preceding calendar year”. Let us recall that before the mechanism of calculating deflator coefficient was established through court procedure. According to the court decision, the coefficient deflator for the current year was set by multiplying the index of price changes over the entire period from the regulatory definition of the reference price, and this approach for a long time caused objections from the Ministry of Finance and Ministry of Economic Development, which believed that the coefficient should be calculated only for one year. In accordance with the Federal Law No. 94-FZ of 25.06.2012, deflator coefficient for 2013 is assumed to be 1. With the patent system, the deflator coefficient is applied to the potential income, established by relevant criteria.

5. Federal Law of the Russian Federation No. 97-FZ of June 29, 2012 has introduced amendments to the RF Tax Code, which caused heated debates in the State Duma on clarification the issue of taxation of interest on corporate Eurobonds. The essence of the problem faced by the Russian issuers paying interest on loans placed abroad is that issuers and their agents were not ready to keep track of recipients of interest and identify their tax jurisdiction for the assessment and deduction of taxes in accordance with the Russian legislation and international agreements on the avoidance of double taxation. To overcome the situation, which threatens the Russian issuers with large losses in terms of image and economical damage due to the accrual of penalties, the

Russian government was forced to introduce a temporary benefit, providing for exemption from withholding tax on income paid to foreign corporate bond issues undertaken during the period from 2007 to 01.01.2014

Herewith, from 2012, there established a common procedure for withholding tax on income from emitted securities with mandatory centralized custody in respect to issues, which state registration or ID assignment were made after January 1, 2012 (with regard to the above mentioned temporary benefit). For the income paid to the entity entitled to receive such income being a foreign entity, the tax is assessed and withheld by the depository, making payment (transfer) of the said income to the taxpayer. ●

CHANGES IN THE REGULATORY BASE OF THE BUDGETARY PROCESS

M.Goldin

In July 2012, in the regulatory base of the budgetary process the following main developments took place: by amendments to the Tax Code of the Russian Federation authors of intellectual outputs on claims to grant them the right to use intellectual outputs the exclusively right to which belongs to another person (a compulsory license) were exempted from payment of state duties; until January 1, 2015 individual provisions of statutory acts of the Government of the Russian Federation related to granting of federal budget funds have been suspended.

By Federal Law No. 100-FZ of July 10, 2012 on Amendment of Article 333.36 and Article 333.37 of Part Two of the Tax Code of the Russian Federation and Article 8 of the Federal Law on the Skolkovo Innovation Center, authors of intellectual outputs on claims to grant them the right to use intellectual outputs the exclusive right to which belongs to another person (a compulsory license) are exempted from payment of state duties.

It is to be reminded that in accordance with Article 1239 of the Civil Code of the Russian Federation, at request of the interested person the court may take a decision to grant that person on the basis of conditions specified in the court ruling the right to use intellectual outputs the exclusive right to which belongs to another person (a compulsory license). Such instances are specified in Article 1362 and Article 1423 of the Civil Code of the Russian Federation.

Also, Federal Law No. 100-FZ of July 10, 2012 specified the name of the authority (envisaged by Federal Law No.244-FZ of September 28, 2010 on the Skolkovo Innovation Center) whose approval is to be secured in respect of amendments made in the founding documents of the managing company which is in charge of the project organization and implementation. The above amendments were necessary due to the fact that by Decree No.878 of June 18, 2012 of the President of the Russian Federation on The Council on Modernization of the Economy and Innovation Development of Russia under the President of the Russian Federation the above authority – the Commission on Modernization and Technological Development of the Economy of Russia under the President of the Russian Federation – was transformed into the Council on Modernization of the Economy and Innovation Development of Russia.

By Resolution No. 712 of July 13, 2012 of the Government of the Russian Federation on Suspension of Some Statutory Acts of the Government of the Russian Federation in Connection with the Federal Law on the Federal Budget in 2012 and the 2013-2014 Planned Period, until January 1, 2015 individual provisions of statutory acts of the Government of the Russian Federation related to granting of federal budget funds to the Fund for Facilitation of Development of Small Companies in R&D, the Russian Humanitarian Research Fund and the Russian Fundamental Research Fund have been suspended. ●