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## RUSSIAN ECONOMY: TRENDS AND PROSPECTS

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## THE RUSSIAN ECONOMY IN JUNE 2012: PRELIMINARY DATA AND MAJOR TRENDS

*The political background in June was shaped in the main by the authorities' attempt to launch an unprecedented crackdown on the Russian protest movement. In anticipation of the opposition's next demonstration set for 12 June, a new, tougher version of the law on public rallies was hastily adopted. The size of fines as envisaged in that law has destroyed the entire logic of the administrative penalty system: thus, it appears that the penalties for administrative law violations committed during mass protest marches are to be much higher than those to be imposed for similar violations unrelated to political protests, and they also exceed in their magnitude the penalties for crimes envisaged in many articles of the Criminal Code. Besides, early June also saw some active measures undertaken by the Investigation Committee in connection with the so-called "6 May riots". The investigation team numbers some 180 officers, thus giving some idea as to the scale of the planned case against the opposition. Thirteen persons have been officially charged, and on the eve of the 12 June rally the protest movement's leaders were subjected to house searches. The detainees' counsels declare that their clients are being forced to testify against the opposition leaders. Russian Human Rights Ombudsman Vladimir Lukin issued a special statement where he compared the way the investigation was conducted with the similar political case against the opposition organized by Alexander Lukashenko after the 2011 presidential election.*

*In late June, President Putin made public a new version of the law on the elections to the Council of the Federation; this new wording differs from the previously discussed draft law in that it has lost one of its key points, namely the intended rating-based voting for candidates to the Council of the Federation nominated by the executive authority; and it has been augmented by an absurd provision that a Council's member cannot be recalled by the body that has delegated him or her. The law, if adopted in this wording, is not going to increase the prominence of the Council of the Federation in the existing political system, because the senator admission mechanism will remain effectively unchanged.*

*Meanwhile, in the second half of May and early June, Vladimir Putin's rating and the estimates of the current situation in the country were on the decline, and towards the end of June (after the period of pre-election mobilization) these indices were almost at the level of their historic lows recorded in late 2011.*

*Another remarkable development in June was the establishment of the President's Commission for the Strategic Development of the Fuel & Energy Complex and Environmental Safety, whose responsible secretary became Igor Sechin, the president of Rosneft. This fact in part confirms our assumption that the new government under Dmitry Medvedev is not going to enjoy much authority, and that the central management and decision-making will be in the hands of the RF President's Executive Office. One stipulation from the Provision on the Commission to the effect that its decisions adopted within the sphere of its competence shall be mandatory for the federal bodies of executive authority, the bodies of executive authority of RF subjects and bodies of local self-government reminds one of the Soviet experience when major decisions in the economic sphere were made by relevant commissions of the USSR Communist Party's Central Committee, and not by the Council of Ministers of the USSR.*

**The macroeconomic background** in June was traditionally shaped by the developments on the world markets. In the month's first half the general outlook was pessimistic due to the negative news from the eurozone and the slowdown of economic growth in the USA and China. However, the formation of a new government in Greece and its determination to keep that country in the eurozone, followed by the EU summit which softened the rules for granting financial aid, gave rise to some optimism on the markets. As a result, oil prices, after having declined over the period from 31 May to 21 June by 12.25% (ICE Brent) below \$ 90 per barrel, towards the month's end rose by 9.2% on

the historic low recorded on 21 June. The growing oil prices strengthened the ruble, and so in late June the bi-currency basket's value effectively returned to its level of early June (Rb 36.64 as of 30 June against Rb 36.46 as of 1 June), although during that month, in response to the behavior of oil prices, its value sometimes was as high as Rb 37.73 and Rb 37.36. MICEX index was mostly on the rise in the course of June, and so at the first trading session in July it surged above 1,400 points; the overall growth of MICEX index in June amounted to 8.1%, and that of RTS index – to 10.6%.

However, the core of the issue is just how long this upward trend demonstrated by oil prices is going to last. Any further news of a slowdown in the USA and China's economies will be working against it. The downgraded forecasts of the world economic growth rate in the next few years coupled with fluctuations on the energy market have triggered an impressive wave of analytical reports containing predictions that oil will be cheapening. Evidently, such opinions expressed by experts have urged the Russian authorities to adjust their expectations. Thus, in the RF President's Budget Message it was announced that a new budgetary rule was to be introduced whereby the base oil price was to be calculated as a five-year average value (\$ 92 per barrel for 2013). It should be reminded that early this year the Russian government's officials were firm in their rejections of the plans for such a dramatic reduction of permitted expenditures. But now the five-year average oil price appears to be far more realistic than the price planned by the government for this year (\$ 115 per barrel).

The inflation rate observed in May (0.5%) remained at the same level in June (0.5% by the results of four weeks). Thus, for the first time, the June inflation rate will be higher than the same index recorded in 2011 (0.2%). As in May, in June the main locomotive of the price growth were the prices of fruits and vegetables (3.8%); however, contrary to the situation in May, the prices of petrol did not change. This summer, some significant inflation-triggering effects will result from the planned indexation of the tariffs for services rendered by natural monopolies and the housing and utilities sector. At the same time, the factors working in the opposite direction will be the slow growth of money supply throughout the year 2012, the low demand level, and the seasonal cheapening of foodstuffs. However, in the opinion of the Bank of Russia's Chairman Sergey Ignatiev, no deflation can be expected in August. The monetary authorities believe the forecasted per annum inflation rate of 5–6% to be realistic, although as of the end of June the accumulated inflation rate was already at the level of 3.2%.

The situation with regard to liquidity in the banking sector saw no improvement in June due to the renewal of currency sales by the Bank of Russia in the framework of its currency interventions (thus reducing the volume of liquidity being made available by the regulatory body via net currency purchases). Simultaneously, the volume of banks' outstanding debt against direct REPO operations is on the rise: over the month's second half, it increased to Rb 1.4 trillion. The elevated demand for liquidity displayed by banks influences the rates on the interbank lending market (in May and June, Mosprime 3M was fluctuating in the interval of 6.75–7.25%).

On 15 June, the Bank of Russia decided to leave unchanged its rates of refinancing and the interest rates on its main operations. At the same time, from 18 June onwards, the parameters of overnight currency swaps were altered: the interest rates were lowered from 8% to 6.5% per annum for ruble-denominated operations; from 0.25% to 0% for the ruble/US dollar instrument; and from 1% to 0% for the ruble/euro instrument. This measure is designed to make it cheaper for commercial banks to attract liquidity secured by foreign currency.

**The developments in the real sector** over the period of January-May 2012 were determined by the simultaneous growth of both consumer and investment demand. In early 2012, the improved situation in the construction investment complex was increasingly influencing the economic situation. Growth of investments in fixed assets in May alone amounted to 107.7%, and that over the period of January-May – to 112.1% of the corresponding indices for the same periods of last year.

Consumer demand growth, just as in the previous months, was largely determined by the increasing scale of consumer crediting. Thus, growth of retail turnover rose to 107.2% above the values recorded in January-May 2011, and to 106.8% above those recorded in May 2011 (the volume of payable services rendered to the population rose to 103.9% and 101.2% respectively). Meanwhile, the real incomes of the population in May 2012 grew by only 3.6% on May 2011 (real wages – by 11.1%). And the amount of credits granted to physical persons rose 1.41 times on May 2011.

*The industrial production index over January–May amounted to 103.4% of its value recorded over January–May 2011, and in May 2012 – to 103.7% of its value recorded in May 2011. This growth rate was triggered by accelerated growth in the processing industries (growth over January–May to 104.8% on January–May 2011, and in May alone – to 107.0% on May 2011). Meanwhile, the extracting industries are nearly stagnating (99.7% in January–May 2012 as compared to January–May 2011; and 101.2% in May 2012 as compared to May 2011).*

*A negative effect on the extracting sector's indices was produced by the shrinking natural gas extraction (in January–May 2012, extraction dropped by 1.9% on the corresponding period of 2011). Gas exports over the same period of 2012 amounted to 87.4% of the level recorded in January–May 2011. A positive contribution to the extracting sector's development was made by production of means of transportation, the metallurgical industry, and the timber processing industry. And the indices of light industry and the production of machinery and equipment in May 2012 declined on May 2011.*

*The economic surveys conducted by the Gaidar Institute have provided no indications of any prospects of an industrial leap in the nearest future. The very slow growth of the industrial optimism index (3 point over the 3 previous months) finally halted in May: that month, none of its components displayed any positive changes. The index of forecasts in industry based on the forecasts of demand, output and employment hit its historic low of the last 29 months.*

*The slight surge in demand observed in the first spring months later on gave way to stagnation. In May, the share of “normal” estimates remained at the level of 57%, which is higher than in January (48%) but is below the post-crisis period's historic high registered in October 2011 (64%). The estimates of industrial production's dynamics point to a slowdown in output growth by another 7 points; i.e., over the last two months the estimates have dropped by 15 balance points. The industrial plans of enterprises have not changed and remain at the level of the worst parameters recorded for those months. As a consequence, the revival of workforce recruitment in the spring effectively came to a halt in May. The enterprises, having assessed their prospects for demand growth, and having accordingly adjusted their output plans, decided to hire no more new personnel.*

*Overall credit availability in Q2 remains stable, as demonstrated by enterprises' estimates. Since this year's beginning, that index for industry as a whole has remained within the range of 70–72%. At the same time, the decline of the average minimum interest rate on ruble-denominated credits offered by banks was halted in May. Over the month, that index for industry as a whole rose from 12.1% to 12.4%, thus hitting its historic high of the last 11 months. The rising rates had no effect whatsoever only on the biggest companies (those with over 1,000 employees). ●*



## THE POLITICAL AND ECONOMIC RESULTS OF JUNE 2012

S.Zhavoronkov

*In June 2012, Igor Sechin effectively reestablished his former status of the fuel and energy complex's supervisor when he succeeded in creating the President's Commission for the Strategic Development of the Fuel & Energy Complex and Environmental Safety, headed by Putin himself. Sechin became the Commission's responsible secretary, thus adding a formal instrument to his personal influence. Neither the St. Petersburg International Economic Forum nor the President's Budget Message produced any sensations. One noteworthy point is the promise not to raise until 2018 the taxes unrelated to raw materials; however, the Message does not rule out the possibility that taxes may indeed be raised in 2012 and thereafter remain stable. The news in the political sphere is that now all regional and municipal elections in Russia will be taking place on the same day in September instead of two days in March and October; so, election campaigns will be held during the period of summer vacations, thus further strengthening United Russia's influence.*

In June 2012, a number of important developments took place in the public and political sphere in connection with the introduction of new legislation on elections and public rallies; besides, all the posts in the RF Government were filled, and its leaders made public declarations concerning this country's future economic policy (at the St. Petersburg International Economic Forum and elsewhere).

The newly introduced legislation on public rallies has eclipsed in the eyes of the public the other new amendments to legislation whereby all regional and municipal elections in Russia will be taking place on the same day in mid-September starting in 2013 instead of the presently established two voting days in March and October. In effect, this law – which has been initiated by the executive authority and adopted with the support of *United Russia* and the LDPR – will mean that the election campaign (including the collection of signatures) will have to be conducted at the height of the summer vacation season, when many voters – primarily those with high incomes – will be vacationing outside their voting districts, which will reduce the already bleak prospects for voter turnout at regional and municipal elections where, if they do not coincide with a federal election, no more than one-third of all voters actually come to the polling stations. Besides, this law has aimed a mighty blow at the election campaign organization itself, because hardly anybody can afford to be thus occupied for three or four months in a year except the official staff of the bodies of executive authority of different levels servicing *United Russia* and the official candidates. What this can lead to has already in part been demonstrated by the early mayoral elections in Omsk and Krasnoyarsk (which were held outside of the single voting day framework). In Krasnoyarsk, voter turnout was 21.2%; in Omsk – 17.3%. In relatively well-off Krasnoyarsk (where he also enjoyed support from his popular predecessor Piotr Pimashkov), *United Russia's* candidate Edkham Akbulatov took 69.37% of the vote. In poverty-ridden Omsk where, in December 2011, CPRF came ahead of *United Russia* even by the official results of voting, *United Russia's* candidate V. Dvorakovsky managed to capture 49.35% of the vote and also won the election. By way of comparison, *United Russia* suffered heavy losses in March at the mayoral elections in Yaroslavl and Togliatti, where two-thirds of voters turned out for the balloting.

The focus of public attention, however, was the new legislation on public rallies hastily adopted in the wake of the events that took place on 6 May 2012. The new law introduces numerous innovations. Among the most important ones there is the ban on wearing masks at rallies; besides, the persons who have been sentenced twice in the course of one year for the organization of unauthorized rallies are not allowed to submit applications to hold authorized rallies; the fines to be imposed on the organizers of and participants in unauthorized actions, as well as for various violations of public order, have been substantially increased. However, it should be added that the previously established size of the fines was indeed rather low – in the range from Rb 500 to 1500.

During the discussions that took place within a month's period, the initially suggested rates of fines were brought down from about, say, Rb 1m to Rb 300,000 for the organizer of an unauthorized act where property has been damaged; to Rb 100,000 for a participant in such an act; and to Rb 20,000 for a participant in such an act without aggravating consequences. Considering the fact that public order crime (including without any political motivation whatsoever) is a rather common feature of Russian life, this form of punishment does not appear to be something extraordinary. Besides, in terms of Russian life, of far more importance was the practice of holding public actions in the course of which it was possible to detain the organizers and participants even in an authorized act and accuse them of a refusal to submit to the lawful demands of the police (up to 15 days of administrative arrest), or of violence against the representatives of authority (which could even imply a term in prison, although "violence" could simply mean that somebody pushed the policeman who was trying to detain him or her), etc. The new law also implies that regional authorities may set up special areas for holding mass rallies and prohibit any events of this sort to be held outside of those areas. By way of summing up, it can be said that some of the norms stipulated in the new law (for example, the ban on wearing masks) are reasonable, while others (the incoherent wording of the definition of "an unauthorized act", or of the so-called "Hyde park" outside of which any such acts may be further restricted) will only worsen the already problematic situation with regard to freedom of meetings. However, such steps were predictable in view of the authorities' general departure from their democratic promises made in December 2011, coupled with the lack of clarity in the ranks of the opposition.

This year, no sensations were reported from one of the main arenas for economic declarations – the St. Petersburg International Economic Forum. RF President Vladimir Putin announced the plans to invest citizens' pension savings in *long-term bonds for the funding of infrastructure projects* that would be both profitable and secure. When speaking of the medium-term perspective, President Putin noted that the Russian Federation needs a budget with a high safety threshold, which can be achieved by lowering the dangerously high margin established for the non-oil-and-gas deficit. In this connection, it is intended to adopt, in a while, new budgetary rules whereby spending obligations will not be pegged to current price of oil (although what form this will take is still unclear. – *Author's note.*).

Among Russia's competitive advantages, Putin noted the low unemployment rate – less than 5.4%, "much lower than it was prior to the crisis"; the decline of the inflation rate to 6.1%; GDP growth by 4.3%; a high level of foreign direct investment – eighth in the world; the successful performance of the Russian Direct Investment Fund created last year, which attracted \$ 800m from foreign investors; and the fact that this country did not deviate from the principle of free capital movement. At the same time, Putin actually said nothing about how to deal with Russia's most notorious economic issues – the high and constantly increasing capital outflow over the last few years; the continuing growth of government expenditure; and corruption. For example, corruption was assessed as follows: "...*No doubt, this is a complex task, and recently we have spoken often and a lot about it. Of course, this problem cannot be solved easily, but it is equally impossible to pretend that it does not exist. It is necessary to talk about it and to look for appropriate instruments that can be applied in solving it*". It must also be mentioned that the St. Petersburg International Economic Forum provided no answers to any of the relevant smaller issues raised by Russian officials: the fate of the halted implementation of the Shtockman natural gas deposit project. Over a period of four years, a total of more than a billion dollars was spent on that project by the joint venture established by Gazprom, Total and Statoil, but so far they have not yet begun any drilling, let alone gas extraction.

Besides, Vladimir Putin released his Budget Message. In it, he traditionally emphasized the high dependence of the RF budget on raw materials markets, low cost-effectiveness of implemented budget expenditures, and the frequent amendments to tax legislation. A newly mentioned point was the high dependence of the budgets of RF subjects on the higher-tier budgets. As a solution, it is proposed that a large document should be prepared – a budget strategy until 2030 – which must be linked to the plans of this country's socio-economic development. It is pointed out that, by September 2012, the government must determine the "parameters for further development of the pension system", so that these could be taken into consideration when preparing each year's

budget. In addition, it is promised that at the same time the tax load on those sectors of the national economy that are not linked to raw materials will not be increased until 2018 (however, it is added that tax rates will have to be raised later on before the end of the year 2012 – after which, in theory, they must remain at the same level for six years; this means, in particular, that 2012 may see “for the last time” an increase of the rates of insurance contributions, the government currently discussing this possibility). Instead of cuts on government expenditures, the principal solution is considered to be the struggle against tax evasion, which will somehow be combined with simplification of tax report forms.

As expected, the government’s presidium considered the privatization program for the period of 2012–2013, effectively placing a ban on the privatization of at least the biggest companies, and more likely – on that of all the more or less sizable ones. All the discussed sales among those planned for 2012–2013 (*Sberbank*, *VTB*, *Rosnano*, *Rosagroleasing*, Open-end JSC *Rossiiskie zheleznnye dorogi* [Russian Railways]) will involve the sale of those blocks of shares that will have no impact on the controlling stakes (the biggest stake earmarked for sale is in *Ob’edinennaia zernovaia kompania* [United Grain Company], but even in this case its size is only 49%). As for the other promises concerning the privatization of big complexes, these – similarly to the four-year period of Dmitry Medvedev’s formal leadership – are a thing of a distant future (at the moment, “until 2016”, but there is no doubt that the line will be moved further away, “towards the horizon”). Instead, the markets will be now and then faced with some puzzling declarations voiced by government officials to the effect that the controlling stakes in Rosneft or Sberbank may eventually be sold, while the real presence of state-owned companies in the economy will only be increasing under the pretext of additional capitalization. Besides, it is intended to add more secrecy to the activity of state companies, and to no longer resort to the procedure of tender. In June, Prime Minister Dmitry Medvedev signed a decree approving the law on the purchasing procedures for companies with state stakes of more than 50% that comes in force only in 2012; from now on, state companies may make secret purchases not only for formal reasons like state secret, but for any reason at all – for example, “commercial secret”. The decision-making on such issues is to be the prerogative of the RF Government. And as for the two tenders planned to be held in June – the sale of a block of shares in *Apatit* was called off, while the results of the tender for an additional emission of shares in *Ob’edinennaia zernovaia kompania* (where *Summa Group* was declared to be the winner) are being disputed by the Federal Antimonopoly Service.

June’s most relevant development in the sphere of public administration was the establishment, by Vladimir Putin, of the President’s Commission for the Strategic Development of the Fuel & Energy Complex and Environmental Safety. Putin himself headed the Commission, while its responsible secretary (and so effectively its unofficial head) became Igor Sechin, the president of *Rosneft*. The Commission is composed of directors of big oil companies and several top government officials, including (as its rank-and-file member) Vice Prime Minister Arkady Dvorkovich, whose responsibility in the government is to supervise this country’s fuel and energy complex. It is established that *the Commission’s decisions adopted within the sphere of its competence shall be mandatory for the federal bodies of executive authority, the bodies of executive authority of RF subjects, and bodies of local self-government*. Putin and Sechin’s Commission is to be responsible not only for oil and gas, but also for transport and the electric power industry – in fact, this used to be Sechin’s sphere of competence in the former cabinet of ministers. Thus, in less than a month, Sechin reestablished his formal status enabling him to meet with Vladimir Putin on a regular basis, in the presence of other industrialists and government officials, and to formally proclaim certain decisions. By doing so, Igor Sechin has demonstrated that he is going to remain the real supervisor of the fuel and energy complex, although formally he will only be one of the several appointed directors of state companies.

Among the personnel reshufflings at the federal level, a noteworthy event is the notice given in by Roman Trotsenko, head of the United Shipbuilding Corporation, who explained his move by his conflict with Minister of Defense Anatoliy Serdyukov. The latter, in Trotsenko’s opinion, attempts to determine in a dictatorial manner issues like the construction of ships of certain class, research and development, approaches to financing and pricing, etc. Simultaneously, the Federal Service for Defense Order (*Rosoboronzakaz*) that organizes trading with regard to the Military-

industrial Complex is no longer subordinated to the RF Ministry of Defense, and from now on it will be supervised by the RF government, although the Service's director L. Vorobieva, previously appointed by Anatoliy Serdyukov, has retained her post. Thus, the acute conflict between the directors of contractor companies and the Minister of Defense that has lasted for over a year is still going on.

As expected, the reshufflings in the Ministry of Internal Affairs are continuing – head of its Inherent Security Department (and former FSS official) Yuri Draguntsov was dismissed from his post, as were head of the Investigation Department Valeriy Kozhokar and Deputy Ministers Alexander Smirny and Sergey Bulavin (the latter having been in charge of the reform of the police service). They were replaced by Yuri Alexeev (who became head of the Investigation Department), Igor Zubov (who had been Deputy Minister more than a decade ago), and Mikhail Vanichkin (former head of St. Petersburg Main Directorate of Internal Affairs in the first half of the noughties). So, the new Minister has managed to put together his own team and eliminate all the alternative centers of gravity within the Ministry<sup>1</sup>.

Olga Dergunova, member of VTB's board of directors, was appointed head of Rosimushchestvo (its former head Yuri Petrov left his post in late December 2011 when he became Deputy of the State Duma).

The new ombudsman for entrepreneurs' rights became *Business Russia's* Chairman Boris Titov. He is renowned in the Russian business community as a campaigner for lowering taxes, especially VAT, while at the same time he has never specifically cared for any given sector, or dealt with any specific business interests; his association differs from *Opora Russia* in that it has no regional affiliations. His political career is unimpressive: at first he was a member of *United Russia*, then became co-chairman of *Pravoe delo* (Right Cause), but none of his doings have brought him any fame. The ombudsman, according to Vladimir Putin (who presented him to the public), will be endowed with the right to defend the interests of businesses in a court of justice, suspend departmental normative acts until a relevant court decision is to be adopted, and to apply to a court of justice for the suspension of government officials' acts. The new business right activist became notorious on his very first day in office when he called for freedom for Mikhail Khodorkovsky, and then promptly took back his words. Most probably, nothing serious can be expected from his activities. ●

<sup>1</sup> At least two of the people who have been dismissed, Sergey Bulavin and Yuri Draguntsov, had been considered as potential candidates for the post of Minister.



## INFLATION AND MONETARY POLICY

N.Luksha

*In May inflation accelerated to 0.5% (versus 0.3% in April), having matched the figure of a similar period of 2011. Within 18 days in June consumer price index reached 0.4% as compared with 0.2% in 2011. As a result, the cumulative inflation since the beginning of the year reached on 18 June 2.7%, which is almost twice lower than at the same period of 2011. In May and in early June ruble was weakening: exchange rate of the Russian currency during this period versus the dollar has declined by 16 % (as of June 5). As a result, in May, for the first time since January 2012, the RF Central Bank went to the market with the sale of currencies to support the ruble, remaining, however, by the end of the month its net buyer. In May, the Bank of Russia has expanded the ability of banks to raise the ruble liquidity from the Central Bank of Russia: lending to banks under the foreign currency deposits was resumed. On June 18 the Central Bank reduced interest rates on operations with “currency swap” for a period of 1 day.*

After the April inflation slowdown, in May the index of consumer prices has reached 0.5%. The same value of inflation in this month was observed in the past, in 2010. The May inflation acceleration was associated with a significant increase in the rate of growth in prices for foodstuffs and commercial services to population.

The growth rate for food prices in May made 0.6% (against 0.2% in April). The main contribution to the rise in prices has made by fruit and vegetable products, which increased by 5.8%. In addition to fruit and vegetables, bakery products, meat and poultry, all kinds of food items monitored in May became cheaper or the prices were not rising. The most significant decline in prices in May were noted for eggs, which fell down by 17.1%. In April prices for milk and dairy products have declined as well (-0.1%).

The growth rate of prices for industrial goods in May was stable and made 0.4%. This is twice lower than in 2011. Like in the previous month, prices for tobacco products rose most significantly (+1.3%) and gasoline (+1.4%). At the same time, audio and visual goods decreased in price by 0.2%.

In May the rate of growth prices has increased more than twice for commercial services (+0.7%). This is explained by seasonal factors: May is the beginning of mass holidays period, when traditionally prices rise on passenger transport (3.3%), foreign tourism (2%) and healthcare and recreational services (1.7%).

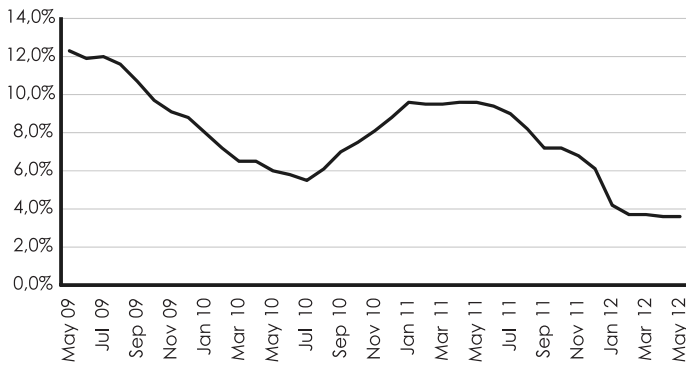
Annual inflation (May 2012 against May 2011) at end of the month has not changed and amounted to 3.6%, which is the lowest indicator in the history of monitoring (*Fig. 1*). Thus, inflation in Russia remains significantly lower than in the last year.

In May, for the first time in this year, the basic consumer price index<sup>1</sup> dropped to 0.2%. For the last time such index was recorded in April 2010. The slowdown in core inflation indicates a low contribution to monetary factors in inflation.

Within 18 days of June consumer price index made 0.4%. Please, note that the inflation for the first time has exceeded for the first time not only the rate of the previous in year, but in general the indicator of June 2011 (0.2%). The main contribution to the rise in prices in June was brought by fruit and vegetables, which rose in price by 4.2–4.4% per week. At the same time, due to falling global oil prices, the growth rate in gasoline prices has dropped significantly and amounted to 0.1% as of June 18. The cumulative of inflation since the beginning of the year on June 18 made 2.7% (against 4.9% in 2011).

Apparently, in May, the trend of inflation slowing gave way to its acceleration. In summer a significant inflationary pressure will have a planned for the July indexation of tariffs for natural

<sup>1</sup> The core consumer price index reflects the level of inflation on 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 Statistics Service (Rosstat).



Source: RF Statistical Service.  
 Fig. 1. The Growth rate of the CPI in 2009–2012  
 (% year to year)

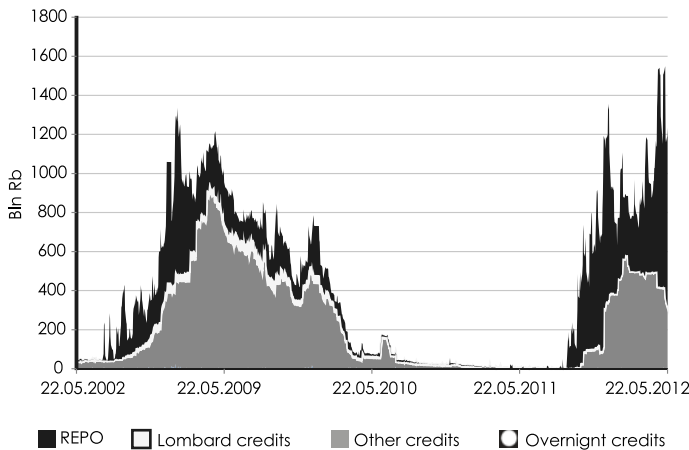


Fig. 2. Indebtedness of commercial banks  
 at the Bank of Russia in 2008–2012

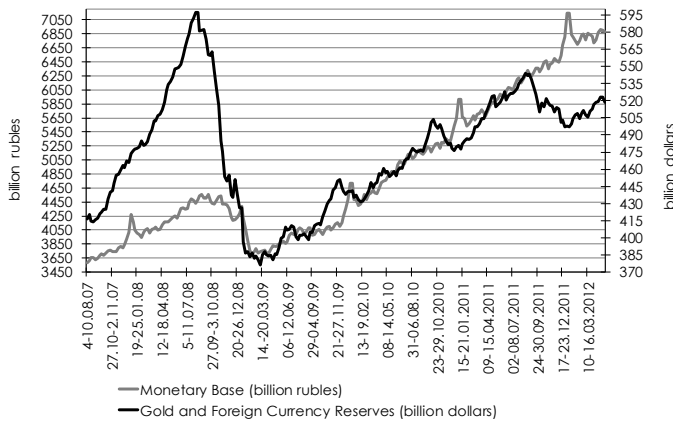


Fig. 3. Dynamics of the RF monetary base (in narrow definition) and gold and foreign currency reserves in 2007–2012

monopolies and public utilities. At the same time, the inflation factors are hindered by slow growth in monetary supply, throughout 2012, as well as seasonal fruit-term reduction in price of products in July and August. May reduce the effect of exchange rate may not lead to an acceleration in inflation due to low demand.

The May effect of ruble exchange rate reduction may not lead to an acceleration of inflation due to low demand in the May volume of broad monetary base does not change and amounted to Rb 7.7279 trillion on June 1. We would like to note, that after the April sharp decline in deposits of credit institutions with the Central Bank in May they have grown by third to Rb 112.2bn.

The growth of banks' deposits with the RF CB on the one hand, and the continued reduction of correspondent accounts of commercial banks in the Bank of Russia (in the last month they got down by 4% or to Rb to 595.7bn), on the other hand, led to the fact that the excessive reserves of commercial banks<sup>1</sup> in May, were virtually unchanged, having made Rb707.9bn (-0.2%) by the end of the month. The increased demand for liquidity with the banks provides pressure on the rates in the interbank market (in May and June, the indicative rate of Mosprime 3M ranged within 6.75-7.25%).

In June the liquidity situation has not improved due to resumption of foreign currency net sales by the Central Bank in the framework of foreign exchange interventions. Thus, the volume of liquidity provided by the Regulator through net purchases of currency has declined. At the same time, the debt of banks under direct repo is growing: in the second half of the month it reached Rb 1.4 trillion (Fig. 2).

Monetary base in narrow definition (cash plus mandatory reserves) in May has remained virtually unchanged, amounting to Rb 7.02 trillion at the end of the month (Fig. 3).

Since late April to mid-June, with the exception of one week from June 2 to 8, international reserves of the Central Bank

have reduced. In six weeks, their volume decreased by \$11.1bn, or by 2%, to \$512.2bn as of June 15. The decrease in the volume of international reserves was primarily due to the strengthening USD against euro and the dollar equivalent of a corresponding reduction in reserves, denominated in euros.

1 Under the excessive reserves of commercial banks in 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.

In May, at the background of the ruble exchange rate weakening, the Bank of Russia for the first time since the beginning of the year went to the market with sales of foreign currency, though their amount was relatively small – \$276.4m. At the end of the month the Bank of Russia still remained a net purchaser of currency: foreign currency interventions amounted to \$1.2bn and Euro 99.45m (Fig. 4). At the same time, the Central Bank currency purchases in May were reduced nearly 2.5 times as compared with the previous month.

Minor foreign exchange interventions of the RF CB confirm its inflation targeting and minimizing the foreign exchange market operations. In addition, the maintenance of the ruble rate by selling foreign currency would cause a further reduction in liquidity of the banking system.

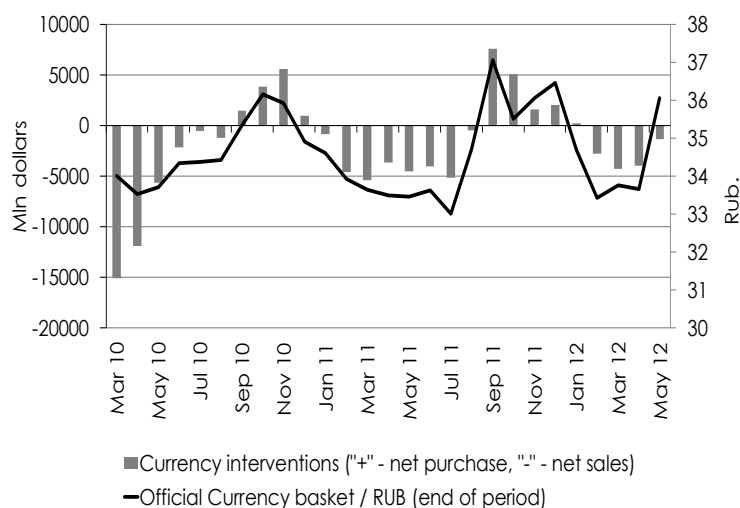
In May, the real effective exchange rate continued to decline (-2%). As a result, the index of real effective exchange rate fell down to 152.51<sup>1</sup> (Fig. 5).

Throughout May and early June, the ruble was weakening. Since the beginning of May to June 5, it fell against dollar by 16%: on June 5, for the first time since April 2009 the exchange rate of the Russian currency fell down to the level of Rb 34 to \$1. During the same period, the downgrading of ruble against euro has been less significant, 8.8%: on June 5, euro has exceeded Rb 42. The main reason for Rb decline has been energy falling prices: in early June, oil prices fell below \$100 per barrel.

Being a currency of commodity, ruble follows oil prices fluctuation, which resumed the decline, having reached at the level of late 2010. This is a reaction to the worsening debt crisis in Europe (a decrease of Spain credit rating), slowing down of Chinese economy and the negative news from the US (the speech of B. Bernanke, MPC has not met the expectations of investors about the third phase of quantitative easing QE-3).

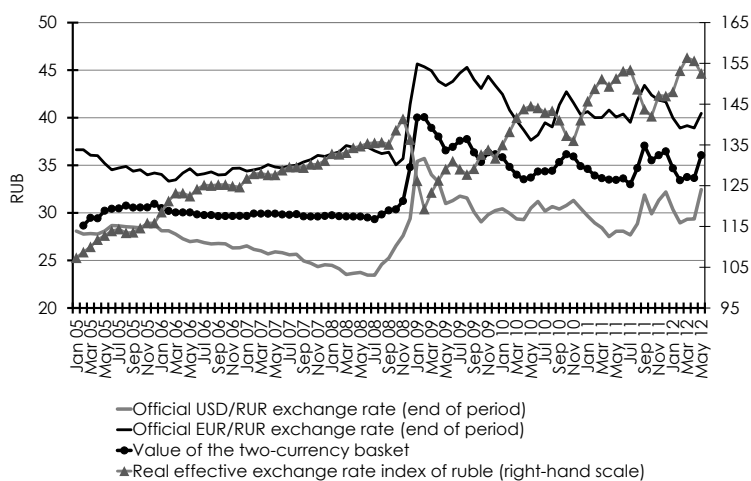
As a result of 23 days of June, the dollar exchange rate fell down by 3.3% to 33.52 rubles. Dollar. During the same period, the Russian towards the European one has cheapened 3.9%, to Rb 42.05. As a result, the two-currency basket has increased by 3.6% to Rb 37.36. A similar level of the two-currency basket was reached in September 2011 after a smooth ruble devaluation of the ruble.

On June 15 the Bank of Russia has decided to remain unchanged the rate of refinancing and interest rates on the basic operations of the RF CB. At the same time from June 18 the operations of “currency swap” for a period one day, were changed: interest rates were reduced from 8% to 6.5% per annum for the ruble transactions, from 0.25% to 0% for “Rb-\$” instrument and from 1% to 0% “Rb-euro” instrument. This step of the RF CB was aimed at making cheaper to attract liquidity for commercial banks under security of foreign currency. As a result of significant Rb weakening in



Source: RF Central Bank, author's estimates.

Fig. 4. Central Bank Currency Interventions and Dynamics of Ruble Exchange Rate in March 2010 – May 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%.

May – early June, foreign exchange assets of banks have grown. The adopted measure encourages the banks to raise the required ruble liquidity from the RF CB under the guarantee of available foreign currency.

On May 22 the RF CB has informed on the resumption of direct repo transactions with the banks under the security of shares included in the Lombard list of the RF CB. This step was taken by the Bank of Russia in view of the Russian banking system growing dependence on the funds provided to it by the monetary regulation. Recall, that in the post-crisis period the funds provided by the RF CB to commercial banks have become the main source of monetary supply in the RF. In this situation, and at the background of increased volatility in global financial markets, the RF CB has decided to resume lending to banks against shares. At the same time it should be noted, that the rapid expansion of banks' lending on the part of the RF CB is accompanied by a rather slow growth of deposit base, creates grounds for the future financial instability in case of such loaning slowdown. In this situation, the RF CB should be more prudent in credit institutions refinancing and carefully control the banks' risks. ●



**REAL ECONOMY: TRENDS AND FACTORS**

O.Izryadnova

*The economic situation in January-May 2012 is characterized by the intensified influence of the construction and investment sector on the macroeconomic indices. In May 2012 investments in fixed assets went up by 7.7%, retail trade turnover – by 6.8% versus the corresponding indices of the previous year. The situation in the industry is ambiguous. While the manufacturing industries growth rates accelerated to 7% versus May 2011, the minerals extraction reduced by 0.3%. It is the transport vehicles production that still holds the leading position in the manufacturing industry. In concordance with the estimations of the RF Ministry of Economic Development in 2012 the expected GDP growth will make 3.4%, investments in the fixed assets growing by 6.6% and the industrial growth of 3.1%.*

In January–May 2012 the dynamics of the internal production was determined by the simultaneous growth of both the consumer and investment demand. Retail trade growth made 107.2% versus January–May 2011 and 106.8% versus May 2011, the volume of paid services rendered to the population – 103.9% and 101.2%, correspondingly. The expansion of the retail trade volume was supported by the increase in the real incomes of the population and the expansion of the consumer crediting. In May 2012 real incomes of the population went up by 3.6%, real wages – by 11.1% versus the corresponding period of the previous year. The volume of credits issued to natural persons in May 2012 was 1.41 bigger than in the corresponding month of 2011. Consumer prices index in January–May 2012 was the minimum over 20 years of monitoring and made 102.3%, foodstuffs prices index – 103.1%, non-food goods process index – 102.0%, paid services rendered to the population – 101.5%. The inflation deceleration was greatly affected by the postponement of the planned increase in the regulated prices and tariffs till July 2012. Despite a possible acceleration of the inflation in the second half of the current year the RF Ministry of Economic Development estimated the annual growth rate of consumer prices in 2012 to fall in the range of 105.0–106.0%.

At the beginning of 2012 the improvement of the situation in the construction and investment complex started to have more and more pronounced effect on the macroeconomic situation. The growth of the investments in fixed assets this May reached 107.7% in May of the current year, and 112.1% in January–May 2012 as compared with the corresponding figures of the previous year.

Over the first five months of the current year the index of the industrial production made 103.4% as compared with January-May 2011 and 103.7% in May 2012 versus May 2011. It was the manufacturing industries that had a prevailing impact on the industry's dynamics and structure. In January–May 2012 the growth rates of the manufacturing industries made 104.8% versus January–May 2011, and reached the level of 107.0% this May versus May 2011, index of extractive industries being, correspondingly, 99.7% and 101.2%.

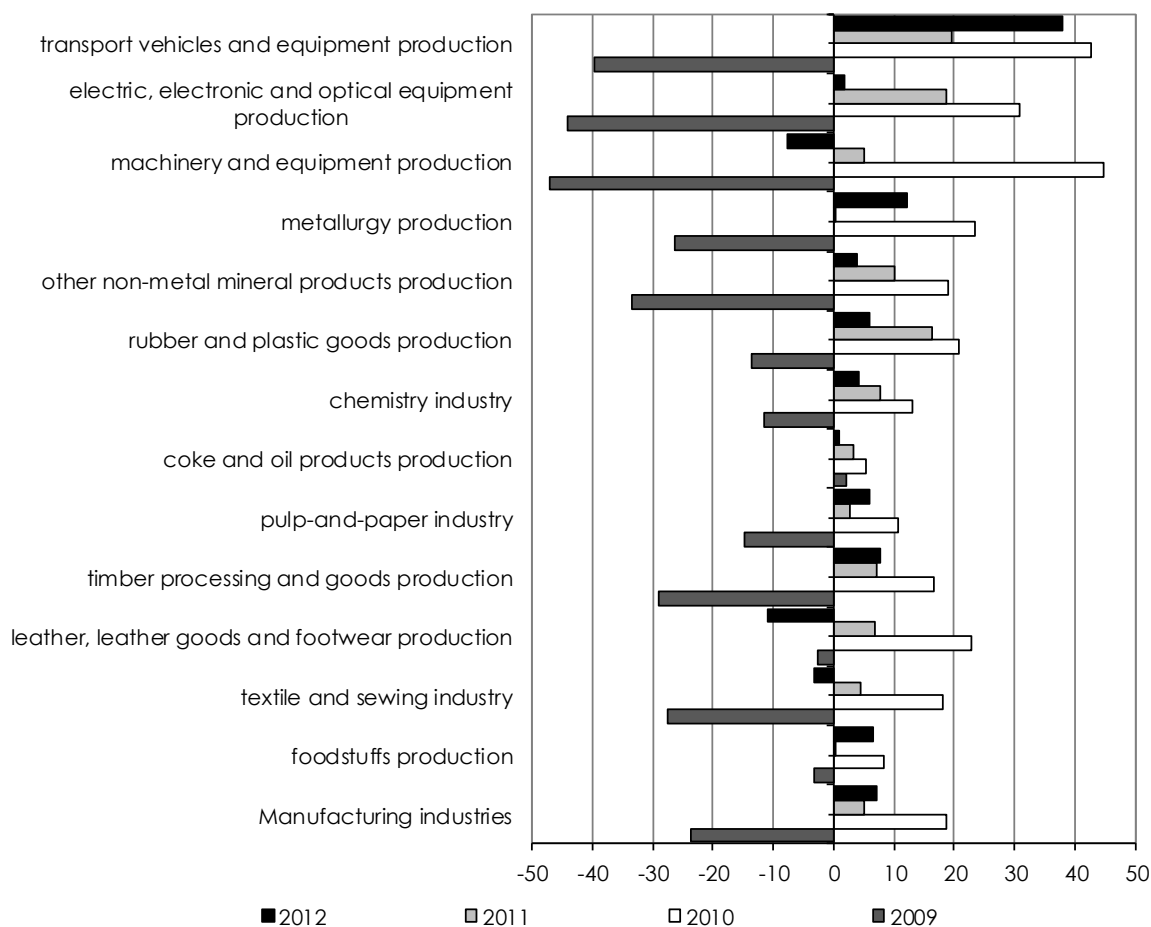
In January-May 2012 the growth rate in the fossil fuels extractions made 1.6% versus the corresponding period of 2011, being -0.3% in May.

In January–May 2012 the volume of the oil production went up by 1.5% versus the level of the corresponding period of 2011 and made 214m tons. At the same time in May 2012 the production remained at the level of last May and made 43.5m tons. According to the live data of the RF Ministry of Energy in January–May 2012 oil export volume is estimated to be 98.8m tons (98.7% of January-May 2011). In January–May 2012 RF oil refineries received 109.5m tons of crude oil or processing (103.8% versus the corresponding period of 2011) including 21.5m tons (98.8%) in May 2012. The proportion of oil processing in January–May 2012 in the total volume of oil production went up to 51.1% versus 50.0% over the corresponding period of 2011. In January–May 2012 as compared with the corresponding period of 2011 the growth rates of oil products production made 102.8%, being 99.8% in May 2012. It should be noted that in May 2012 the volumes of oil processing and consequently oil products production have been observed to diminish for the first time since October.

In January–May 2012 the natural gas production went down by 1.9% as compared with the corresponding period of 2011 and made 202bn cu m, which is connected with the decrease in gas consumption at the internal and external market starting from April of the current year. In January–May 2012 gas export made 79.8bn cu m (87.4% versus the level of January–May 2011). The proportion of export in the total volume of gas production reduced by 3.3% versus the level of January–May of the previous year and made 27.3%.

The dynamics of the manufacturing industries in the Russian Federation is considerably differentiated by the types of the economic activities and depends on such factors as the level of industrial facilities utilization structure and dynamics of the internal solvent demand, extent of the orientation to the external market, dynamics of expenditures and prices. In May 2012 the growth rates of the manufacturing industries exceeded the index of the corresponding period of the previous year by 2%. Such types of activities as transportation vehicles production, metallurgy and timber processing made a positive contribution in acceleration of the dynamics of the manufacturing industries. The complex of light industries and machinery and equipment production is characterized by negative dynamic in May 2012 as compared with May 2011.

RF Ministry of Economic Development has published “Scenario conditions for the formation of forecast versions of socio-economic development in 2013–2015” taking into account the expected estimations for the economy development in 2012. In concordance with these conditions the dynamics of the internal demand in 2012 is determined by the simultaneous expansion of the consumer and investment demand: the increase in the retail trade turnover is estimated to be at the level of 6.3% and the investments in the fixed assets – 6.6% versus the previous year. The dynamics and the structure of the internal market in 2012 is considerably influenced by the anticipating growth of import (112.5% versus 2011) versus GDP and final consumption dynamics.



Source: Federal State Statistics Service.

Fig. 1. Growth Rates as Broken by Main Types of Manufacturing Industries in May 2009–2012 as Percentage to the Corresponding Period of the Previous Year

The main parameters of the socio-economic development in 2013–2015 are based on unified estimation of the external conditions and differ in the quality of the economic growth in Russia.

According to the conservative scenario (1) annual GDP growth rate is estimated in the range of 3.1–4.1% of the GDP in the conditions of firm budget policy connected with the stagnation of the public investment demand and low growth rates of state employees' wages.

Moderately optimistic scenario (2) is focused on innovations and suggests active measures to stimulate economic growth and modernization, improvement of the investment climate, increase in competitive ability and business efficiency. In 2012 the GDP growth rates is estimated at the level of 3.4% accelerating to 4.2% in 2013–2015. Moderately optimistic scenario is suggested as the main version for the elaboration of the federal budget parameters for 2013–2015.

In 2013–2015 according to the scenario conditions of variant 2 average annual rates of the internal demand expansion is forecast to be in the range of 105.2%–106.6% while the investments growth rates – in the range of 6.4–7.8% and the consumption by the population – 5.0–5.7%. In 2013–2015 import growth rates are forecast to slow down to the average annual of 7–8%. Structural changes in import supplies towards the increase in the proportion of the investment goods will have a considerable effect on the characteristics of construction and investment complex development.

In 2013–2015 the growth of the final consumption according to the forecast will be supported by the increase in the real disposable incomes of the population up to 4.5–5.2% a year real wages growing by 5.4–6.0%. It is assumed that the real pensions and social payments growth rates will slow down which will result in further differentiation of the population by the level of incomes which will also limit the possibilities to solve the problems of poverty in the country. According to the forecast the poverty level (proportion of the population with the monetary incomes below the subsistence level) will make 11.5% in 2015 as compared with 12.6% in 2011.

It is expected that on average in 2012 the total number of the unemployed will make 4.5m or 6.1% of the economically active population and will remain at approximately the same level. Taking into account the demographic trends by 2015 the number of the average number of the employed in the economy will reduce by 1.0% as compared with 2011. In this case the achievement of the declared growth parameters will be possible only due to the increase in production factors efficiency. In concordance with the forecast, on the whole over 2011–2015 the labor efficiency will go up by 18.5% and will be supported by the anticipating growth of capital-labor ratio. According to the forecast the trend of the anticipating growth of the wages versus labor efficiency and the expansion of the labor remuneration proportion in the GDP will be maintained till 2015.

According to the scenario conditions it is assumed that it is the shift towards the investment complex that will be the determining factor in the change of the economy structure in 2012–2015. The growth rates of the industrial production in 2012–2015 being 3.1–4.2% according to the moderately optimistic variant the trend for the anticipating growth of the manufacturing industries as compared with the extractive industries and electricity, gas and water production and distribution will be maintained. In 2012–2015 the structure of the industrial production is forecast to diversify further. The proportion of the investment complex in the structure of the industry will go up to 21.3% in 2015 as compared with 18.6% in 2012. According to the main version of the forecast it is the transport vehicles production (147.7%), machinery and equipment production (135.3%), electric equipment production (128.0%) that will be characterized by the highest growth rates in 2015 as compared with 2011. It should be noted that the accession to the WTP can make corrections to the further development of some sectors of the machine-building complex (automotive vehicles construction, agriculture machine building).

Consumer complex of the industry is forecast to have quite high growth rates. In 2015 the volumes of the foodstuffs production, textile and sewing industry will increase by 13.3%, leather and footwear production – by 20.4% as compared with 2011.

As to intermediate goods production, it is the chemistry (131.3% versus 2011) and metallurgy industry (114.7%) that will demonstrate high growth rates in 2015. the growth of the metallurgy production will be supported by the investment policy of the ferrous metallurgy companies which is focused on the overcoming of the technological underdevelopment of the facilities and decrease of the energy-output ratio. The forecast high demand in the sphere of the housing construction and transportation infrastructure will allow to secure increase in the demand for the construction materials (132.4%).

Table 1

MAIN PARAMETERS OF THE RUSSIAN ECONOMY DEVELOPMENT FORECAST IN 2012–2015,  
MODERATELY OPTIMISTIC SCENARIO (2), AS PERCENTAGE TO THE PREVIOUS YEAR

	Reported			Forecast				
	2009	2010	2011	2012	2013	2014	2015	2015 on 2011
GDP	92.2	104.3	104.3	103.4	103.8	104.4	104.7	117.3
Industrial production index	90.7	108.2	104.7	103.1	103.4	104.1	104.2	115.8
Agriculture production	101.4	88.7	122.1	99.0	103.2	102.2	102.9	107.4
Investments in fixed assets	84.3	106.0	108.3	106.6	106.4	107.3	107.8	131.2
Retail trade turnover	94.9	106.4	107.0	106.3	105.0	105.6	105.7	124.6
Volume of paid services rendered to the population	97.5	101.5	103.0	105.0	105.5	106.1	106.3	124.9
Export	64.3	132.1	130.3	106.9	94.3	104.7	105.5	111.3
Import	65.7	129.7	130.2	114.1	110.1	109.4	109.0	149.7
Real disposable incomes of the population	103.1	105.1	100.8	105.0	104.5	105.3	105.2	121.5
Real wages	96.5	105.2	104.2	106.3	105.4	106.3	106.0	126.4
Employed in the economy	98.5	100.2	102.0	100.2	99.7	99.7	99.5	99.0
Total number of the unemployed	134.3	88.2	89.0	89.6	100.0	97.8	99.1	86.9
Consumer prices index	108.8	108.8	106.1	105-106	104.5-105.5	104-105	104-105	122.8
For reference:								
Labor efficiency	95.9	102.7	103.4	103.1	104.2	104.8	105.2	118.5
Proportion of labor remuneration in the GDP	27.3	26.0	24.2	24.3	25.0	25.1	25.0	
Proportion of the investments in fixed assets in the GDP	20.6	20.3	19.7	20.4	21.5	22.1	22.9	
Level of the unemployment versus the economically active population	8.7	7.7	6.8	6.1	6.1	6.0	6.0	
Population with monetary incomes below the subsistence level as percentage to the total population	13.0	12.6	12.8	12.6	12.6	12.2	11.5	

Source: RF Ministry of Economic Development.

Table 2

STRUCTURE OF THE INDUSTRIAL PRODUCTION IN CONCORDANCE WITH MODERATELY  
OPTIMISTIC SCENARIO (2), AS PERCENTAGE IN 2011 PRICES

Sectors of industry	2011 reported	2012 estimated	2013	2014	2015
			forecast		
Industry – total	100	100	100	100	100
<i>Fuel and energy complex</i>	<i>45.1</i>	<i>44.4</i>	<i>43.5</i>	<i>42.5</i>	<i>41.4</i>
fossil fuels extraction	20.5	20.0	19.5	18.8	18.1
coke and oil products production	13.0	13.0	12.8	12.8	12.6
electricity, gas and water production and distribution	11.6	11.4	11.1	10.9	10.6
<i>Consumer complex</i>	<i>11.3</i>	<i>11.3</i>	<i>11.3</i>	<i>11.2</i>	<i>11.1</i>
foodstuffs production	10.6	10.5	10.5	10.4	10.3
light industry complex	0.8	0.8	0.8	0.8	0.8
<i>Industry and investment complex</i>	<i>17.9</i>	<i>18.6</i>	<i>19.4</i>	<i>20.2</i>	<i>21.3</i>
construction materials production	2.9	3	3.1	3.2	3.3
machine-building industries	15.0	15.6	16.2	17.0	18.0



Table 2, cont'd

Sectors of industry	2011 reported	2012 estimated	2013	2014	2015
			forecast		
<i>Production of goods of intermediate demand</i>	24.4	24.3	24.6	24.9	24.8
minerals extraction excluding fossil fuels	2.9	2.8	2.8	2.8	2.7
timber industry complex	2.8	2.8	2.8	2.8	2.8
chemistry complex	6.9	7.0	7.3	7.6	7.7
metallurgy complex	11.8	11.7	11.7	11.7	11.6

Source: RF Ministry of Economic Development. ●

## RUSSIAN INDUSTRY IN MAY 2012

S.Tsukhlo

According to the data of surveys of the Gaidar Institute<sup>1</sup>, the dynamics of the demand, output and employment in May was sooner negative, rather than positive. Assessment of the demand and stocks of finished goods points to the fact that sentiments in industry are getting worse. In the meantime, forecasts and plans of industries do not suggest any improvement in the situation in the forthcoming months.

### The Industrial Optimism Index

In May, sluggish growth in the Industrial Optimism Index (3 points within 3 months) stopped (Fig. 1). In the past month, none of the components of the Index showed positive dynamics.

The Industry Forecasts Index (Fig. 2) determined on the basis of forecasts of the demand, output and employment remained at the level of the 29-month minimum.

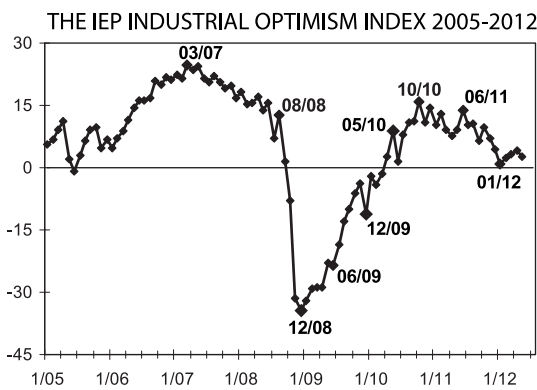


Fig. 1

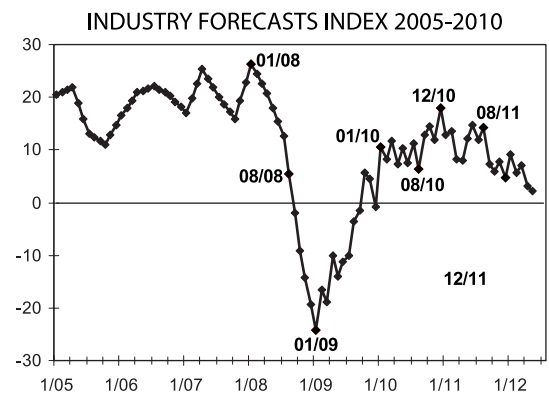


Fig.2

### Demand in Industrial Products

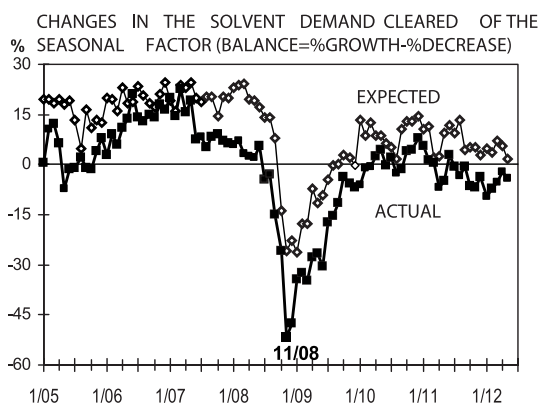


Fig. 3

In May, the actual changes in the demand failed to support the positive dynamics of March-April neither as regards the initial data, nor the data cleared of the seasonal factor (Fig. 3). As a result, a small positive spike in March and April changed for stagnation in sales. Clearing of the May data on the dynamics of the demand from the seasonal factor showed that slowdown of a decrease in industrial products sales registered on the basis of surveys after a dip in January stopped.

That situation resulted in a halt of growth in satisfaction with sales. In May, the share of normal assessments of the demand remained at the level of 57% which is better than 48% registered in January 2012, but still worse than the post-crisis maximum (64%) in October 2011. At present, the demand is regarded normal with capacity utilization of 73%, while a year ago, with that of 76%.

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 engaged in industry. The panel is shifted towards large enterprises by each sub-industry. The return of queries amounts to 65–70%.

After a spike of 43 points in the 1<sup>st</sup> quarter, the initial forecasts of the demand are losing optimism for two months running. So far, they have fallen by 13 points and remain in the positive zone (+9 points), but with the seasonal factor cleared they went down to +2 points which is the 20-month minimum.

### Output

In May, the initial data on the dynamics of industrial production showed slowdown of growth in the output by another 7 powers. As a result, in the past two months the growth rates of production lost 15 balance points. Clearing of the seasonal factor showed that growth rates remained at the April level which seems reasonable with May holidays taken into account (*Fig. 4*).

In May, initial output plans of enterprises did not change and remained, as a result, at the level of worse values for those months not only as regards the first post-crisis years, but also the last pre-crisis years. Clearing of the seasonal factor confirmed that result: the output plans of May 2012 are the 29-month minimum (that is from January 2010). In the period between the crises (from November 1998 till September 2008), such low optimism of plans was never registered. Evidently, the the latest developments in the country and a lack of progress in solution of the problems of the euro area have a negative effect on the sentiments in the Russian industry.

### Prices of Enterprises

In May, no principal changes took place in enterprises' pricing policy. In March–May, intensity of the actual growth in prices remained at the same relatively modest level as compared to the beginning of the year (*Fig. 5*). The highest growth in factory prices was registered in chemical industry (March–May balance +20 points) and building industry (+18 points). An absolute decrease in prices was registered in nonferrous industry (-21 points on average in March–May) and timber industry (-15 points). In other industries, balances (rates) of actual growth in prices were close to nil.

In March–May, enterprises' pricing forecasts as regards industry in general were stable (at the level of +19 points), however, the situation varied by the sector. The record-high forecasts of price rises were registered in building industry (where 43% of enterprises intends to raise prices against only 1% of enterprises which is prepared to reduce them; such a situation resulted in the balance of  $43 - 1 = 42$  points), chemical industry ( $33 - 3 = 30$  points) and engineering ( $23 - 1 = 22$  points). The most modest plans of price rises were in iron and steel industry ( $16 - 10 = 6$  points), timber industry ( $13 - 8 = 5$  points) and food industry ( $14 - 12 = 2$  points).

### The actual dynamics and lay-off plans

Revival of hiring of workers which began in March–April virtually stopped in May (*Fig. 6*). Enterprises which

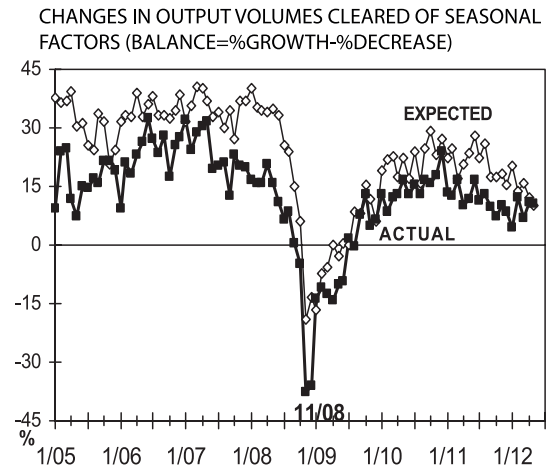


Fig. 4

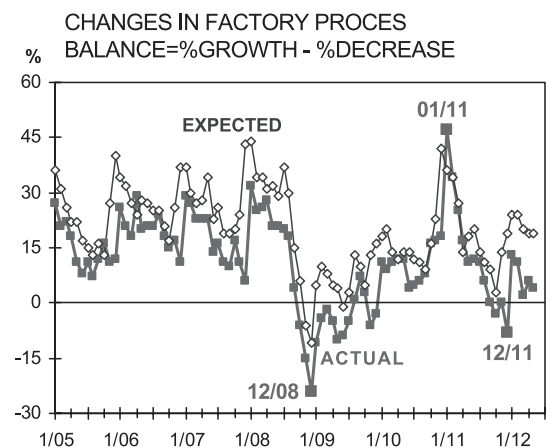


Fig. 5



Fig. 6

evaluated the prospects of growth in demand and made relevant adjustments in their output plans decided to stop hiring personnel. In May, the number of workers increased only in engineering and building industry. In other industries, particularly, light industry and nonferrous industry, layoffs prevailed.

In the 2<sup>nd</sup> quarter, hiring plans lacked optimism. As compared to the results as of the beginning of the year, the balance of forecasts as regards industry in general got worse by 50%. Growth in the number of workers was planned only in building materials industry (balance of April-May +32 points) and engineering (balance of +6). Explicit redundancy (-15 points) is possible only in light industry. Enterprises of other sectors preferred to preserve the number of their workers unchanged.

### Lending to Industry

THE SHARE OF ENTERPRISES WITH LOAN AVAILABILITY (ABOVE THE NORM + NORMAL)

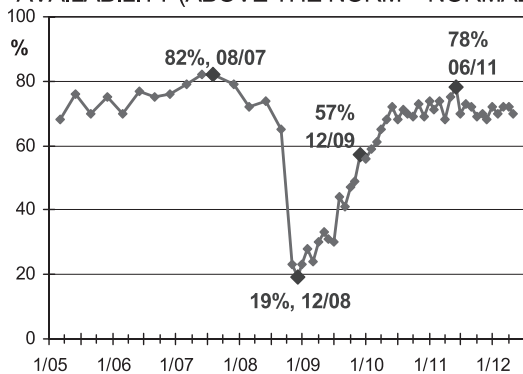


Fig. 7

Growth took place mainly on account of building materials industry (14.9% after 13.7%), timber industry (13.2% after 12.3%) and light industry (13.9% after 13.2%). As regards chemical industry and food industry, the rates kept falling. In May, growth in the rates did not affect only large enterprises (with over 1,000 workers).

In the 2<sup>nd</sup> quarter of 2012, the aggregate availability of loans remained stable and did not differ much from the results of the 1<sup>st</sup> quarter of 2012 (*Fig. 7*). From the beginning of the year, that index is in the range of 70%–72% for industry in general. In the current quarter, the highest availability of loans is registered in iron and steel industry (87%) and food industry, chemical industry and engineering (76% each). As regards light industry, the situation is quite the opposite (34%), but, the above value generally correlates well with the sectorial level of a loan servicing ability: in light industry that index amounts to 35%.

In May, the average minimum rate offered by banks on loans in rubles stopped falling. Within a month, that index increased in industry in general from 12.1% to 12.4% which value became the 11-month maximum.



## INVESTMENTS IN FIXED ASSETS

O.Izryadnova

*The growth of the investment expenditures in January–May 2012 as compared with the previous year had a positive influence on the macroeconomic situation. Over January–May 2012 the growth rates of the investments in fixed assets made 112.1% versus the corresponding period of the previous year. It was the acceleration of the investments in fixed assets of the industry growth rates that was a positive feature of the investment process in 2012. Traditionally high investment activity in the extractive sector was supported by the dynamic growth of the investments in manufacturing industries – 128.9% versus the 1<sup>st</sup> quarter 2011. The structure of financial sources of the investments was characterized by the expansion of the proportion of own funds and reduction of the banks' credit and organizations' borrowed funds share.*

Analyzing the investment activity the characteristic feature of the post-crisis development of the Russian economy should be taken into account. The peak of the investment crisis was observed in the first half of 2009, and starting with the 3<sup>rd</sup> quarter the trend for the slowdown of the investments decrease has been observed supported by the improvement of the financial situation at the enterprises. Over 2011 the increase in the investments in fixed assets made 14.8% GDP growing by 8.8% versus 2009. According to the estimation of the Federal State Statistics Service in January–May 2012 the investments in fixed assets made Rb 3233.1bn having increased by 12.1% versus the corresponding period of the previous year. The volume of the works executed in the construction made 105.4% in January–May 2012 (100.8% in January–May 2011), commissioning of the residential floor area – 103.7% (93.1%) versus the corresponding period of the previous year.

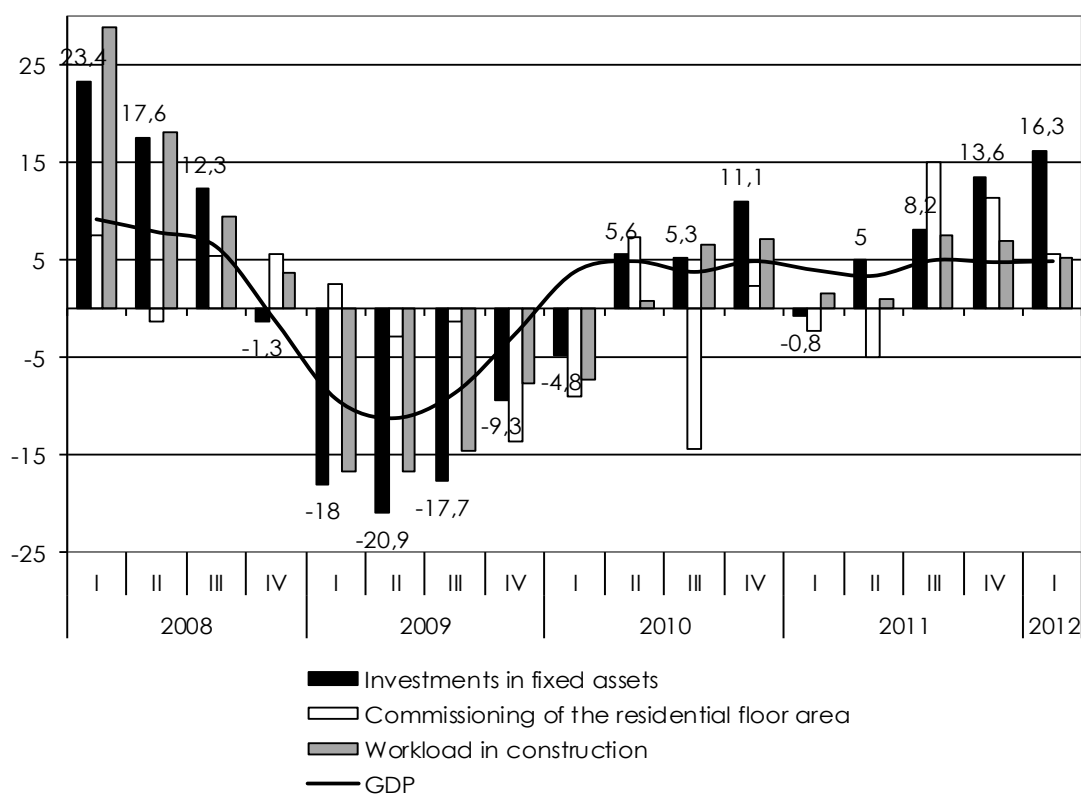
In 2012 the three-year trend for the contraction of the investments in the 1<sup>st</sup> quarter of the year was observed to cease. Investments in fixed assets (for all organization including the volumes of investments not observed by direct statistical methods) in the 1<sup>st</sup> quarter 2012 made Rb 1683.8bn (12.5% of the GDP) having increased by 16.3% (by nearly 1% of the GDP) as compared with the corresponding period of the previous year<sup>1</sup>.

Dynamics of the investments in fixed assets is differentiated between large- and small-scale enterprises. In the 1<sup>st</sup> quarter 2012 in the segment of the large- and medium-scale enterprises investments in the fixed assets went up by 16.8% versus the corresponding period of 2011 remaining at the same time nearly 10% below the pre-crisis figure of 2008 which was unmatched by the investments volumes and growth rates. Changes in the situation at the internal market made the contribution of the small-scale enterprises into the dynamics of the investment activity recovery. In the 1<sup>st</sup> quarter 2012 the growth of the investments in the segment of small enterprises by 15% not only compensated for the low investment activity of the corresponding period of the previous year, but also provided for the recovery of the volumes at the level of the 1<sup>st</sup> quarter 2008 indices for these type of enterprises.

In the 1<sup>st</sup> quarter 2012 the structure of the investments in the fixed assets was transformed due to a considerable increase in the volume and proportion of investments in machinery, equipment and transport vehicles the proportion of the investments in housing and buildings construction decreasing. As compared with the 1<sup>st</sup> quarter 2011 the investments in machinery and equipment went up by Rb 115.1bn including Rb 107.2bn in the domestically produced models. Over the past three years the proportion of the investments for the purchase of import machinery, equipment and transportation vehicles in the total volume of the investments in machinery, equipment and transportation vehicles have been observed to decrease gradually from 25.5% in the 1<sup>st</sup> quarter 2009, to 19.5% in the 1<sup>st</sup> quarter 2011 and 16.2% in the same period of 2012.

Table 1

<sup>1</sup> In May 2012 Federal State Statistics Service published corrected data for the volume and dynamics of the investments in fixed assets by months and results of the 1st quarter of the current year.



Source: Federal State Statistics Service.  
 Fig. 1. Dynamics of the Investments in Fixed Assets and GDP in 2008–2012, as Percentage to the Corresponding Quarter of the Previous Year

#### STRUCTURE OF INVESTMENTS IN FIXED ASSETS BY TYPES OF THE FIXED ASSETS IN THE 1<sup>ST</sup> QUARTER 2009–2012, EXCLUDING THE SUBJECTS OF SMALL-SCALE ENTREPRENEURSHIP AND PARAMETERS OF INFORMAL ACTIVITIES, AS PERCENTAGE TO THE TOTAL

	Rb billion				As percentage to the total			
	2009	2010	2011	2012	2009	2010	2011	2012
Investments in fixed assets	933.3	802.1	956.8	1211.0	100	100	100	100
including:								
housing	56.4	44.3	47.6	48.4	6.0	5.5	5.0	4.0
buildings (excluding housing) and constructions	481.8	410.5	499.2	604.6	51.6	51.2	52.2	49.9
machinery, equipment and transportation vehicles	300.6	266.7	326.1	441.1	32.2	33.2	34.1	36.4
of which:								
purchase of import machinery, equipment, transportation vehicles	76.6	54.4	63.6	71.4	8.2	6.8	6.6	5.9
other	94.5	80.6	83.9	116.9	10.2	10.1	8.7	9.7

Source: Federal State Statistics Service.

The characteristic feature of post-crisis development of construction and investment complex consists in a very constrained recovery of the volume of investments in housing. In the 1<sup>st</sup> quarter 2012 the volume and proportion of investments in housing in the total volume of investments in fixed assets remained considerably below the corresponding figure of 2009.

The positive dynamics of commissioning of the residential floor area has been observed since the 2<sup>nd</sup> half of 2011 and was determined by some improvement of the situation with financing. In the 1<sup>st</sup> quarter 2012 the organizations of all form of ownership built 11,800 of apartments of 9.8m sq m of total area, which is 5.7% above the corresponding period of the previous year. Individual

contractors built 5.3m sq m of housing or 53.8% of the total volume of housing commissioned in the 1<sup>st</sup> quarter 2012.

Analyzing the trends of changes in the total volume of investments in housing in 2010–2012 one should take into account the structural features of financing connected with the increase in volumes and proportion of funds of the population in the structure of financing of the housing construction under shared ownership terms, the funds of the organization dynamics continuing to contract. In the 1<sup>st</sup> quarter 2012 the funds received for the construction under shared ownership terms went up by Rb 8.6bn, including the funds of population – by Rb 6.0bn as compared with the 1<sup>st</sup> quarter 2011. The upsurge in the investment activity of the population was supported by the expansion of the scale of its crediting. As a result of the 1<sup>st</sup> quarter 2012 mortgages made Rb 179bn and went up by 1.75 times as compared with the corresponding period of the previous year.

Table 2

STRUCTURE OF INVESTMENTS IN FIXED ASSETS AS BROKEN BY SOURCES OF FINANCING,  
IN THE 1<sup>ST</sup> QUARTER 2009–2012 (NOT TAKING INTO ACCOUNT THE SUBJECTS OF SMALL-SCALE  
ENTREPRENEURSHIP AND PARAMETERS OF INFORMAL ACTIVITY)

	Rb billion				As percentage to the total			
	2009	2010	2011	2012	2009	2010	2011	2012
Investments in fixed assets	933.3	802.1	956.8	1211.0	100	100	100	100
including by sources of financing:								
own funds	381.3	362.1	464.8	613.3	40.9	45.1	48.6	50.
of which:								
profit remaining on hands	168.7	120.7	172.5	241.4	18.1	15.0	18.0	19.9
amortization	184.5	199.3	244.4	312.9	19.8	24.8	25.5	25.8
borrowed funds	552.0	440.0	492.0	597.7	59.1	54.9	51.4	49.4
including:								
banking credits	125.0	76.0	66.5	97.6	13.4	9.5	7.0	8.1
of which foreign banks credits	40.0	25.3	17.4	23.2	4.3	3.2	1.8	1.9
borrowed funds of other organizations	85.9	51.3	47.0	64.4	9.2	6.4	4.9	5.3
budget funds	121.5	103.3	127.6	133.4	13.0	12.9	13.3	11.0
of which:								
from the federal budget	37.9	44.2	51.9	57.0	4.1	5.5	5.4	4.7
from the budgets of the subjects off the Russian Federation	75.9	52.8	69.0	67.8	8.1	6.6	7.2	5.6
off-budget funds	2.1	1.6	3.4	2.9	0.2	0.2	0.3	9.2
other	217.5	207.8	247.5	299.4	23.3	25.9	25.9	24.9
of which:								
funds of overhead organizations	164.2	154.5	200.7	237.4	17.6	19.3	21.0	19.6
funds received for construction under shared ownership terms (organizations and population)	20.3	16.1	17.3	25.9	2.2	2.0	1.8	2.1
including the funds of the population	8.4	7.8	10.6	16.6	0.9	1.0	1.1	1.4
funds from corporate bonds emission	0.1	0.02			0.01	0.0		
funds from stocks emission	5.2	14.9	10.0	13.6	0.6	1.9	1.0	1.1
foreign investments in the volume of total investments in fixed assets	62.9	46.2	36.4	40.3	6.7	5.8	3.8	3.3

Source: Federal State Statistics Service.

Post-crisis recovery of the investment financing process was determined by the intensification of the tendency to use own funds. In the 1<sup>st</sup> quarter 2012 the proportion of the investments made from own funds of organizations expanded as compared with the 1<sup>st</sup> quarter 2011 by 2%, and as compared with the 1<sup>st</sup> quarter 2009 – by 10%. Despite the fact that in the 1<sup>st</sup> quarter 2012 the profitability on the whole throughout the economy made 107.% having decreased by 1.9% versus

the corresponding period of the previous year the proportion of the investments financed from the profits of organizations went up to 19.9% versus 18.0% in the 1<sup>st</sup> quarter 2011.

The banking sector downplayed the support of the investment programs financing. In the 1<sup>st</sup> quarter 2012 only Rb 97.6bn of Rb 597.7bn of borrowed funds or 16.3% was accounted for by the banking credits. While the volumes and proportion of the banking credits in the structure of the sources of financing have been increasing as compared with the 1<sup>st</sup> quarter 2011 their values are considerably below the figures of crisis 2009. The changes in the structure of banking crediting in the last three years are defined by the expansion of the Russian banks share. As compared with the 1<sup>st</sup> quarter 2011 the credits of the Russian banks went up by Rb 25.3bn while the credits of foreign banks – by Rb 5.8bn.

The level of the banks funds participation in investment programs financing in the 1<sup>st</sup> quarter 2012 was negatively influenced by the sustention of the trend towards the capital withdrawal. According to the preliminary estimation of the RF Central Bank the net outflow of the capital in the private sector in January-March of the current year made \$35.1bn versus \$19.8bn a year ago. Besides, foreign investments in the Russian economy in the 1<sup>st</sup> quarter 2012 reduced by 17.4% as compared with the corresponding period of the previous year making \$36.5bn. As a result the volume of the foreign investments in fixed assets in the 1<sup>st</sup> quarter 2012 was below the figures of 2009-2010, and their share in the total volume of investments in the Russian economy diminished from 3.3% versus 3.8% a year ago.

The role of the budget funds in the structure of the borrowed funds for financing of the investments in fixed assets was observed to change. In the 1<sup>st</sup> quarter 2012 Rb 133.4bn of the investments in fixed assets (11.0% of the total volume of the investments in the economy) was financed at the expense of the budget funds. The increase in the investments financing at the expense of the federal budget funds compensated for the contraction of the participation of the budgets of subjects of the Federation even though the proportion of both the former and the latter diminished.

The public demand for the production and services of the Russian enterprises was supported through the fulfillment of the planned investments projects in the segment of transportation, telecommunication etc. within the framework of FTP and FTIP as well as infrastructure projects.

Federal targeted investment program for 2012 (FTIP) envisages Rb 911.4bn of the federal budget funds which exceeds by Rb 6.4bn the figure of 2011. The volume of funds envisaged for financing of the special works included in the state defense order within program and non-program part of FTIP makes Rb 163.0bn.

Within the first 5 months of 2012 FTIP was subject to several changes: the volume of budget allotments went up to Rb 925.0bn, of which Rb 789.6bn are budget investments for financing of the objects of federal property and open joint-stock companies, and Rb 135.4bn make subsidies. The volume of funds for financing of the special works included in the state defense order due to correction of non-program FTIP part decrease to Rb 143.5bn.

In concordance with the corrections in 2012 the volume of funds envisaged for FTIP execution for financing of the objects included in federal target programs went up to Rb 602.1 bn (planes Rb 593.4bn) of which budget investments make Rb 484.1bn (Rb 475.4bn). Funds of Rb 322.9bn (planned Rb 320.9bn) of which budget investments make Rb 305.5bn (Rb 303.5bn) are envisaged for construction of objects not included in the federal target programs.

According to the data of the Federal State Statistics Service FTIP objects (excluding special works included in the state defense order) are financed at the level of Rb 225.2bn in January-May 2012 or 33.1% of the total volume of funds envisaged for the year. In January-May 2012 Rb 180.0bn or 36.7% of the volume envisaged for the year was financed at the expense of the federal budget. Rb 39.2bn or 18.9% of the objects not included in the federal target programs was financed at the expense of the federal budget.

In January–May 2012 the use of funds at the expense of all the sources of financing at objects included in federal target programs made Rb 86.1bn or 12.2% of the volume of funds at the expense of all the sources of financing envisaged for the year (13.0% in 2011). Rb 70.8 bn was used for objects included in federal target programs. According to the RF Ministry of Economic Development low level of financing and use of the budget allotments envisaged for FTIP fulfillment at the beginning of the current year is accounted for by the late lifting of financing restrictions

by the chief superintendents of the budget funds (as on 28.05 2012 427 limitations concerning financing at the total volume of nearly Rb 122bn were still in effect in FTIP).

The structure of investments in fixed assets as broken by types of economic activities was subject to considerable changes in 2009–2012. In the crisis period the decrease in the investment activity in industry was less dramatic than the contraction of the investments on the whole throughout the economy. As a result the proportion of investments in the 1<sup>st</sup> quarter 2012 went up to 58.2% as compared with 47.1% in the 1<sup>st</sup> quarter 2009. The investments recession was observed to cease since the 1<sup>st</sup> quarter 2011, which is accounted for by the simultaneous growth of the investments demand in the extractive and manufacturing industries. In the 1<sup>st</sup> quarter 2012 the increase in the investments in the fixed assets in the industry made 30.1% versus the figure of the previous year as a result of which the volume of investments of pre-crisis 1<sup>st</sup> quarter 2008 was exceeded.

In the 1<sup>st</sup> quarter 2012 the growth rates of the investments in fixed assets of medium- and high-technological segments accelerated. As compared with the 1<sup>st</sup> quarter 2011 investments in fixed assets in machine-building went up by 32.1%, in science – by 30.7%, in communication – by 29.0%, in transportation vehicles production – by 27.0%. The growth of the investments in fixed assets in health care – by 25.7% - was also a positive trend of the beginning of 2012.

Such types of activity as education, operations with real estate, whole sale trade made a negative contribution into the dynamics of the investments. The slowdown of the investments in transportation development is also worrying.

Table 4

 INVESTMENTS IN FIXED ASSETS IN THE 1<sup>ST</sup> QUARTER 2009–2012, EXCLUDING THE SUBJECTS OF SMALL BUSINESS AND VOLUME OF INVESTMENTS NOT DETECTED BY DIRECT STATISTIC METHODS

	RUR billion				As percentage to the total				Growth rates versus the corresponding period of the previous year			
	2009	2010	2011	2012	2009	2010	2011	2012	2009	2010	2011	2012
Total	933.3	802.1	956.8	1211.0	100	100	100	100	95	78.9	101.9	116.8
agriculture, hunting and forestry	26.7	26.9	29.1	38.4	2.9	3.4	3.0	3.2	74.8	100.8	107.8	116.7
fishing and fish breeding	0.4	0.4	1.0	1.6	0.04	0.1	0.1	0.1	85.8	107.3	194.4	161.4
industry	439	415	473.9	705.0	47.1	51.7	49.5	58.2	95.2	90.2	102.0	130.1
minerals extraction	192.9	180.4	211.5	302.5	20.7	22.4	22.1	25.0	90.7	89.9	107.5	132.2
manufacturing industries	178.2	141.8	170.8	277.5	19.1	17.7	17.9	22.9	97.8	78.6	104.7	128.9
electricity production and distribution	67.9	92.8	91.6	125.0	7.3	11.6	9.6	10.3	100.6	122.6	87.2	121.9
construction	29.5	19.8	22.3	31.7	3.2	2.5	2.3	2.6	97.5	70.3	96.7	134.5
wholesale and retail trade	25.9	15.7	26.4	26.5	2.7	2.0	2.7	2.2	96.2	84.2	129.7	91.8
hotels and restaurants	2.8	4.2	4.5	2.2	0.3	0.5	0.5	0.2	89.9	141.2	94.7	40.3
transportation and communication	238.6	194.4	252.0	291	25.6	24.2	26.3	24.0	105.4	76.5	113.0	106.2
railway transportation	28.3	54.6	51.0	82.1	3	6.8	5.3	3.7	61.4	130.7	87.8	82.1
pipelines transportation	124	69	106.0	126.2	13.3	8.6	11.1	10.4	147.4	55.1	125.8	107.3
communication	28.3	24.9	28.8	38.5	3	3.1	3.0	3.2	75	82.8	107.9	129.0
financial activity	14.2	8.6	12.8	17.3	1.5	1.1	1.3	1.4	135.3	61.4	129.6	140.6
operations with real estate	95.3	70.6	70.5	75.9	10.2	8.8	7.4	6.3	76	66.7	87.5	97.9
state management	10.2	10.1	7.5	9.6	1.1	1.2	0.8	0.8	106.7	81.5	85.7	121.3
education	10.6	10.4	14.2	14.0	1.1	1.3	1.5	1.2	80.9	97	124.3	88.7



Table 4, cont'd

	RUR billion				As percentage to the total				Growth rates versus the corresponding period of the previous year			
	2009	2010	2011	2012	2009	2010	2011	2012	2009	2010	2011	2012
health care and social service	14	12.1	14.8	19.7	1.5	1.5	1.6	1.6	93.2	83.8	115.8	125.7

Source: Federal State Statistics Service.

In concordance with scenario conditions for formation of the variants of socio-economic development in 2013–2015 the expected growth rates of the investments are estimated to be at the level of 106.6% in 2012 and 106.4% – in 2013. It is supposed that it is oil and gas complex and infrastructure that will make a decisive contribution in the investments in fixed assets growth. It should be noted that the forecast anticipating growth of the investment import as compared with the dynamics of the investments in fixed assets is a continuation of the existing trends of the recent years and testifies of the insufficiently intensive development of the domestic production of investment goods. ●

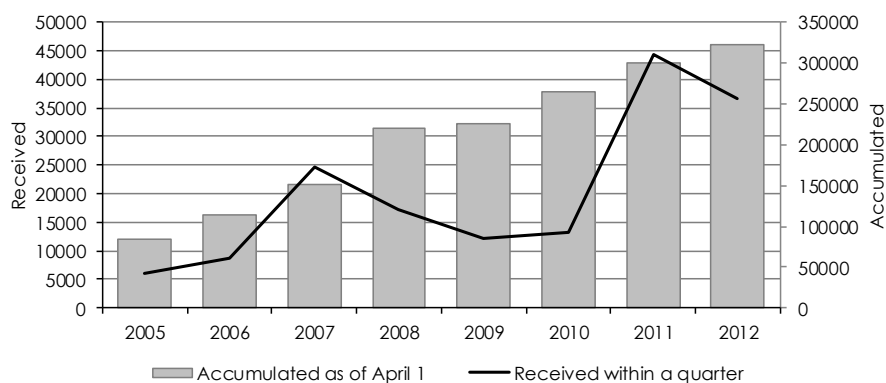
## FOREIGN INVESTMENTS

E.Ilyukhina

In the 1<sup>st</sup> quarter of 2012, foreign investments in the Russian Federation decreased by 17.6% as compared to the 1<sup>st</sup> quarter of 2011. The accumulated foreign investments in the Russian economy fell by 6.9% as compared to the index as of the beginning of the year. It is to be noted that investments from Russia to abroad increased and amounted to 86.2% of the aggregate volume of foreign investments in the Russian economy. As in 2011, the financial sector and industry remained the most attractive areas to foreign investors. In the geographic pattern, in the 1<sup>st</sup> quarter of 2012 the largest volume of investments came from Switzerland which accounted for 48.5% of all the foreign investments in the Russian economy. On June 26, 2012, Standard & Poor's, an international rating agency raised Russia's short-term rating to A-2, having confirmed the long-term rating of the Russian Federation as regards foreign currency obligations at the level of BBB with a "stable" forecast.

In the 1<sup>st</sup> quarter of 2012, the volume of foreign investments to the non-financial sector of the Russian economy (without taking into account monetary regulating authorities, commercial banks and savings banks), including the USD equivalent of investments in rubles amounted to \$36.5bn which is 17.6% lower than the index of the 1<sup>st</sup> quarter of 2011 (Fig. 1).

In the 1<sup>st</sup> quarter of 2012, withdrawn abroad from the Russian economy as foreign investors' income and interest earnings for use and repayment of loans was \$35.9bn which figure is 12.3% lower than the index of 2011. So, in the 1<sup>st</sup> quarter of 2012 the volume of funds which is equivalent to 98.4% of foreign investments received was withdrawn (in the 1<sup>st</sup> quarter of 2011 it was equal to 92.5%). It is to be noted that in the 1<sup>st</sup> quarter of 2012 investments from Russia abroad rose by 8.1% and amounted to \$31.7bn or 86.2% of the ag-



Source: Rosstat.

Fig. 1. Dynamics of foreign investments in the Russian economy in the 1<sup>st</sup> quarter of 2005–2012, million \$.



Source: Rosstat.

Fig. 2. Foreign capital movement in the 1<sup>st</sup> quarter of 2005–2012

gregate volume of foreign investments in the Russian economy (in the 1<sup>st</sup> quarter of 2011 the ratio of Russian investments abroad to foreign investments in Russia was estimated at 66.2%) (Fig. 2).

By investment lines, the year 2012 is characterized by mixed dynamics of foreign investments in the Russian Federation. In the 1<sup>st</sup> quarter of 2012, in the direct investments segment investments were equal to the index of the 1<sup>st</sup> quarter of 2011, that is, \$3.9bn (a decrease of 0.7%) (in the 1<sup>st</sup> quarter of 2011 there was growth of 48.3% on the respective period of the previous year). On the basis of the results of January–March 2012, portfolio investments increased 8.3 times over to \$1.0bn (in the 1<sup>st</sup> quarter of 2011 they fell by 58.2%). The volume of other investments in the Russian Federation dropped by 21.5% to \$31.7bn (in the 1<sup>st</sup> quarter of 2011 other investments increased 3.9 times over)<sup>1</sup>.

Taking into account considerable growth in portfolio investments and a noticeable drop in other investments in the 1<sup>st</sup> quarter of 2012 with direct investments remaining at the same level, the pattern of the aggregate investments in the Russian economy has changed (Table 1).

Table 1

THE PATTERN OF FOREIGN INVESTMENTS IN THE RUSSIAN FEDERATION  
IN THE 1<sup>ST</sup> QUARTER OF 2005–2012, %

Investments	2005	2006	2007	2008	2009	2010	2011	2012
Direct	31.9	43.7	39.5	32.4	26.4	20.0	8.8	10.6
Portfolio	1.3	2.6	0.8	0.7	1.0	2.2	0.3	2.8
Other	66.8	53.6	59.6	66.9	72.6	77.8	90.9	86.6

Source: Rosstat.

It is to be noted that with aggregate indices of direct investments remaining virtually unchanged the volume of reinvestments decreased by 86.9% as compared to the 1<sup>st</sup> quarter of 2011. It is to be noted that the share of reinvestment in the pattern of direct foreign investments fell to 3.7% (in the 1<sup>st</sup> quarter of 2011 it was 27.8%). Loans received from foreign co-owners of entities decreased by 2.8% (their share in the pattern of direct investments fell from 44.8% to 43.8%).

In January–March 2012, the volume of trade loans increased by 18.6% on the 1<sup>st</sup> quarter of 2011. It is to be noted that their unit weight in the aggregate pattern of other investments rose to 18.6% (in the 1<sup>st</sup> quarter of 2011 it amounted to 12.3%). The volume of other loans which accounted for 54.7% of the aggregate volume of other foreign investments in the Russian economy (in the 1<sup>st</sup> quarter of 2011 it was 85.6%) decreased by 33.1%. Among them, the largest drop of 35% to \$17.3bn was registered in the segment of short-term loans extended for the period of less than 180 days.

Growth in portfolio investments was justified by higher interest taken in investments in shares and interests; such investments grew 15.8 times over as compared to January–March 2011.

As in 2011, in January–March 2012 the largest volume of foreign investments was made in the financial sector. The second most attractive area to foreign investments was industry. However, a noticeable drop in investments in transport and communications was observed (Table 2).

Table 2

SECTORIAL PATTERN OF FOREIGN INVESTMENTS IN THE RUSSIAN ECONOMY  
IN THE 1<sup>ST</sup> QUARTER OF 2010–2012

	In million \$			% of the total			Changes as % of the respective period of the previous year		
	2010	2011	2012	2010	2011	2012	2010	2011	2012
Industry	8025	10240	13050	61.0	23.1	35.7	127.4	127.6	127.4
Building	228	96	139	1.7	0.2	0.4	129.5	42.1	144.8

<sup>1</sup> Direct investments are investments in tangible assets and controlling interest or equity stake which give the right to the investor to participate in management; portfolio investments are investments made in securities for the purpose of earning income; other investments are investments made on a return basis (loans of international financial institutions, trade loans and other).

Table 2, cont'd

	In million \$			% of the total			Changes as % of the respective period of the previous year		
	2010	2011	2012	2010	2011	2012	2010	2011	2012
Transport and communications	1513	3632	394	11.5	8.2	1.1	118.6	240.1	10.8
Wholesale and retail trade	1407	3503	3267	10.7	7.9	8.9	54.0	249.0	93.3
Operations with real property, lease and rendering of services	922	1585	2066	7.0	3.6	5.7	82.0	171.9	130.3
Financial sector	925	25072	17352	7.0	56.5	47.5	278.6	2710.5	69.2
Other industries	126	221	266	1.1	0.5	0.7	57.0	175.4	120.4

Source: Rosstat.

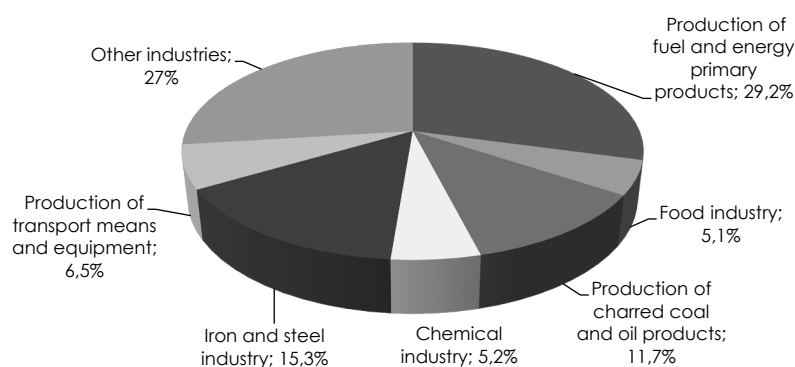
On the basis of the results of the 1<sup>st</sup> quarter of 2012, foreign investments in production of fuel and energy materials amounted to \$3.8bn which is 15.9% lower than the level of the 1<sup>st</sup> quarter of 2011. Generally, foreign investments in the primary sector increased by 11.55% to \$5.3bn as compared to the 1<sup>st</sup> quarter of 2011.

In January–March 2012, the volume of foreign investments in the Russian manufacturing industry grew by 30.9% to \$7.2bn as compared to the 1<sup>st</sup> quarter of 2011. In the 1<sup>st</sup> quarter of 2012, investments in iron and steel

industry increased by 85.7% to \$2.0bn on the respective period of the previous year, while those in production of transport means and equipment and food industry, by 120% to \$847m and 57.9% to \$660m, respectively. It is to be noted that the volumes of foreign investments in chemical industry and production of charred coal and oil products decreased by 4.7% and 11.2% to \$684m and \$1.5bn, respectively as compared to the January–March 2011. The mixed dynamics of foreign investments by the branch of industry resulted in changes in the pattern of foreign investments in industry (Fig. 3).

The pattern of foreign investments in industry differs from the similar pattern of the aggregate foreign investments in the Russian economy by higher unit weight of direct investments. In particular, in January–March 2012 direct investments in industry fell by 24.6% on the 1<sup>st</sup> quarter of 2011, while portfolio investments and other investments in industry rose 17.7 times over and by 35.1%, respectively, which situation resulted in a decrease of the unit weight of direct investments in the pattern of foreign investments in industry (Table 3).

In the 1<sup>st</sup> quarter of 2012, the main volume of foreign investments in the Russian economy came from Switzerland (\$17.7bn), the Netherlands (\$3.6bn), Cyprus (\$3.0bn), the UK (\$2.0bn) and Luxemburg (\$1.7bn). The above countries accounted for 76.5% of foreign investments in the Russian Federation (in the 1<sup>st</sup> quarter of 2011 the top five countries making investments in the Russian economy accounted for 82.4%).



Source: Rosstat.

Fig. 3. Sectorial pattern of foreign investments in industry in the 1<sup>st</sup> quarter of 2012

Table 3

FOREIGN INVESTMENTS IN INDUSTRY IN THE 1<sup>ST</sup> QUARTER OF 2005–2012, %

	2005	2006	2007	2008	2009	2010	2011	2012
Direct investments	43.2	56.2	70.3	46.0	30.4	19.1	27.9	16.5
Portfolio investments	2.2	3.5	1.0	1.2	0.1	1.6	0.5	7.6
Other investments	54.5	40.3	28.7	52.8	69.5	79.3	71.6	75.8

Source: Rosstat.

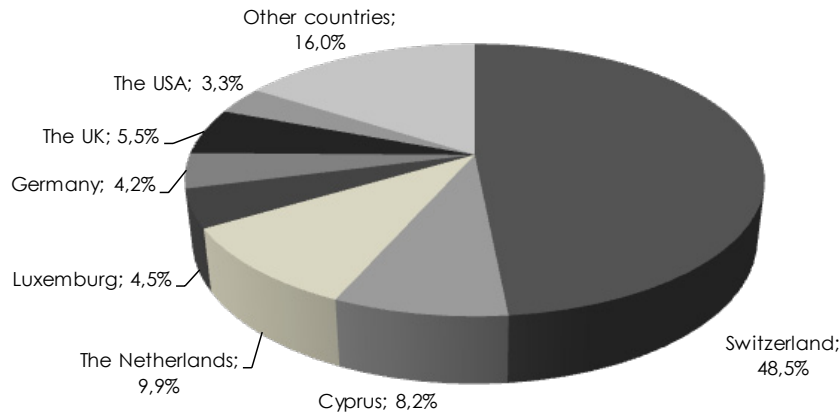


Fig. 4. The geographic pattern of foreign investments in the Russian Federation in the 1st quarter of 2012

Switzerland retained the leading position in the list of countries making investments in the Russian Federation; Swiss investments in the Russian economy were 31.4% lower than in the 1<sup>st</sup> quarter of 2011. The main area of interest to Swiss investors was still the financial sector. Switzerland accounted for 96.1% of all the foreign investments in that industry in the 1<sup>st</sup> quarter of 2012.

In January–March 2012, investments from the Netherlands in the Russian Federation fell by 10.6% on the respective period of 2011. In production of fuel and

energy primary products, Dutch investments amounted to \$2.6bn (the Netherlands accounts for 72.6% and 49.4% of the aggregate investments in the Russian economy and the aggregated foreign investments in the above industry, respectively), while in real-estate operations, to \$392m (10.9% and 19.0%). In the 1<sup>st</sup> quarter of 2011, the main portion of investments from the Netherlands (about \$1.8bn or 43.7% of the aggregate Dutch investments in the Russian Federation) was made in production of primary products, too and amounted to 37.1% of the aggregate foreign investments in that industry.

In January–March 2012, investments from Cyprus grew by 10.4% on the respective index of the 1<sup>st</sup> quarter of 2011. The main volume of investments from Cyprus was made in manufacturing industry – \$800m (26.7% of all the investments from Cyprus in the Russian Federation and 11.1% of the aggregate volume of foreign investments in that industry), real-estate operations – \$664m (22.2% and 32.1%) and production and distribution of power, gas and water – \$473m (15.8% and 81.8%).

The UK investments in the Russian Federation decreased by 10.1% as compared to January–March 2011. It is to be noted that the main portion of those investments was made in production of charred coal and oil products – \$733m (36.4% of all the UK investments in the Russian economy and 47.8% of the aggregate foreign investments in that industry). In addition to the above, UK investors took interest in real-estate operations – \$711m (35.4% and 34.4%) and trade – \$477m (23.7% and 14.6%).

In 2012, investments from Luxemburg in the Russian Federation increased by 28.2% on the 1<sup>st</sup> quarter of 2011 with the largest volume of investments (\$1.3bn) made in production of primary products (75.7% of all the investments from Luxemburg in the Russian Federation and 23.7% of foreign investments in the that industry).

In January–March 2012, the largest decrease in investments among countries making investments in the Russian Federation as compared to the respective period of the previous year was registered with Ireland (a drop of 95.5% to \$72m), while the highest growth in investments, with the USA (an increase of 280% to \$1.2bn).

Generally, as of the end of March 2012 the volume of the accumulated foreign investments in the Russian economy amounted to \$323.3bn which is 7.4% higher than the index as of the end of March 2011 and 6.9% lower than the level registered as of January 1, 2012. A considerable decrease in the accumulated foreign investments in the Russian economy on the previous quarter was registered last time in the 1<sup>st</sup> quarter of 2009 (a drop of 14.3%). ●



## THE FOREIGN TRADE

N.Volovik, K.Kharina

*In April 2012, for the first time since November 2009 shrinkage of the Russian foreign trade turnover due to a decrease both in the export and import in physical terms was observed. Insignificant growth in the export in monetary terms was justified by a favorable situation on the oil market in April.*

In April 2012, dynamics of the Russian foreign trade indices deteriorated. The foreign trade turnover calculated on the basis of the methods of the balance of payments amounted to \$72.9bn which is 0.2% lower than the index of April 2011. The export grew by the mere 0.2% as compared to the same index of 2011 and amounted to \$46bn. The import decreased by 0.9% to \$26.9bn. The surplus on Russia's foreign trade balance amounted to \$19.1bn, having increased by 1.9% as compared to the same index of 2011.

In April 2012, growth in the Russian export in monetary terms as compared to the same period of 2011 was justified by growth of 6.5% in the index of average export prices with a decrease of 5.7% in the volume index.

Reduction in the volume of the Russian import took place due to a decrease in its physical amount which index amounted to 97.5%. The index of average prices on imported goods remained virtually at the last year's level (99.3%).

In April 2012, trade conditions remained favorable: the trade conditions index was equal to 107.3, however, a year earlier trade conditions were much better and the index was at the level of 117.1.

A drop in the growth rates of the Russian export is explained by worsening of the global market situation. In April 2012, global oil prices started to go down. On April 2, the oil price amounted to \$125.45 per barrel, while by the end of the month the Brent oil price fell to \$119.37 a barrel. In May-June, oil prices kept falling on the global market: in mid-May oil prices fell below \$110 per barrel, while early in June, below \$100 per barrel. On June 21, 2012, the price on Brent oil was below \$90 per barrel.

The main factor which determined the situation on primary commodity markets was still a slowdown of growth rates of the main global economies. The Federal Reserve System (FRS) revised downward its forecast of the US economy. In China which is the world's main consumer of base metals and the second largest consumer of oil after the USA, industrial activity in the manufacturing sector declined. There was still uncertainty about further developments in the euro area. The information about growth in reserves of energy carriers in the USA to the record-high level in the past 22 years contributed to a drop in oil prices, as well.

However, there are factors which may trigger growth in oil prices. The meeting between representatives of

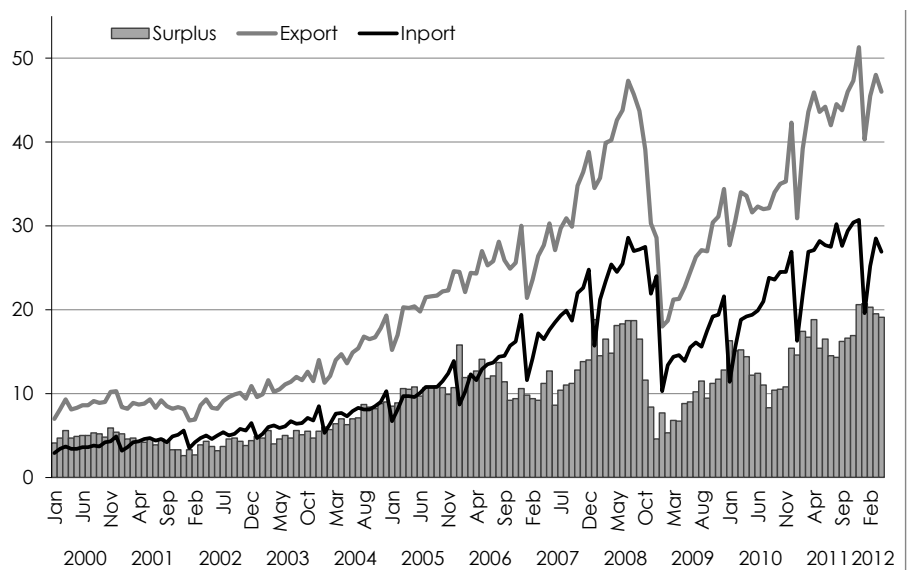


Fig. 1. The main indices of the Russian foreign trade (billion \$)

Iran and international intermediaries (Russia, the UK, China, the USA, France and Germany) which was held in Moscow in June ended up without any results. From July 1, sanctions planned by the EU and the US against Iran are to come into effect and export supplies from Iran to some countries will stop. Under the above sanctions, insurance companies from the EU are banned to underwrite Iranian export which situation may create problems to some Asian buyers from, for example, Japan, South Korea, India and China. If oil traders respond nervously to imposition of sanctions against Iran oil prices will grow again. In addition to the above, OPEC countries have an immense potential to influence the market: in case of a sudden drop in oil prices they will reduce production quotas and oil prices will grow inevitably again.

Table 1

## AVERAGE MONTHLY GLOBAL PRICES IN APRIL OF THE RESPECTIVE YEAR

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2000
Oil (Brent), USD/per barrel	26.26	25.81	24.79	33.5	50.6	68	68.32	108.26	50.85	84.98	123.07	120.46
Natural gas*, USD/1 million BTU	4.48	2.81	4.03	3.92	5.86	8.24	8.00	12.19	8.51	7.52	10.36	11.42
Petrol, USD/per gallon	0.999	0.814	0.855	1,152	1,603	2,016	2.13	2,884	1,459	2,321	3.24	3.22
Copper, USD/per ton	1689.4	1620.8	1598.5	2950	3395	6370	7766.5	8684.9	4406.6	7745.1	9483.3	8289.5
Aluminium, USD/per ton	1493.7	1370.3	1332.8	1734	1894	2620	2814.8	2959.3	1420.9	2316.7	2662.6	2049.7
Nickel, USD/per ton	6303.1	6940.6	7915.3	12872	16142	17935	50267	28763	11166	26031	26329	17939.8

\* The market of Europe, average contractual price, franco border.

Source: The World Bank.

In April 2012, prices on Urals oil amounted to \$117.1 per barrel and decreased by 2.0% and 4.5% as compared to April 2011 and March 2012, respectively.

In the period from May 15 till June 14, 2012, the average oil price amounted to \$102.7 per barrel. As a result, in accordance with Resolution No. 618 of June 25, 2012 of the Government of the Russian Federation from July 1, 2012 the export duty on oil in the Russian Federation will amount to \$369.3 per ton. In June, the export duty on oil was at the level of \$419.8 per ton. Thus, the duty decreased by 12%. The reduced duty rate decreased by 18%: from \$210.8 per ton in June to \$173 per ton. From July 1, the duty on light and dark oil products which from October 1, 2011 was unified at the level of 66% of the oil duty will amount to \$243.7 per ton. From June 1, it was set at the level of \$277 per ton. From July 1, the export duty on petrol will be reduced from \$377.8 per ton in June to \$332.4 per ton.

According to the data of the London Metal Exchange, in April 2012 prices on aluminium, copper and nickel decreased by 23.1%, 12.9% and 32.0%, respectively, as compared to April 2011, while steel prices fell by 7.6%. As compared to March 2012, prices on aluminium, copper, nickel and steel fell by 6.2%, 2.3%, 4.3% and 0.7%, respectively.

In April 2012, the food price index of the UN Food and Agricultural Organization (FAO) fell by 3 points or 1.4% as compared to March. It was the first decrease in the three months of uninterrupted growth. Though the index is much below its record-high level of 235 points which was registered in April 2011, the level of April 2012 is quite high (214 points). Prior to 2008, the average level was below 200 points.

According to the data of the Central Bank of the Russian Federation, in January–April 2012, the Russian foreign trade turnover amounted to \$280bn (111.4% on January–April 2011), including export – \$179.8bn (113.0%) and import – \$100.2bn (108.7%). The export surplus increased to \$79.6bn against \$66.9bn in January–April 2011.

In 2012, growth rates of the Russian export slowed down considerably. Throughout 2011, the monthly average growth rates of export on the respective month of the previous year amounted

to 30.3%; in January 2012, February 2012, March 2012 and April 2012 they amounted to 32.9%, 16%, 9.9% and 02%, respectively on the respective month of the previous year.

In January–April 2012, in the structure of export the unit weight of food products and their primary products, fuel and energy products, machines, equipment and transport means increased, while the share of metals, metal products, chemical products, wood and pulp and paper products decreased.

The volume of export of food products and their primary products in monetary terms grew by 90% which was justified by an increase in the physical amount of the export. For instance, the export volume of sunflower oil increased 11.9 times over. By mid-April, the record-high export of wheat (18.5m tons) was registered in Russia. The previous record was registered in the 2009/10 season when 18.1m tons (without flour on grain basis taken into account) were exported. Also, the record-high export of pulse crop – over 600,000 tons – was registered. In the first decade of April, the export of maize amounted close to the record level and exceeded 1.2m tons. The share of food products and their primary products in the total volume of export increased from 1.3% in January–April 2011 to 2.8% in January–April 2012.

The average monthly growth rates of import in monetary terms on the respective period of the previous year on the basis of the results of 2011 amounted to 32.2%, in January 2012 – to 20.1%, in February – to 15.6% and in March – to 5.9%. In April 2012, the index amounted to 0.9% which can be explained by a slowdown of investment activities and small depreciation of the ruble exchange rate (in April depreciation of the nominal effective rate of the ruble amounted to 0.2%, while that of the real effective rate, to 0.5%). In addition to the above, a decrease in the imports contributed to a reduction in the volume of food purchases which remained high last year due to a low level of domestic reserves as a result of bad harvest of 2010. In the four months of 2012, import food supplies decreased by 12.9%.

In the commodity pattern of the import, in January–April 2012 the share of machines, equipment and transport means increased to 50.1% against 44.9% in January–April 2011.

On May 24, 2012, the Collegium of the Eurasian Economic Commission adopted a Resolution On Measures to Protect Economic Interests of Producers of Rolled Products with Polymer Coating in the Customs Union. Under the above Resolution, from July 1, 2012 an antidumping duty is introduced for the period of five years in respect of flat cold-rolled products with a gauge of over 0.2 mm to maximum 2 mm with polymer coating produced in the Peoples Republic of China<sup>1</sup>. The above decision of the Eurasian Economic Commission was taken on the basis of the results of the antidumping probe carried out by the Ministry of Industry and Trade of the Russian Federation. It is to be noted that it was the first probe which was made in accordance with the legislation of the Customs Union (CU).

The probe began on February 11, 2011 upon application of Russian producers of rolled products with polymer coating – OAO Severstal, OAO Novolipetsky Metal Works (OAO NLMK) and OAO Magnitogorsky Metal Works (OAO MMK) – and it established the fact of dumping export of polymer rolled products from China which caused material damage to the industry of member-states of the Customs Union; under the rule of the WTO such a situation constitutes grounds for antidumping measures to be introduced.

In the 2008–2010 period, the volume of import of rolled products with polymer coating from China to the Customs Union increased considerably by 257,700 tons or nearly 100%. It is to be noted that the largest growth in import volumes of that product from China fell on the first six months of 2010: as compared to the first half year of 2009 the volume of import supplies from China increased 9.7 times over. In the 2008–2010 period, the share of rolled products with polymer coating from China in the total volume of import to the territory of the Customs Union increased from 52.6% in 2008 to 74.7% in 2010.

The size of the antidumping duty amounts to 22.6% of the customs value of goods. It is to be noted that a special duty is set in respect of three companies producing polymer coated rolled products, namely: Angang Steel Co., Ltd (a duty of 12.9%), Dalian POSCO Co., Ltd. (11.4%) and Shandong Guanzhou Co., Ltd. (8.1%).●

1 [http://www.tsouz.ru/db/spec\\_measures/Pages/def\\_measures.aspx](http://www.tsouz.ru/db/spec_measures/Pages/def_measures.aspx)

## STATE BUDGET

T.Tischenko

The continuous decline in international oil prices noted since April 2012 has not yet seriously affected federal budget revenues. At the end of the period between January and May 2012 revenues to the federal budget accounted for 22.2% of GDP, or up 1.4 percentage points above the respective figure of the same period in 2011, which, proved to be a fairly favorable year in terms of prices for carbohydrates. That said, the increase in the oil-and-gas revenues to the federal budget between January and May 2012 made up 1.6 p.p. of GDP on a year-on-year basis. Meanwhile, federal budget expenditures were up 2.8 p.p. of GDP over the period in question vs. the five months of the prior year and hit the level of 21.7% of GDP. As a consequence, at the end of the five months of 2012, the federal budget was executed with a subtle surplus of 0.6% of GDP.

### Analysis of Main Parameters of Execution of the Federal Budget between January and May 2012

Federal budget revenues accounted for Rb 5,082.3bn, or 22.2% of the nation's GDP between January and May 2012, or up 1.4 p.p. of GDP on a year-on-year basis (see *Table 1*). As far as oil-and-gas revenues are concerned, the increase was 1.6 p.p. of GDP vs. the same period of 2011. The major revenue administrators, the Federal Tax Service and the Federal Customs Service, reported a 0.6 p.p. of GDP increase in revenue collection on a year-on-year basis each. That said, at the end of the five months of the year, the federal budget received 43.1% of the overall volume of revenues approved in the initial draft of the federal budget act for 2012-2014, while the respective figure of the five months of 2011 was 47.5%. So, this year, the pace of increase in federal budget revenues displays some deceleration on a year-on-year basis.

The budget expenditure volume over the period in question hit Rb 4,962.3bn (21.7% of GDP), or up Rb 1,147.5bn. (2.8 p.p. of GDP) on a year-on-year basis. Expenditure-wise, cash execution of the budget between January and May 2012 accounted for 39.2% of approved volumes, while at the end of the same period of 2011, the figure was 35.8%. At the end of the five months of the year, the federal budget surplus made up Rb 120.0bn (0.6% of GDP), or down 1.3 p.p. of GDP vs. the same period of the past year. The non-oil-and-gas deficit volume surged 2.9 p.p. of GDP (11.2% of GDP) on a year-on-year basis.

*Table 1*

MAIN PARAMETERS OF THE FEDERAL BUDGET OF RF BETWEEN JANUARY AND MAY 2011–2012

	January–May 2012		January–May 2011		Bias error, p.p. of GDP
	Rb bn	% of GDP	Rb bn	% of GDP	
Revenues, including:	5082.3	22.2	4200.0	20,8	1,4
Oil-and-gas revenues	2688.0	11.8	2067.0	10,2	1,6
Revenues across major revenue administrators:					
– FTS	2120.2	9.3	1761.2	8,7	0,6
– FCC	2839.1	12.4	2391.7	11,8	0,6
Expenditures, including:	4962.3	21.7	3814.8	18,9	2,8
Interest revenues	128.6	0.6	98.9	0,5	0,1
Non-interest revenues	4833.7	21.1	3715.9	18,4	2,7
Surplus (deficit) of the federal budget	120.0	0.6	385.3	1,9	-1,3
Non-oil-and-gas deficit	-2568.9	11.2	-1681.8	8,3	2,9
GDP(estimated)1	22932		20269		

Source: MinFin of Russia, the Federal Treasury of RF, calculations by the Gaidar Institute.



During each of the five months of the year, the expenditure part of the federal budget (*Table 2*) displayed a continuous trend to decline in expenditure as a share of GDP, on a year-on-year basis, across sections “National Economy” (by 0.3 p.p. of GDP), “Housing and Utilities” (by 0.4 p.p. of GDP) and “Interbudgetary Transfers” (by 0.3 p.p. of GDP). At the end of the period of January-May 2012, like during the preceding four months, it was the following sections of the federal budget which experienced the greatest increase in expenditures on a year-on-year basis: “National Defense” – by 1.2 p.p. of GDP, “Social Policy” – by 0.7 p.p. of GDP, “National Security and Law-Enforcement Activities” – by 0.6p.p. of GDP, “Education” – by 0.5 p.p. of GDP, “Health Care” – by – 0.4 p.p. of GDP.

Table 2

## FEDERAL BUDGET EXPENDITURES BETWEEN JANUARY AND MAY 2011 AND 2012

	January–May 2012		January–May 2011		Bias error, p.p. of GDP
	Rb bn	% of GDP	Rb bn	% of GDP	
Expenditures, total	4962.3	21.7	3814.8	18.9	2.8
including					
General public administration matters	271.2	1.2	223.7	1.1	0.1
National defense	895.4	3.9	537.3	2.7	1.2
National security and law-enforcement activities	598.7	2.7	414.7	2.1	0.6
National economy	521.3	2.3	514.6	2.6	-0.3
Housing and utilities	24.8	0.1	92.0	0.5	-0.4
Environmental management	8.6	0.1	5.3	0.1	0.0
Education	282.7	1.3	162.5	0.8	0.5
Culture and the moving picture industry	34.8	0.2	23.7	0.2	0.0
Health Care	267.2	1.2	154.5	0.8	0.4
Social policy	1631.8	7.2	1260.4	6.3	0.7
Physical culture and sport	16.2	0.1	16.4	0.1	0.0
Mass media	29.8	0.2	26.2	0.2	0.0
Public debt servicing	128.6	0.6	98.9	0.5	0.1
Interbudgetary transfers	251.4	1.1	284.9	1.4	-0.3

Source: MinFin of Russia, the Federal Treasury of RF, calculations by the Gaidar Institute.

For the other sections, federal budget expenditures over the five months of the year as a share of GDP posted microscopic changes (up to 0.1p.p.) or remained at a level reported between January and May 2011.

Expenditure-wise, cash execution of the federal budget between January and May 2012 hit 39.0%, thus proving to be far lower than the respective figure registered a year ago – 47,5%. The level of cash execution of the federal budget expenditures with regard to federal target programs over the five months of the year accounted for some 20%, which is explained by delays with signing with the Subjects of the Federation of agreements necessary to implement the FTPs. Plus, payments under most public contracts concluded in the course of implementation of FTPs are traditionally effected in the last quarter of the year.

According to the RF MinFin, as of late May 2012 the Reserve Fund and the National Welfare Fund balances increased slightly due to changes in exchange rate differences and made up Rb 1,953.9bn. (+128.6bn in May) and Rb 2,773.8bn (+149.0bn in May), respectively. The public debt volume as of the same date remained unchanged since the previous month and accounted for Rb 3,796.6bn.

### Execution of the Consolidated Budget of the Subjects of RF between January and April 2012

According to the Federal Treasury, *revenues to the consolidated budget of the RF Subjects* between January and April accounted for 13.7% of GDP, or down 2.4 p.p. of GDP on a year-on-year basis



(see *Table 3*). In this regard the unfolding tendency to fall in revenues to the 2012 consolidated budget vs. the 2011 figures is worth a particular notice: while at the end of January 2012 revenues to the RF Subjects' budgets proved to be at 1.3 p.p. above the figure reported in January 2011, in the first two months of the year, the nation's GDP plunged 0.8 p.p. year-on-year, and at the end of the four months of 2012 the gap between the 2012 revenues to the RF Subjects' consolidated budget and the 2011 figures widened up to -2.4 p.p. of GDP.

Table 3

MAIN PARAMETERS OF THE CONSOLIDATED BUDGET OF THE RF SUBJECTS BETWEEN JANUARY AND APRIL 2011-2012

	January–April 2012		January–April 2011		Bias error p.p. of GDP
	Rb bn	% of GDP	Rb bn	% of GDP	
Revenues, including:	2 434.4	13.7	2 511.7	16,1	-2,4
– corporate profit tax	606.7	3.4	749.7	4,8	-1,4
– PIT	637.0	3.6	558.7	3,6	0,0
– domestic excise taxes	132.2	0.8	108.2	0,7	-0,1
– joint income tax	119.5	0.7	89.1	0,6	0,1
– property tax	254.8	1.5	244.4	1,6	-0,1
– non-repayable receipts from the other budgets of the budget system of RF	532.1	3.0	578.2	3,7	-0,7
Expenditures, including:	2 148.3	12.1	1 807.9	11,6	0,5
Surplus (deficit) of the consolidated budget of the RF Subjects	286.0	1.6	703.7	4,5	-2,9
GDP (est.)	17 800.0		15 682.0		

Source: Federal Treasury of RF, calculations by the Gaidar Institute.

Meanwhile, expenditures of the RF Subjects' consolidated budget over the period in question posted a 0.5p.p. of GDP growth on a year-on-year basis and hit 12.1% of GDP, or Rb 2,148.3bn. The fall in revenues and rising expenditures between January and April 2012 as a share of GDP resulted in contraction of the RF Subjects' budget surplus down to 1.6% of GDP (Rb 286bn), or down 2.9 p.p. of GDP on a year-on-year basis and 0.7 p.p. of GDP below the figure reported over the period January to March 2012.

It was the corporate profit tax revenues to the RF Subjects' budgets which dipped the most on a year-on-year basis over the first four months of 2012 (by 1.4 p.p. of GDP), followed by interbudgetary transfers (down 0.7 p.p. of GDP). The contraction in the corporate profit tax revenues can be ascribed to the fact that a sizeable part of the amount of tax payments due in April 2012 was collected to the budgets of all tiers in May 2012, per the corporate profit tax payment timelines: the payments were due by 28 April, ie. the last working day of the month. Revenues to the consolidated budget from the property tax and excise taxes dwindled insignificantly – by 0.1 p.p. of GDP on a year-on-year basis.

Meanwhile, the dynamic of the consolidated RF Subjects' budget expenditures has remained unchanged over the first four months of the year (*Table 4*). As at the end of Q1 of the year, the increase in spending was likewise boosted by items "Education" (up 0.5 p.p. of GDP), "National Economy" (0.5 p.p. of GDP), and "Healthcare" (0.2 p.p. of GDP), while expenditures under the "National security and Law-Enforcement Activities" section were slashed by 0.3 p.p. of GDP on a year-on-year basis. All other sections saw no changes in spending as a share of GDP equivalent on a year-on-year basis or the changes in questions found themselves being under 0.1 p.p. of GDP.

As of 1 May 2012 the RF Subjects' public debt stood at Rb 1161.9bn, down by nearly Rb 2bn since early April. The major challenge currently facing regional budgets is financing housing and utilities, power generating and electricity supply facilities the Ministry of Defense transferred to municipalities. While the 2012-14 Budget Act holds that their transfer should go hand-in-hand with reallocation of funds from the Ministry of Defense in favor of the RF Subjects,

the latter thus far have seen no cash at hand. The situation with the already transferred or scheduled for transfer facilities may further exacerbate by the autumn, as their maintenance costs are going to rise in the wintertime. That said, regional budgets have foreseen no specific allocations to address the issue.

Table 4

EXPENDITURES OF THE CONSOLIDATED BUDGET OF THE RF SUBJECTS  
BETWEEN JANUARY AND APRIL 2011–2012

	January–April 2012		January–April 2011		Bias error, p.p. of GDP
	Rb bn	% of GDP	Rb bn	% of GDP	
Expenditures, total					
including	2148.3	12.1	1807.9	11.6	0.5
General public administration matters	136.3	0.8	131.5	0.9	-0.1
National defense	0.9	0.0	0.7	0.0	0.0
National security and law-enforcement activities	21.9	0.2	72.5	0.5	-0.3
National economy	337.5	1.9	239.7	1.6	0.3
Housing and utilities	182.3	1.1	164.6	1.1	0.0
Environmental management	4.8	0.1	3.0	0.1	0.0
Education	582.2	3.3	440.3	2.8	0.5
Culture and the moving picture industry	73.0	0.5	57.0	0.4	0.1
Health Care	360.1	2.1	292.5	1.9	0.2
Social policy	379.1	2.2	341.9	2.2	0.0
Physical culture and sport	37.1	0.2	33.4	0.3	-0.1
Mass media	10.3	0.1	8.2	0.1	0.0
Public debt servicing	16.8	0.1	16.8	0.1	0.0
Interbudgetary transfers	5.8	0.1	5.5	0.1	0.0

Source: Federal Treasury of RF, calculations by the Gaidar Institute.

### The Budget Policy Milestone Developments

June 2012 saw the passing of amendments to the federal budget<sup>1</sup>, which are based on a specified socio-economic development forecast<sup>2</sup>. The 2012 federal budget revenues were raised by Rb 877.2bn up to Rb 12,677.0bn; the expenditure volume was increased by Rb 88.7bn up to 12,745.1bn. The upper margin of the domestic public debt as of 1 January 2013 was lowered by Rb 868.7bn to Rb 5,462.1bn. Consequently, the budget deficit shrank from 1.5% of GDP to до 0.1% of GDP. However, with roller coaster international oil prices and Rb/\$ and Rb/€ exchange rates, reducing the federal budget deficit and the public debt volume to earlier established figures seems a truly herculean task. The Russian Government admits the possibility of a fall in the 2012 budget revenues due to a downfall in carbohydrate prices. If the situation with oil prices fails to get back to normal, securing the budget deficit within the pre-established limits would require abandonment of financing of conditionally approved spending.

In late May, with its Resolution the RF Government approved<sup>3</sup> the 2012 Action Plan on implementation of the 2012 Government Program on boosting efficiency of budget spending. The core move under the Action Plan is crafting a new version of the Budget Code of RF and, in particular, its sections on the use of oil-and-gas revenues, setting budgetary procedures and identification of a minimum amount of conditionally approved expenditures.

The issue of introduction of a new budget procedure, which should form the basis for adjustment of the cap on federal budget spending for 2013-14 basing on an oil price five-year average has been practically resolved. As well, the marginal level of the federal budget deficit was set at a level of 1.0% of GDP. It is envisaged that the novelty should be legislated until the beginning of the State Duma's summer recess. So, it can be admitted that the RF Government has started implementing measures to ensure the national budget system's sustainability.

1 Federal Act of 05.06.2012 N 48-FZ.

2 More specifically, the oil price forecast was modified: from \$100/b up to \$115/b, with the average H1 price equaling \$120/b.

3 Executive Order of the RF Government of 28 May 2012r № 853-r.

## RUSSIAN BANKING SECTOR

M.Khromov

*In May 2012 the banking sector has faced with a reduction of almost all kinds of borrowed funds. The largest decrease has affected loans and funds borrowed from the Bank of Russia. Among the active operations, an intensive growth continued only in the market of retail lending.*

Within May 2012, the Russian banking sector assets grew by 2.5%. However, all this growth was due to the revaluation of bank assets denominated in foreign currency. In May, the US dollar against the ruble rose by 12%, Euro – by 5%. Adjusted for revaluation, the dynamics of banking assets in May was negative -0.2%, and annual growth rates of assets slowed down to 20% (from 23% in January 2012).

In May the banks' own funds<sup>1</sup> grew by 1.3%, which is less than the nominal growth rate of total assets. At the same, capital adequacy ratio has declined from 14.3 in May to 14.1%. Reduction of capital adequacy is sustained nearly through the total post-crisis period, which is associated with an acceleration of growth in banks' loan portfolio. And although the overall level of capital adequacy has not reached the threshold of 10%, capital adequacy ratio of some large banks is already approaching the critical point. Thus, in VTB this figure as of June 1, 2012 was 11.8%, in Gazprombank – 11.1%, in Alfa-Bank – 11.3%.

The profit of the banking sector in May amounted to Rb 74bn, which corresponds to the level of the rate of return on assets (ROA) at 2.1%, and return on equity (ROE) – 18.1% in annual terms. Since the beginning of the year decrease in the profitability of the banking business can be noted. In the first five months ROA indicator made 2.4% and ROE – 20.6%.

**Raised funds**

The volume of bank *deposits of the population* in May has increased in nominal terms by 1.9%. However, as with most other balance indicators, their dynamics was strongly affected by ruble depreciation. Adjustment for the changes in currency rates reveals a negative trend of household savings with the banks; they have decreased over the month by 0.2%. The annual rate of public funds flow in the banks has declined to 17.9%

In terms of currency structure of deposits in May, the individuals preferred the ruble deposits, despite the depreciation of the currency. Ruble accounts of physical persons rose by 0.7%, or by Rb 68bn, while foreign currency accounts denominated in dollars declined by 3.9% or by Rb 2.9bn, which defined a negative trend of the individual savings with the banks.

The value of *bank assets in the accounts of corporate clients*, after adjusting for currency and has not changed: the growth rate was 0.2. The increase in balances on ruble deposits stood at 1.2%, and the amount of funds in foreign currency (in dollar terms) has declined by 3.5%.

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	02.12	03.12	04.12	05.12
Liabilities, Rb bn	20125	28022	29430	33805	35237	38443	41628	41150	40874	41533	42151	43225
Own assets	15.3	14.1	19.3	18.7	18.5	17.3	16.9	17.3	17.6	17.5	17.3	17.0
Loans of the Bank of Russia	0.2	12.0	4.8	1.0	0.9	1.3	2.9	3.3	3.1	3.5	4.4	3.9
Interbank operations	4.1	4.4	4.8	5.5	5.2	5.4	5.7	5.7	5.3	5.1	4.9	4.7
Foreign liabilities	18.1	16.4	12.1	11.8	10.9	11.4	11.1	10.6	10.2	10.2	10.4	11.0
Private deposits	26.2	21.5	25.9	29.6	30.4	29.0	29.1	28.7	29.4	29.4	29.6	29.4
Corporate deposits	25.8	23.6	25.9	25.7	24.3	24.4	26.0	25.9	25.9	25.7	24.8	24.9

1 Estimated under the form of statements for credit institutions 040 913.

Table 1, cont'd

	12.07	12.08	12.09	12.10	06.11	09.11	12.11	01.12	02.12	03.12	04.12	05.12
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	1.4	1.4	1.7
Securities issued	5.8	4.1	4.1	4.0	4.0	3.8	3.7	3.8	4.4	4.8	4.6	4.6

Source: Bank of Russia, Gaidar IEP estimates.

In terms of the structure of corporate clients' deposits, the trend of fixed-term deposit dominance over the current accounts is sustained. 48% are recorded in settlement accounts of enterprises and organizations, and the deposits make 52%. Thus, the volume of fixed-term deposits of enterprises makes about 10% of GDP.

Foreign liabilities of the banks in May 2012 decreased by \$0.5bn. As a result, total debt of banks to non-residents has returned to the level of early 2012, i.e., to \$139bn. Herewith, foreign assets of the banks reduced much more strongly – by \$14bn. As a consequence, the external sector in May acted as a net creditor to the banking sector in the amount of about \$9bn.

### Investments

Despite the stagnation of the main types of borrowed funds in the domestic market, in May the banks continued an active *lending in the retail market*. The volume of outstanding arrears of individuals to banks increased in May by 3.9% (3.4% upon adjustment for currency revaluation). Annual growth rates of retail credit portfolio reached 42%

The rate of growth of overdue debts and provisions for losses on loans to individuals continue to lag behind the rate of growth in credit debt, amounting to 2.0% and 1.5%, respectively. As a result, the formal credit quality of retail portfolio continues to improve. The share of overdue loans has decreased to 4.9%, and the amount of available provisions – up to 6.6% of the total portfolio of loans to individuals.

*Lending to corporate clients*, on the contrary, almost stopped in May. Adjusted for currency revaluation, the amount of credit outstanding debt has declined by 0.3%, while the annual growth rate declined to 19.3%. In case this category includes the banks' investments in the bonds of Russian issuers, reduction in loans to non-banking sector of the economy would be even greater. In this case, reducing the total volume of bank loans to non-banking sector has decreased over the month by 0.7%. At the same time, the banking portfolio of corporate bonds declined in May by 7.8%.

Indicators of the quality of corporate banking loan portfolio over the past month has not changed. The share of overdue debt on loans to enterprises and organizations remained at the level of 5.1%. The ratio of reserves for possible losses versus total credit debt got reduced from 8.3 to 8.2%.

### Liquidity and state support

The share of liquid assets<sup>1</sup> of the banking sector once again has updated a new minimum peak – 4.1% of total bank assets, as compared with 4.3% a month earlier and 6.2% at the beginning of the year. However, in May the reduction in liquidity was due to primarily growth of the nominal amount of bank assets. The amount of liquid assets remained virtually unchanged. The amount of the banks' funds on correspondent accounts with the Bank of Russia decreased by Rb 24bn, and the deposits, on the contrary, increased by Rb 26bn.

Factors of forming the banking sector liquidity or, in other words, the sources of monetary emission in May were also volatile. The volume of banks' debt to the Bank of Russia decreased by Rb 142bn. It was offset by the Bank of Russia's interventions in the domestic foreign currency market in the amount of \$1.4bn and the reduced balances in the extended government accounts with the Bank of Russia by Rb 67bn.

It is noteworthy that the greatest share of the banks' liquid assets formed by the balances in cash boxes (and ATMs) of banking institutions, i.e., by the eventual withdrawal of funds from

1 The amount of cash in credit institutions' cash boxes, correspondent accounts and deposits with the Bank of Russia.

customer accounts, rather than not non-cash payments. Cash (with regard to foreign currency in cash) share makes Rb 1.0 trillion of Rb 1.7 trillion of liquid assets, i.e., nearly 60% of their total volume.

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	01.12	02.12	03.12	04.12	05.12
Assets, Rb bn	20125	28022	29430	33805	35237	38443	41628	41150	40874	41533	42151	43225
Cash and precious metals	2.5	3.0	2.7	2.7	2.2	2.3	2.9	2.5	2.5	2.4	2.5	2.4
Deposits with the Bank of Russia	6.9	7.5	6.9	7.1	4.5	3.5	4.2	3.6	3.2	3.2	2.6	2.6
Interbank operations	5.4	5.2	5.4	6.5	6.4	6.2	6.4	6.6	6.3	6.2	6.0	5.7
Foreign assets	9.8	13.8	14.1	13.4	13.8	14.6	14.3	14.6	14.3	14.2	14.3	14.6
Individuals	16.1	15.5	13.1	13.0	14.0	14.2	14.4	14.6	15.0	15.3	15.6	15.8
Corporate sector	47.2	44.5	44.5	43.6	45.3	45.1	44.0	44.2	44.2	44.4	44.6	44.1
Government	4.1	2.0	4.2	5.1	5.8	6.0	5.0	4.8	5.1	4.9	4.1	4.5
Property	2.2	1.9	2.7	2.6	2.5	2.4	2.3	2.4	2.4	2.4	2.4	2.3

Source: Bank of Russia, Gaidar IEP estimates. ●



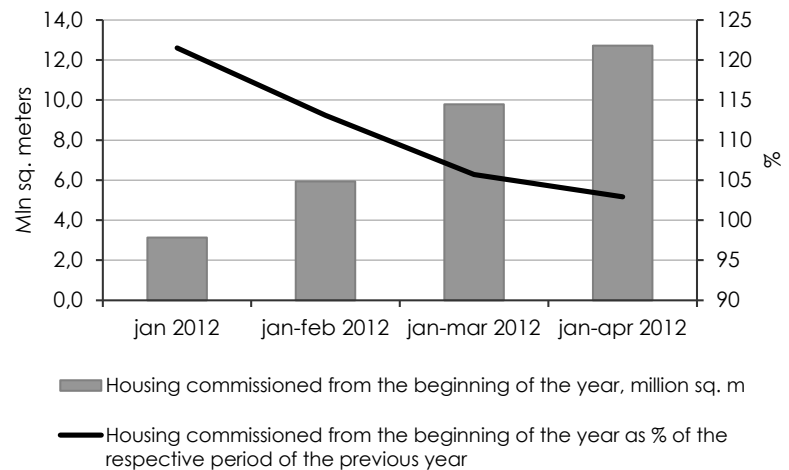
## THE REAL ESTATE MARKET IN THE RUSSIAN FEDERATION

G.Zadonsky

In April 2012, 30,900 new apartments with the total floorspace of 2.9m sq. meters were built or 94.4% as compared to April 2011. In the 1<sup>st</sup> quarter of 2012, the average price of a sq. meter of housing in the primary market (Rb 44,955.5) increased by 8.24% on the 1<sup>st</sup> quarter of 2011. The ratio between the price of a sq. meter of housing on the primary market and the cost of building of a sq. meter of housing increased by 30.15p.p. and amounted to 160.38%. In January–April 2012, 198,865 housing loans for the total amount of Rb 279.0bn were extended, including 184,817 mortgage housing loans for the amount of Rb 266.86bn which figure exceeds by 69.92% the monetary volume of MHL extended in January–April 2011. In April 2012, the outstanding debt on MHL in rubles rose by 3.24% to Rb 1,442 trillion, while that on loans in foreign currency decreased by 6.7% to Rb 131.51bn.

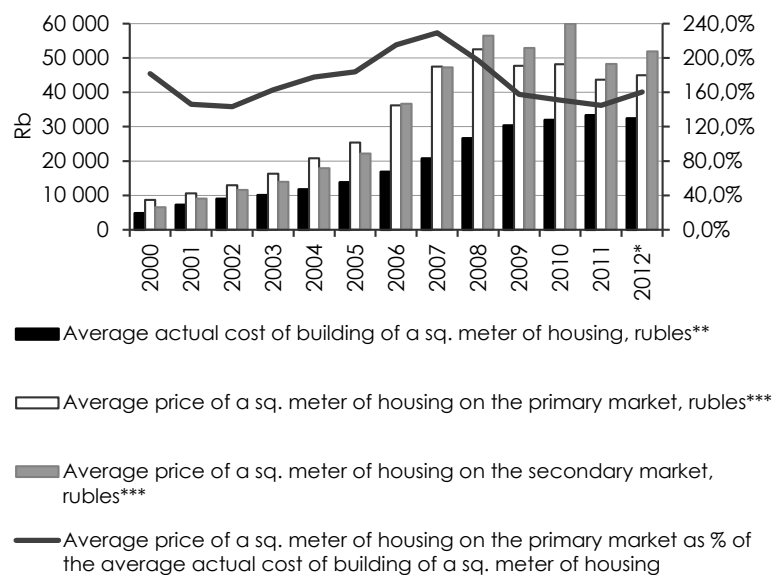
According to the Rosstat's data, in the 1<sup>st</sup> quarter of 2012 111,800 apartments with the total floorspace of 9.79m sq. meters were built, which amounted to 105.7% on the respective period of the previous year. Individual developers accounted for 5.3m sq. meters of housing in the above volume or 53.8% of the total floorspace commissioned in the 1<sup>st</sup> quarter of 2012. In April 2012, 30,900 new apartments with the total floorspace of 2.9m sq. meters were built or 94.4% on April 2011 (Fig. 1).

In the 1<sup>st</sup> quarter of 2012, the average actual cost of building of a sq. meter of housing amounted to Rb 32,366 (Fig. 2) having increased by 1.48% on the 1<sup>st</sup> quarter of 2011 (Rb 31,893). In the 1<sup>st</sup> quarter of 2012, the average price of a sq. meter of housing on the primary market (Rb



Source: on the basis of the Rosstat's data.

Fig. 1. Dynamics of commissioning of housing on an accrual basis from the beginning of the year Source



\*1st quarter of 2012;

\*\*The average actual cost of building of a sq. meter of floorspace of detached dwelling houses (all the apartments) without extensions, overstory and built-in premises in the Russian Federation (without those built by households at their own account and by means of borrowed funds);

\*\*\*all the apartments.

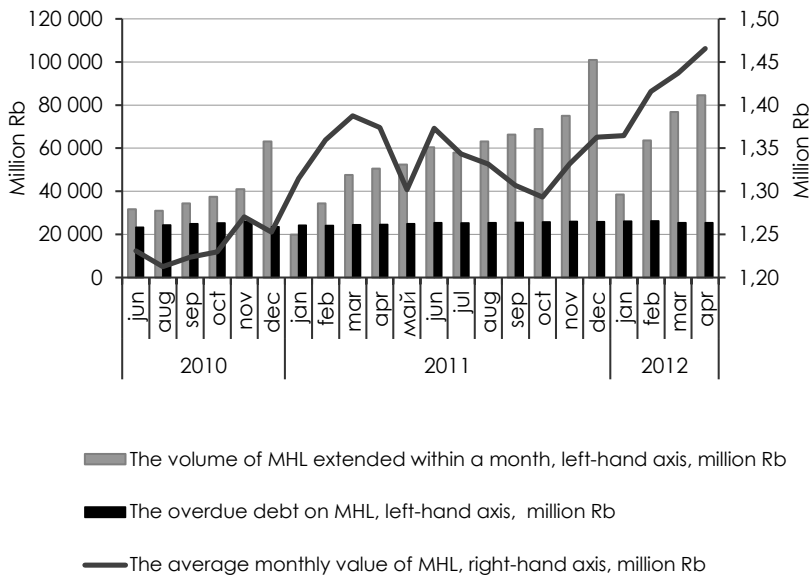
Source: on the basis of the Rosstat's data.

Fig. 2. Dynamics of the cost of building and housing market prices

44,955.5) rose by 8.24% on the 1<sup>st</sup> quarter of 2011 (Fig.2), but remained lower than the average price of a sq. meter of housing on the secondary market (Rb 51,907.2), which price rose too as compared to the 1<sup>st</sup> quarter of 2011. It is to be noted that in the 1<sup>st</sup> quarter of 2012 the ratio between the price of a sq. meter of housing on the primary market and the cost of building of a sq. meter of housing increased by 30.15 p.p. and amounted to 160.38% (Fig 2).

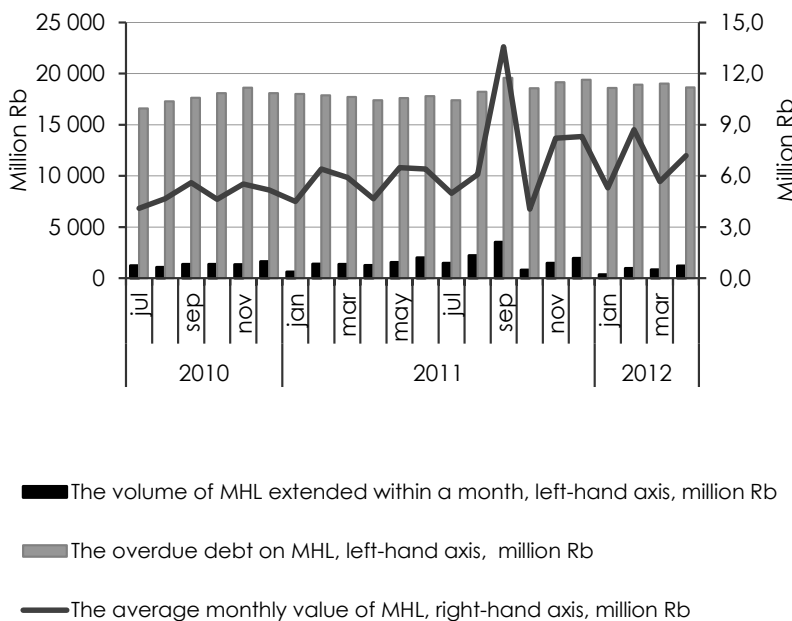
According to the Rosstat's data, in the 1<sup>st</sup> quarter of 2012 the average actual cost of building of a sq. meter of housing was over 50% higher than the nationwide average level in the Chechen Republic (Rb 64,239), the Republic of Ingushetia (Rb 56,200) and the Khabarovsk Territory (Rb 50,696) and below it in 50 constituent entities of the Russian Federation with the lowest one in the Republic of Adygea (Rb 15,976), the Lipetsk Region (Rb 18,053) and the Republic of Dagestan (Rb 19,896).

According to the data of the Central Bank of the Russian Federation, in January–April 2012



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

Fig. 3. Dynamics of mortgage housing lending in rubles



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

Fig. 4. Dynamics of mortgage housing lending in foreign currency

198,865 housing loans (HL) for the amount of Rb 279.0bn were extended, including 184,817 mortgage housing loans (MHL) for the amount of Rb 266.86bn which exceeds by 69.92% the monetary volume of MHL extended in January–April 2011. In April 2012, MHL in rubles were extended for the amount of Rb 84.55bn which is 67.35% more than in April 2011 (Fig. 3), while MHL in foreign currency, for the amount of Rb 1.21bn which is 3.27% less than in April 2011 (Fig. 4). In April 2012, the outstanding debt on MHL in rubles rose by 3.24% to Rb 1,442 trillion, while that on loans in foreign currency decreased by 6.7% to Rb 131.51bn.

The average value of MHL in rubles within a month starting from October 2011 rose by 13.32% and amounted to Rb 1,465m as of May 1, 2012 (Fig. 3). The average value of MHL in foreign currency lacked a strong trend within a month and in April 2012 amounted to Rb 7,178m which is 26.76% more than in March 2012 (Fig. 4).

As of May 1, 2012, the overdue debt on MHL (Rb 44.1bn, including a debt of Rb 25.46bn on loans in rubles (Fig. 3) and a debt of Rb 18.64bn on loans in foreign currency (Fig. 4)) was 5.09% higher than that as of May 1, 2011. The overdue debt as a percentage of the outstanding debt went down steadily and as of May 1, 2012 amounted to 2.8%, which is 0.76 p.p. lower than that as of May 1, 2011.

The overdue debt as a percentage of the outstanding debt on MHL in rubles keeps declining steadily: as of May 1, 2012 it amounted to 1.77%, which is 0.72 p.p. less than that as of May 1, 2011. The overdue debt on MHL in foreign currency as a percentage of the outstanding debt keeps growing invariably and as of May 1, 2012 it was at the level of 14.17%, which is 3.24 p.p. more than that as of May 1, 2011.

According to the data of the Central Bank of the Russian Federation, as of May 1, 2012, the debt on the defaulted MHL (with an overdue period of over 180 days) amounted to Rb 51.53bn or 3.25% of the total amount of the debt; it remained almost at the level of the previous month (*Table 1*). As of May 1, 2012, the share of the debt on MHL without overdue payments increased by 0.38 p.p. as compared to April 1, 2012 and amounted to 94.59% of the total amount of the debt.

Table 1

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

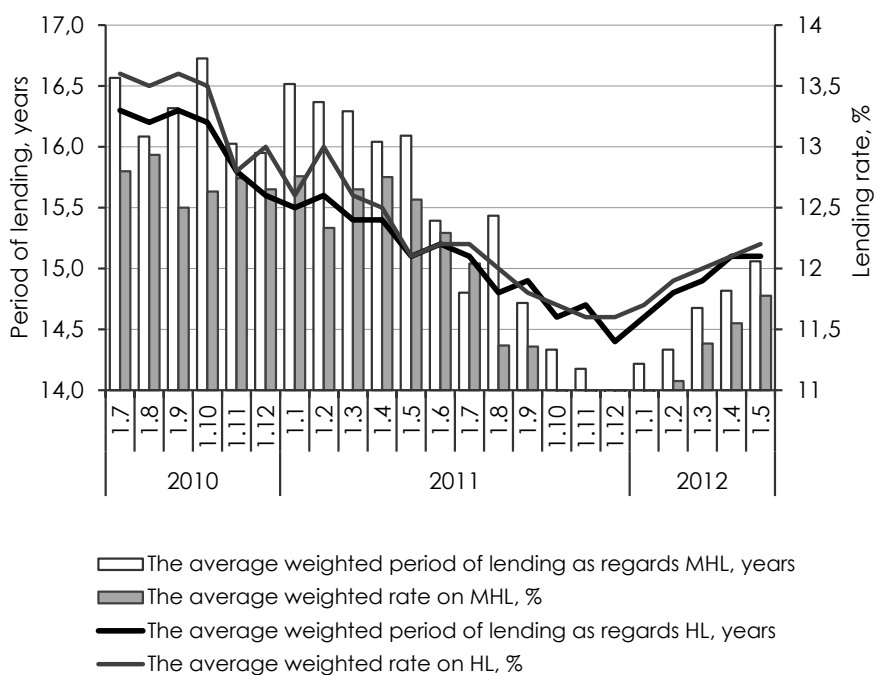
	The total amount of the debt on MHL, million Rb	Without overdue payments		With payments overdue					
				from 1 to 90 days		from 91 to 180 days		over 180 days	
		Million Rb	%	Million Rb	%	Million Rb	%	Million Rb	%
01 Jan.	1 478 982	1 391 130	94.06	27 805	1.88	5 916	0.4	54 131	3.66
01 Feb.	1 477 175	1 377 466	93.25	40 327	2.73	6 647	0.45	52 735	3.57
01 Mar.	1 499 489	1 398 423	93.26	42 136	2.81	5 698	0.38	53 232	3.55
01 Apr.	1 538 093	1 449 037	94.21	32 146	2.09	5 845	0.38	51 065	3.32
01 May	1 573 945	1 488 795	94.59	28 331	1.80	5 666	0.36	51 153	3.25

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

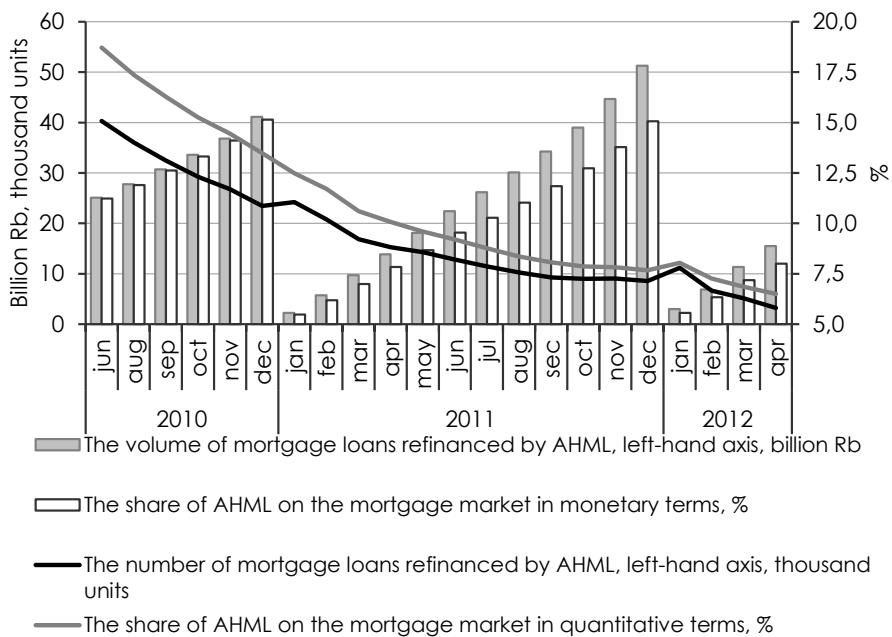
In April 2012, growth in average weighted rates on MHL in rubles extended within a month stopped at the level of 12.1%, while that on HL in rubles continued and amounted to 12.2% (*Fig. 5*). As of May 1, 2012, average weighted rates both on MHL and HL in foreign currency extended within a year amounted to 9.6%.

In April 2012, average weighted periods of lending as regards loans in rubles extended within a month increased as compared to March: to 15.1 years and 12.2 years as regards MHL and HL, respectively (*Fig. 5*). In April 2012, the average weighted period of lending in foreign currency as regards MHL extended from the beginning of the year amounted to 13.1 years, while that as regards HL, to 11.2 years.

According to the data of the OAO Agency for Housing Mortgage Lending (AHML), as of May 1, 2012 the Agency refinanced 12,017 mortgage housing loans in rubles for the sum of Rb 15.52bn which amounts to 6.5% in quantitative terms and 5.8% in monetary terms of all the mortgage loans extended in that period (*Fig. 6*). As compared to the respective period of 2011, it is 3.58 p.p. and



Source: on the basis of the data of the Central Bank of the Russian Federation.  
 Fig. 6. The average weighted periods and interest rates on loans in rubles extended within a month



Source: JVC AHML.

Fig. 6. Dynamics of refinancing by JVC AHML of mortgage loans in rubles

3.01 p.p. less, respectively. In 2012, as in 2011, the share of AHML on the mortgage market has kept decreasing. The only exception was January 2012 (Fig. 6).

AHML has made a decision to extend the term of the Stimul program for two more years; as a result, the program will include projects with the planned period of completion of building and commissioning until December 31, 2015. As of May 1, 2012, within the frameworks of the Stimul program AHML assumed obligations in respect of 180 funding agreements for the total amount of Rb 63.6bn (the volume of housing

development is 2.9m sq. meters): 127 agreements with current obligations for the total amount of Rb 55.2bn and 53 agreements with obligations fulfilled completely for the amount of Rb 8.4bn.

AHML plans implementation of a new program: *Mortgage Lending to Young Teachers* in accordance with Resolution of December 29, 2012 of the Government of the Russian Federation on the Procedure for Provision and Allotment of Subsidies from the Federal Budget to the Budgets of Constituent Entities of the Russian Federation for Refunding of a Portion of Expenditures in Connection with Providing Mortgage Loans to Teachers of Educational Establishments. Under the terms of the program, the minimum initial installment amounts to 20%, but half of it will be paid by means of a subsidy.

The Council of Federation has approved the law which permits to exclude from the funded mortgage system those servicemen who received housing with support of the state.

In order to reduce banks' risks related to mortgage lending, the Ministry of Economic Development of the Russian Federation and AHML propose that the government should introduce limitations on the legislative norm adopted in March; under the above norm the mortgage is deemed repaid in case of a sale of the mortgaged property even if the volume of the proceeds from the sale is lower than the amount of the debt. According to the data of AHML, in mortgage loans refinanced by the Agency the share of the borrower's own funds in the cost of the purchased and mortgaged housing exceeds 40% of the loan, reducing accordingly a risk of the bank in case of a drop in housing prices and application of recovery to the collateral at the expense of funds invested by the borrower. ●

**REVIEW OF THE ECONOMIC LEGISLATION**

I.Tolmacheva

*In June, the following amendments were introduced in the legislation: individuals with three or more children will not be discarded from the register of those who are in need of housing if a land plot was allocated to them for building of a house; amendments were introduced in the rule of mandatory sending of a public offer as regards purchasing of equities of an open-end company.*

**1. Amendment No.55-FZ of June 05, 2012 “ON AMENDMENT OF ARTICLE 56 OF THE HOUSING CODE OF THE RUSSIAN FEDERATION”**

Individuals with three or more children will not be discarded from the register of those who are in need of housing if a land plot was allocated to them for building of a house. The above amendment was introduced into Article 56 of the Housing Code of the Russian Federation which provides for instances of discarding individuals from the register of those who are in need of housing. The new provision applies to legal relations which arose from June 17, 2011.

**2. Amendment No. 77-FZ of June 14, 2012 “ON AMENDMENT OF ARTICLE 84.2 OF THE FEDERAL LAW ON JOINT-STOCK COMPANIES”**

Another exception was made to the rule of mandatory sending of a public offer as regards purchasing of equities of an open-end company. In particular, under the Law on Joint-Stock Companies a person who has bought over 30% of the total number of equities of an open-end company with equities owned by that person and its affiliated parties taken into account is obligated to send to shareholders – owners of other equities of relevant categories (types) and owners of issued securities which are convertible into such equities – a public offer as regards purchasing of such securities from them. Exceptions from the above rule are listed in Article 84.2 (8) of the above Law. According to the Law as amended, the rule in question is not applied in case of transfer of equities:

- from the federal ownership to the ownership of a constituent entity of the Russian Federation or municipal ownership,
- from the ownership of a constituent entity of the Russian Federation to federal or municipal ownership,
- from municipal ownership to federal ownership or ownership of a constituent entity of the Russian Federation. ●



## REVIEW OF THE MEETING OF THE GOVERNMENT OF THE RUSSIAN FEDERATION

M. Goldin

*In June 2012, at the meetings of the Presidium of the Government of the Russian Federation, the following issues were discussed: the Annual Report “On the State of Competition in the Russian Federation” by the Head of the Federal Antimonopoly Service (FAS) of the Russian Federation; results of execution of the federal budget in the 1st quarter of 2012 and the draft program of meetings of the Government of the Russian Federation in July–December 2012.*

On **June 14, 2012**, at the meeting of the Presidium of the Government of the Russian Federation the sixth Annual Report “On the State of Competition in the Russian Federation” was delivered by the Head of the Federal Antimonopoly Service of the Russian Federation. The report is developed in accordance with Article 23.2. (10) of Federal Law No. 135-FZ of July 26, 2006 on Protection of Competition. Under the above Law, the FAS of the Russian Federation “submits on an annual basis to the Government of the Russian Federation a report on the state of competition in the Russian Federation and places it on the Internet site of the antimonopoly authority. The Report outlines the main results of the competition policy carried out in the country, provides the analysis of the most important changes in the legislation and findings of the research in the state of competition in individual sectors of the economy and commodity markets and deals with the main problems of functioning of the above sectors and markets.

It was stated in the Report that an important factor behind low efficiency of measures aimed at prevention of violations of the antimonopoly legislation was a passive stance of key agencies of the Government of the Russian Federation as regards development of a complex of measures (reports) on promotion of competition in the sectors of the economy which were within their jurisdiction. Also, an attention was paid to the fact that the Program of Development of Competition in the Russian Federation in the 2009–2012 period failed to yield the expected results. In particular, all the reforms in the key sectors of the economy were postponed.

At the same time, some positive changes in securing of competition were mentioned in the Report. According to the results of Rosstat’s surveys of respondents which represent large and mid-sized enterprises, the biggest changes in assessment of competitive environment took place in production of charred coal and oil products. So, 27% of the number of the respondents pointed out that competitive environment had improved (against 18% in 2010). According to respondents which represent the small business, the most considerable improvement in the competitive environment took place in production of food products. So, in 2010 26% of the respondents noted that the competitive environment improved, while in 2011 that number of respondents amounted to 35%. According to 15% and 24% of the respondents, improvements in competitive environment took place in production and distribution of power, gas and water in 2010 and 2011, respectively, while in production of electric, electronic and optical equipment improvements in competition were noted by 19% and 28% of the respondents in 2010 and 2011, respectively.

At the same time, as regards the key index which directly represents the state of competition – the rate of intensity of competition on commodity markets – the Russian Federation is rated the 124th out of 142 countries which participated in the research (the WEF Report on Global Competitiveness in 2011–2012).

It was stated in the Report that such a situation can be partially explained by the fact that heads of regions and municipal entities still tended to monopolization of markets, preferential treatment of some businessmen and collusion with the business (including price collusion). To solve those problems, it is necessary to toughen sanctions for such violations and include the index of reduction of the level of such violations in the list of indices which reflect the extent of development of regions.

In addition to the above, for the purpose of improvement of the competition in the Russian Federation the FAS of the Russian Federation proposes, in particular, the following:

- introduce administrative responsibility for organizers of auctions and electronic site operators for violation of antimonopoly requirements to competitive bidding;
- unify procedures for holding auctions on provision of state property and land and natural resources, including auctions in an electronic form;
- introduce a procedure for administrative appeal of actions (inaction) of authorities and local government in exercising of powers in the sphere of building and land relations;
- amend the legislation regulating the activities of entities of natural monopolies so that the extent of consumers' satisfaction with services of entities of natural monopolies could be raised.

Also, on June 14, 2012 A.G. Siluanov, Minister of Finance delivered a Report “On the Results of Execution of the Federal Budget in the 1st Quarter of 2012” at the meeting of the Government of the Russian Federation.

On **June 25, 2012**, at the meeting of the Presidium of the Government of the Russian Federation a draft program of meetings of the Government of the Russian Federation in July–December 2012 was discussed.

The Office of the Government of the Russian Federation has received over a hundred proposals from federal executive authorities on issues which should be included in the draft program of meetings of the Government in July–December 2012. In the above period, it is envisaged by the draft program to hold 26 meetings of the Government of the Russian Federation. As was stated in the press-release of the Press-Service and Information Department of the Government of the Russian Federation on June 25, 2012, the draft program includes issues of implementation of the seven key objectives set by the Chairman of the Government (those objectives are to be achieved by the Government within the next six months) and instructions in respect of the main social and economic issues specified in decrees of the President of the Russian Federation. ●

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

L. Anisimova

*In May–June 2012 the new President and the Government of the Russian Federation started to work. The RF government is unable yet to develop a coherent approach to the pension reform. This is reflected in the change of politicians' position. The RF government has confirmed its position not to increase the tax burden in the nearest 5 years. Assurances of the RF government and the Ministry of Finance that the tax burden will not grow during a decrease in the global oil prices, while maintaining all adopted social commitments for expenditures is rather a declaration of intent, while the possibility of its implementation is limited exclusively by available reserves. The struggle for equality in decision-making in the field of regulations on economic and tax issues has sharpened.*

1. The RF government is unable yet to develop a coherent approach to the pension reform. This is reflected in the change of public politicians' position. Thus, according to media reports, the Minister of Finance does no longer finds it necessary to increase the retirement age – obviously influenced by the position of former colleague A. Drozdova, the Head of the Pension Fund of Russia, who said that “raising the retirement age will provide a minor short-term effect – no more than Rb 100bn per year within 5 years in case of pensions payment of about Rb 5 trillion per year<sup>1</sup>. Simultaneously, the RF Ministry of Labor was forced to refute some of its proposals to reform the pension benefits, mentioned in the press as “draconian”<sup>2</sup>, in fact based on the position of the RF Ministry of Healthcare. This ministry offered to bring pensions in dependence on the service record of the employee (to increase the proposed parameters of mandatory service record for “social minimum” pension from the current 5 to 15 years, and to replace the “normal” retirement pension for the lost wages at the salary rate of 45%, to increase the mandatory service record up to 40 years).

2. The RF government has confirmed its position avoid the growth of the tax burden for the nearest 5 years. The same opinion was expressed by the RF Minister of Finance. Given the speed of oil prices decline in March–June 2012, from \$123 per barrel to \$90, let us consider tentative consequences of the government agencies' decisions in the near future.

<sup>1</sup> “The Head of the Federal Pension Fund comment: raising the retirement age will provide a kopek effect”, the site newsru.com of 30.05.2012.

<sup>2</sup> According to comments published in the article on the site of A. Bashkatova. ng.ru / economics dated of 25.06.2012, “The death pension”, the Russian Ministry of Labor has proposed one of the versions of pension reform, which in its opinion will reduce the deficit from 2.3% to 0.8% of GDP, has considered the following versions: increasing the pension age up to 40–45 years while reducing the rate of insurance contributions to the Pension Fund from 26% to 20% and increase of premium rates for wages over Rb 68 thousand and extension of obligations to pay insurance premiums to migrant workers. Proposals of the Ministry of Labor already provoked negative comments from experts, but they still require investigation. In particular, it is not clear yet, whether all persons who have reached retirement age, but who for some reason failed to accumulate the required work experience (could not find job and worked in the own farm, lived on income from capital – for example, from property rent, had a long time spent for the care for elderly relatives, family members with disabilities, young children, went to work in other states, etc.). The authors of the radical proposals should be aware that the elderly citizens of the state in any event shall be provided with a minimum for living (not including the cost of treatment) the loss of the last sources of income (only the services of a nurse, for instance, amount approximately to Rb 20 thousand per month in Moscow). Without the help of the government an average family cannot cope with the support of their elderly parents. With regard to the payment of insurance premiums for migrant workers, the authors of this idea has not been fully worked out, because Russia will have to provide non-discriminatory approach to all participants of labor relations. Over time, probably there will be a question of settlements with the budget system of the place of residence of migrants (note: we are talking about insurance premiums, rather than a tax on producers for the use of labor, as this would be the case UST). Another proposed innovation – increased insurance premiums on the wages of more than 68 thousand rubles per month with a decrease in the basic rate from 26 to 20% of salary on the one hand, it would seem much better for the investment climate, but on the other hand, the intention is controversial because, as we mentioned above, there is no simple and comprehensive solution to pension reform and need for funding in the amount of pension costs is unlikely to be drastically reduced, given the already adopted by the government commitments during the election campaign. In addition, the average salary (which covers the bulk of the subjects of social insurance) is Rb 25 thousand, so the use of higher rates to the base estimated on the basis of Rb 68 thousand is unlikely to increase the flow of funds to the Pension Fund.

It is obvious that the fall in prices will result in substantial reduction in the Russian budget revenue base. Theoretically, in the situation of the global oil prices collapse, accompanied the state budget deficit, the maintenance of spending commitments by the RF government at the same level might mean involvement in payment of the accrued financial reserves, increasing government borrowing, privatization of some objects or direct emission.

In our view, in order to overcome the crisis, the government reserves (in the first place, the National Welfare Fund) should be primarily addressed to the key areas, first of all, to support the banking sector, through which the funds are recovered to investors, who allocated assets in monetary settlements, in the future “growth points”, as the banking sector is backing the provided loans. National reserves utilization to maintain the current social needs and benefits to the state employees depletes the country investment opportunities. In developed countries, social spending is immediately reduced in proportion to the revenue base reduction - we see this as an example of the EU policy with regard to Greece. The Rb devaluation may be qualified as the inflation tax on the population, and Rb may devaluated, but the consequences of a sharp devaluation are unpredictable. The privatization of the market-demanded assets (extractive industries) in the nearest future in Russia is unlikely (as the current leadership of the country can hardly agree to the change the national status as the dominant force in the management of the key economic sector, which will certainly happen if a large-scale privatization of extractive industries - we need only to recall the appearance of “Petroleum club” under the Russian President and the opposition of the club to organize their interaction with the authorities at the level of the President, the Prime Minister<sup>1</sup>).

As a result, we believe that Russia may start to expand government borrowing. This is evidenced, in particular, by the fact that in technical terms, government bonds and bonds of municipal borrowing issue is facilitated – the decision for their issue does not require the approval of the Registrar<sup>2</sup>, and disputes over the terms of issue will be resolved in court (this does not dismiss the mere fact of borrowing). However, we should recall that the borrowings are effective when they cover the time lag between investments and the receipt of income from the investments, sufficient to recover the loans and pay interest on them. Borrowing raised to meet current needs is a way to a debt. Payment of such loans (including interest) can be made (after reserves exhaustion) at the expense of either future taxes, or revenue from state and municipal property. Revenue from government property is also objectively declining in crisis situation. During this period, monetary liquidity becomes a more profitable asset than letting real estate or property for rent or income from the participation in equity<sup>3</sup>. Therefore, to cover the accumulated debt, the state and municipal property it might needed. That is, borrowing to cover current budget spending during crisis is a rather risky operation, and most likely, in fact, lead to budget losses.

For the analysis of financial risk in choosing a particular strategy, we should recall that the national GDP for 2013 is estimated at Rb 64.8 trillion<sup>4</sup>, the tax burden, according to the RF Ministry of Finance is estimated for 2011 at 35.6% (before revenue from oil and gas industry - 25.5%)<sup>5</sup>, i.e., revenues of the budget system correspond to  $64.8 * 35.6\% = \text{Rb } 23.1$  trillion, including the oil and gas industry = Rb 6.5 trillion ( $35.5\% - 25.5\% = 10.1\%$ ) from Rb 64.8 trillion. Thus, according to the RF Ministry of Finance, the share of oil and gas industry accounts for  $\text{Rb } 6.5 / 23.1 = 28.1\%$  of budget revenues of the RF extended government.

Let's try to assess the impact of fluctuations in export prices of oil and gas sector over the estimated budget revenues. From the calculations given in Tables 1A and 1B, one can see that due to the export duties there may be formed more than 16% of the RF extended government revenues (in March 2012

1 V. Sitnina, “Sechin did not want to obey Medvedev”, the site slon.ru of 06/13/2012

2 See amendments to Article 16 of the Federal Law “On securities market”, in Art. 5, Part 5 of the Federal Law “On the specifics of issue and circulation of government and municipal securities” made for the Federal-Kohn on 14.06.2012, № 79-FZ. According to amendments, the issuer of government securities on assigns a registration number on his own and is not obliged to contact the federal agency for the securities market for the appropriate permissions of emission. However, follow-up has not been canceled: the federal executive power body is carrying out state registration of the conditions of issue, may refuse such a registration – in this case, the issuing state and municipal securities may apply to the court (changes to Art. 10 of the Federal Law “On the specifics of issue and the treatment of government and municipal securities”).

3 Government (and municipal) property is transformed in either a capital in the capital, or socially significant objects. In the first case the distributed profits of companies are falling during crisis because of the market reduction, while in the latter case the exploitation of social objects is associated with high costs.

4 Federal law of 30.11.2011No. 371-FZ, version of 05.06.2012.

5 RIA News (vedomosti.ru of 21.06.2012, “Siluanov: tax burden will not grow within the nearest five years”).



the export duty on crude oil was \$411 dollars per ton, from April 2012 it was raised to \$ 460 per ton, but then it has dropped again<sup>1</sup>. It is clear that fluctuations in fees depend on the price of oil and gas in the global markets. According to Rosstat, the share of total revenues from foreign trade income in the RF extended government budget in 2009 was 19.7% (Rb 2.7 trillion with the RF extended government budget of Rb 13.6 trillion). That is, according to the carried out assessment, the impact of oil and gas in general do not contradict the established proportions and reflect the rapid growth of oil prices in 2012. It should be reminded that the federal budget for 2013 is estimated with some deficit (about 1.5% of GDP), because it was approved in the situation of rapidly growing oil prices (in March-May, it rose over \$120/bbl.) and was calculated on the basis of \$115/bbl. The RF Ministry of Finance has coordinated the supplementary budget expenditures on the basis of this price<sup>2</sup>.

However, in June the situation has changed – over the month the price of oil has fallen down by one third and amounted to \$91/bbl on June 23. The government has announced the beginning of the preparatory work for the extraordinary budget, estimated on the basis of the price of \$60/bbl<sup>3</sup>. The RF Ministry of Finance has announced the limiting level of tentative budget expenditures not exceeding 80% of the approved level. Applying this figure to the RF extended government budget, we get the limit of the absolute minimum cost, which amounts to Rb 23.1 trillion \* 80% = Rb 17.04 trillion.

If the world price for oil (and gas, respectively) drops 2-fold (\$60/bbl for oil), the budget revenues of RF extended government will decrease by 8.2%, or by Rb 1.85 trillion, which corresponds to the amount of the national reserve fund or 40% of the total reserves of the country, excluding gold and foreign currency reserves of the Bank of Russia<sup>3</sup> and amount to Rb 21.2 trillion (Rb 23.1 trillion – (16% of 23.1) / 2 = Rb 23,1–1,85 = Rb 21.2 trillion). Accordingly, by the author assessment, it can affect the GDP decline by Rb 1.85 / 35.6% = Rb 5.2 trillion, i.e. to Rb 59.6 trillion. In these conditions, to ensure (without using reserves) full funding of the RF Government current expenditure commitments, it is needed to increase the share of tax revenues in GDP from 35.6 to almost 39% ( $23.1 / (64.8 - 5.2) = 23.1 / 59.6 = 38.8\%$ ). Critical for the Russian economy will be the downfall in GDP to Rb 48 trillion (-17.04 / 35.6%), as in this case, the liabilities assumed by the RF government would be close to 48% of GDP (Rb 23.1 trillion / Rb 48 trillion) and approach the critical point of “excessive bend” in the growth in the state budget revenues, distributed by the level of tax burden (Laffer curve)<sup>4</sup>.

Nevertheless, the dependence of the Russian budget on the global price of oil it seems to be close to the overcoming threshold, if the ruble exchange rate remains within the limit established by the RF CB (recall that the RF CB gold and foreign currency reserves amounted to nearly Rb 15 trillion, and even with the annual irreversible output of \$100bn it will be sufficient for 4-5 years). With the maximum reduction of the global oil prices, the GDP “downfall” below Rb 53-55 trillion is unlikely (the total value of oil exports is about \$200m, natural gas – about \$68m, the share of exported oil and gas makes about 13% in the national GDP). In case of the export of hydrocarbons “zeroing” GDP will be about Rb 56.4 trillion at the rate of Rb 30 per \$1 (Rb 64.8 trillion, 13% of Rb 64.8 trillion) and about Rb 56.3 trillion at the rate of Rb 38.5 per \$1 (in this case, the share of hydrocarbons exports will rise to 15.5% of GDP)<sup>5</sup>, which is above the critical Rb 48 trillion. Nevertheless, meanwhile the RF economy is rather unstable, and at this stage its future prospects depend heavily on the economic policy selected by the RF government.

In this situation, the assurances of the RF government and the Ministry of Finance that the tax burden will not increase with the world oil prices reduction, while observing all adopted social commitments for expenditures are rather a declaration of intent, the feasibility of which is limited to the available

1 According to the site “quote.rbc.ru” of 2.04.2012.

2 V.Mironov, “the Finance Ministry did not take into account the tens of percent”, the newspaper “Moskovsky Komsomolets” No. 25970 of June 23, 2012.

3 For comparison, the RF reserves according to the RF Ministry of Finance has published in the “Agency of the experiments” on the site vz.ru on 6/22/2012, made about Rb 4.6 trillion, incl. Rb 2.7 trillion of the National Welfare Fund and Rb 1.9 trillion in – Reserve fund. These reserves are not included in the Central Bank gold reserves, which on average about Rb 510 billion, which corresponds to Rb 16.8 trillion (those reserves are beyond the control of those reserves of the RF government).

4 With the share of mandatory payments of 35.6% of the RF GDP dynamics still retains a positive vector of growth, but its intensity is much weaker, as the volume of investments in the RF is highly dependent on the share of taxes on producers in the overall tax burden.

5 Assessment of the share of exports of hydrocarbons in GDP at Rb 38.5 / \$1:  $100\% * (200 + 68) * Rb 38.5m. \$1 / (Rb 64.8 trillion * 87\% * from Rb 268m to \$38.5m/Rb) = 100\% * RB 10.32 trillion / (Rb 56.34 trillion + Rb 10 32 trillion) = 100\% * Rb 10.32 trillion / Rb 66, 67 trillion = 15.5\% of GDP excluding export of hydrocarbons = Rb 56.33 trillion = Rb 66.67 trillion * (100\% - 15.5\%)$ .



reserves. This limit can be exhausted in 2-3 years with the oil of price \$60 / bbl (the annual budget loss of Rb 1.85 trillion with reserves of Rb 4.6 trillion), and in the absence of a coherent investment policy within 5-6 years the Bank of Russia will face the same problem (its reserves are about \$500bn, while the annual capital flight from Russia makes about \$85bn. It would be unacceptable to Russia to be drawn into a debt pit, which happened in early 90-ies because of political ambitious commitments, when the accumulated debt (liabilities with interest) to the English and French clubs of creditors hindered the development of Russian economy for many years.

3. Another recent trend observed is a sharp struggle for dominance in decision-making in the field of legal regulations development on economic and tax issues.

The newly elected State Duma Committee on Budget and Taxes is firmly positioning itself as the main subject of tax policy in Russia, which defines the final content of the document, submitted to the State Duma for consideration<sup>1</sup>. This is reflected in the style of the Committee activities. It not only prepares the conclusion (with the participation of involved experts) on the bill submitted by the RF government, but also extends and makes amendments to the submitted a draft law, initiated by the deputies. Actually, this pattern of interaction is challengeable.

The State Duma is a representative (elected) body, while the RF government provides professional management of the economy. In the scheme proposed by the deputies, the Russian government will be forced to accept their amendments, which are often lobbied by individual deputies or a group of them. This practice of substantial revisions to the draft laws, initially developed by the RF government in preparation for the second reading of the document was typical for the late 90-ies of the past century, but not explicitly manifested in the recent years. Then the role of the Russian State Duma was largely confined to the execution of legislative initiatives of the RF Ministry of Finance, but now there is an attempt to restore the practice of the legislation revisions. Unlike the situation of the 1990s, the difference lies in the fact that before the RF government's position in the Federal Assembly of Russia was often supported by the Federation Council (which at that time was formed on professional basis and interested in the stability of budget revenues), while it was objectively easier for the business community to interact directly with individual RF State Duma deputies (elected by legislators not on the professional skills, but rather and for their role in the social life of the community), pushing their own interests, as well as tax benefits through the deputies. Now the role of the Federation Council is considerably weakened. Therefore, the role of an arbitrator in respect of regulatory initiatives of the State Duma is likely to be performed by the Presidential Administration, but the laws are still approved by the Federal Assembly. While the majority of the State Duma deputies and the Prime Minister are members of one party, theoretically it is possible that each disputed tax bill will not be directly addressed for the solution of the RF president. But before this opposition has not reached the crisis, if at some point Prime Minister and the majority of the State Duma happen to belong to different parties, it is necessary to find a solution to the conflict in advance.

Here is an example of such a confrontation. Currently, an acute issue was withholding income taxes on corporate Eurobonds of the Russian issuers as tax agents. The bill was introduced on the initiative of the RF Ministry of Finance, but revised by the deputies with regard to the requirements of employers in such a way that the interest on bonds of corporations, placed in foreign markets, were completely exempt from taxation, which could result in the emergence of a new channel for tax evasion and the distortion of equal competitive conditions for borrowers, as well as in distortion of the fair tax burden on income, depending on the type of loan (for example, income from the bank loans or bonds issues by Russian emitters in the domestic market would be less favorable than external borrowing)<sup>2</sup>. As a result, Igor Shuvalov, Deputy Prime Minister had to interfere and stop the adoption of this bill in revised edition.

4. In view of the contribution made by oil and gas sector to the RF government budget revenues, in case of hydrocarbon prices during crisis, the Russian fuel and energy sector would provide an excessive pressure on the RF government in order to reduce the tax burden on the industry. It is motivated by

1 L.Biryukova, D.Kazmin, M.Glikin: "United Russia did not agree with the government of Medvedev. United Russia members have point out to Dmitry Medvedev Government that the laws are made by deputies, rather than by officials. The fraction of the majority blocks the adoption of amendments to the tax laws, which can cost hundreds of millions dollars to the largest Russian companies". Site vedomosti.ru of 29.05.2012.

2 B. Visloguzov, "Kommersant" newspaper, No. 102 (4887), 06/07/2012, "Evrobondiana has failed. Igor Shuvalov put a stop to anti-government activities of the deputies of the Duma».

the fact that necessary exploration works, resource base development and technical renovation are hindered by high cost rent (in the form of export duties and mineral extraction tax), as well as by the fact that the tax is withheld from proceeds, rather than from net income (the difference between revenues and expenditures) regardless of the actual costs of commodity producers. Lack of funds remaining in the industry, in experts' opinion, leads to unprofitability production of significant amounts of mineral reserves and may eventually result in rapid depletion of the exploited resource base. This position, in particular, is supported by the head of the RF Energy Ministry A. Novak, who called "the key problem of the current tax system" taxation based not financial results, but not on the net profit of oil companies<sup>1</sup>.

It is a strategic and rather complicated issue, as nearly a third of the RF extended government budget expenditures is covered by hydrocarbons. A mere transition to NAD (tax on additional income) will lead to a sharp reduction of budget revenues. Promotion of hydrocarbons production with the loss of budget revenues is impractical – the market will work for a quick sale of easily extractable raw materials. Not accidentally, the Russian government highlights the priority of hard-to-extract subsoil deposits development – it allows to master new technologies. The conservative strategy in regard to oil is not to reduce the duty for developed wells, and to help with investments, rather than tax incentives to the fields located in difficult climatic conditions, would look appropriate, if not for Russia accession to the WTO. Export duties would have been abolished, because they will interfere in competitive situation of other Russian producers and can re-orient financial flows from the Russian budget system to other countries – WTO members in the form of anti-dumping sanctions. However, there is time to solve this problem in Russia, as during the negotiations on accession to the WTO it is agreed to maintain duties on hydrocarbons at the current level for an indefinite period<sup>2</sup>. As a result, the financial experts will have together with oil energy sector to find a replacement for the customs duty, probably a combination of tax on additional income and MET (MET is applied to expenses and may partially compensate the duty, but it will also provoke the raise of price for hydrocarbons in the domestic market), while tax on additional income is a typical profit tax on a long-term investment project. Replacement of the export duty by taxes will increase the level of prices in the domestic market at least by 9-10% (Rb 5.9 trillion / Rb 64.8 trillion).

5. Another very important trend, which was mentioned in previous reviews, and which is observed again during the period under review is the position of the Supreme Arbitration Court, which consistently solves the protection of property rights and interests of entrepreneurs with regard to the generally accepted rules of private international law. SAC decision No. SAC 2462/12 of May 29, has repealed the act of the RF government (RF Government Resolution of 26.12.2011, No. 1148), which established the Magadan port as the only "place of shipment" of metal outside the common territory of the Customs Union in the territory of the Far Eastern region. The plaintiff ("Metalltorg" company) stated in his application, that this legal act creates unfair from the legal point obstacles and constraints in the implementation of the applicants business and foreign trade, contradicting Paragraph 2 of Art. 7 and Art. 9 of the Agreement on common non-tariff regulation measures with regard to third countries of 25.01.2008, Art. 1 of the RF Civil Code and P. 8, Part 1 of the Civil Code and Section 8 Part 1, Art. 15 of the Federal Law of 26.07.2006 No. 135-FZ "On Protection of Competition" and leads to unnecessary increase in costs and artificially high prices for the plaintiff. The Court noted that under the generally recognized principles and norms of international law, any interference by public authorities in the property rights of individuals should be legal and cannot be arbitrary.

According to SAC, the document litigated by the plaintiff does not contain any substantiation of the reasons for its adoption and the relevant references to the legal regulations, the applicant did not furnish any information on the grounds of the definition of the quantity and place of the goods departure.

The Court characterized the adoption of the mentioned document as a violation of P.1 and 8 of Part 1 of Art. 15 of the Federal Law of 26.07.2006, No. 135-FZ "On Protection of Competition", under which the federal bodies of executive power are not allowed to pass acts and (or) take actions (failure to take actions) which lead or may lead to preventing, restricting or hindering competition except for cases stipulated by federal laws making acts and (or) the implementation of such actions (failure to take actions), in particular, the following actions are prohibited: imposition of bans or

1 Oil and gas taxation, "Kommersant" newspaper, No. 106 (4981) of 14.06.2012.

2 M. Medvedkov, "Russia cannot rise the 30% export tax on natural gas after the accession to the WTO", the site FINMARKET.RU on November 14, 2011.

restrictions in respect of certain activities, as well as creating discriminatory conditions. Thus, the court disagreed with the possibility for the RF government's decision adopted without adequate grounds, forcing producers to affect their costs.

Among technical clarifications the RF Ministry of Finance and the Federal Tax Service for the period under review one should mention the following ones.

6. Letters of the Federal Tax Service of May 29, 2012 No. ED-4-3/8790@ and RF Ministry of Finance of 10.05.2012 No. 03-03-10/43 clarify the taxation of income received by a party of the consolidated group of taxpayers from sources outside Russia in case of tax deduction at source of payment. In accordance with Art. 278.1, part 1 of the Tax Code, a consolidated tax base for consolidated group is defined as the arithmetic total of the incomes of all group members, minus the arithmetic total of costs of all participants (except for income subject to tax withholding at source). Herewith, this rule is applicable only to the taxable base of the consolidated group who are subject to the basic tax rate of 20% (P. 1, Art. 284 of the RF Tax Code). Income taxed at different rates are not included in the consolidated tax base, and such tax bases, as well income taxed at source (eg, dividends), the taxpayers shall pay tax to the budget on their own, outside the consolidated the group. However, given that the tax liability of each taxpayer nevertheless is formed by the totality of all of its revenue and expenses, regardless of membership of a consolidated group (in accordance with P.2 of Art. 311 of the Tax Code), the RF Ministry of Finance explained that the costs associated with obtaining revenues from sources outside the RF (eg, tax withheld at source of payment) shall be assessed by a responsible member of a consolidated group of taxpayers when paying tax in the RF (otherwise the costs associated with the receipt of income from sources outside Russia, would be payable from own profit at the expense of taxpayers, which would infringe the taxpayer interests as compared to other market participants). The amount of taxes paid by the organization - member of the group outside Russia, cannot exceed the amount of tax attributable to the taxpayer of the Russian Federation, is assessed by responsible consolidated group member.

7. Letter of the Federal Customs Service (FCS) of May 28, 2012 No. 23-20/26488 clarifies the application of benefits on payment of import duties (taxes) on the so-called "conditionally released goods" (conditionally released to the domestic market, for which there are restrictions on the use and (or) disposal thereof). It is, in particular, relates to the goods (except for excisable goods) imported from third countries as a contribution of the foreign partner to the authorized (reserve) capital (fund) within the time limits established by the authorized documents for the formation of capital (fund). Such goods have the status of foreign assets and are exempt from customs duties according to the procedure and in the manner stipulated by normative legal acts of the country member of the Customs Union (CU). In Russia, the procedure and conditions for granting benefits for customs duties are determined by the RF government Decree 23 of July 1996, No. 883. This order provides that in case of a foreign founder (participant) withdrawal from organization, a change of ownership or transfer of the rights to use third party, customs benefits to such conditionally released goods are dismissed from the moment of violation of the restrictions and the duty should be paid at the rate specified on the date of conditionally released goods.

8. Letter of the RF Ministry of Finance of May 29, 2012, No. 03-07-15/54 clarifies the order of payment of the VAT refund in the event of a Russian organization of goods previously purchased by the buyer - tax resident of the country, not a member of the Customs Union (CU). RF Ministry of Finance, with reference to the rules of the Agreement on the principles of levying indirect taxes on the goods (works, services) exports and imports to the CU of 11.12.2009 has clarified that the sale of goods by the supplier - resident of the member state of the CU, to the buyer, who is a tax resident of another member state of the CU, recognized as export, and in this case proceeds of the Russian supplier VAT is not payable. In case of the goods return, disposal does not occur, and VAT is not paid by the Russian organization as well.

## ASSESSMENT

of budget revenues from the main exports of hydrocarbons (oil, natural gas) and the basic income tax on the extraction of these minerals

Table 1A. Natural gas revenues

Gas export, cu. m bn	Extraction, cu.m, bn	Provided for processing	Natural gas <sup>3</sup>			For reference: average export prices, \$ per 1 cu. m thousand	Tariff	The amount of revenue from export duties (Rb bn) at the rate of RB 30 per \$ 1	% versus export duties for hydrocarbons
			bn, amount in cu.m	Total export	Cost \$m				
	669			%-of tax versus extraction	Cost \$m				
2011	669		196	29.3%	64 290,1	338,88	30%	579	*
2012 (estimated)	697		200,2	28,7%	67 843,8	338,88	30%	611	15,9%

*Information sources on gas export:*

- 1) FCS and Rosstat data, published on the website of the Central Bank of Russia cbr.ru;
- 2) Medvedkov, "Russia cannot raise the 30% export tax on natural gas after the accession to WTO", site FINMARKET.RU on November 14, 2011;
- 3) Author's estimates.

Table 1B. Oil export revenues

Oil exports (estimates based on January-April 2012 data	Extraction, cu.m, bn	Provided for processing (tons, m)	Oil			Cost, \$ per 1 cu. m thousand	Tariff, \$ per 1 cu. m thousand	The amount of revenue from export duties (Rb bn) at the rate of RB 30 per \$ 1	% versus export duties for hydrocarbons
			bn, amount in cu.m	Total export <sup>3</sup>	Cost, \$m				
				% of tax versus extraction	Cost, \$m				
2012 (estimated)	511,5	263,7	233,7	45,7%	199 766,8	854,8	460,7	3 230	84,1

*Information sources on oil export:*

- 1) "The oil market situation in January-April 2012. Production, revenue from oil refining and export" site Gks.ru on 21/06/2012;
- 2) Author's estimate.

References to Tables 1A и 1B

- 1) Including gas condensate, the extrapolation of data for January-April 2012.
- 2) According to the FCS of Russia, taking into account the data of mutual trade with Belarus and Kazakhstan.
- 3) Rates of March 2012 per 1 ton of oil was \$ 411.



Table 2. Assessment of the share of export duties on hydrocarbons in the revenues of the RF consolidated budget

Total estimated revenue from export duties on hydrocarbons (total income from export duties on oil and gas)

GDP, accepted for estimates (in Rb bn)

The share of consolidated budget in GDP (%)	35,6
RF consolidated budget (Rb bn)	23,068,8
The share of export duties from hydrocarbons in the RF consolidated budget in GDP (%)	<b>16,6</b>

Table 3. Assessment of marginal revenues of the consolidated budget from the subsoil tax

	Extraction of natural resources (gas - bn, cu. m, oil - m, cu m)	MET rate (Rb for the production of 1 thousand cu. m of gas and 1 ton of oil)	Marginal MET value of oil and gas production (Rb bn)
Gas extraction (cu. m thousand)	697		376,38
MET rate for gas extraction (per 1000 cu. m)		582	
Oil extraction (m per 1000 thousand t)	511,5		2 516,3
MET rate for gas extraction (per 1000 cu. m) Rb		4919,4246	
<b>Total</b>			<b>2 892,7</b>

Information sources on MET rates for oil and gas:

- 1) Minenago offered its rates for gas for the "independent", the site rosbalt.ru on 06/22/2012, Chapter 26 of the Tax Code;
- 2) Art. 342 of the RF Tax Code, Federal Tax Service Letter of 02.16.2012, N ED-4-3/2559 @ "On the data necessary for the severance tax assessment on oil for January 2012" (the basic rate of Rb 446 per 1 ton of oil), FTS information letter on the coefficient rate for May 2012 = 11.03);
- 3) According to P. 4 and P. 5 of Art. 342 of the Tax Code, the coefficient rate of reserve depletion and the coefficient value of stocks in cases not specifically mentioned in the Tax Code should be equal to 1;
- 4) The experts estimates on the site consultant.ru



## CHANGES IN THE REGULATORY BASE OF THE BUDGETARY PROCESS

M.Goldin

*In June 2012, the following developments took place in the regulatory base of the budgetary process: the expected revenues to the income side of the 2012 federal budget were increased by amendments to the Federal Law on the Federal Budget in 2012 and the 2013-2014 Planned Period; the Letter of the Ministry of Finance explained the provisions of the draft Order of the Ministry of Finance which determined the specifics of accounting of budgetary obligations of recipients of federal budget funds.*

**Federal Law No. 48-FZ of June 05, 2012** “On Amendment of the Federal Law “On the Federal Budget in 2012 and the 2013-2014 Planned Period” amended parameters of the Federal Budget in 2012 and the 2013-2014 Planned Period.

In particular, it is expected that revenues to the income side of the budget will amount to Rb 12,677,006bn instead of the earlier planned Rb 11,779,855bn.

Budget expenditures in the volume of Rb 12,656,444bn were increased to Rb 12,745,151bn.

Accordingly, the budget deficit will amount to the mere Rb 68.1bn (that is 0.1% of GDP) instead of Rb 876.6bn (1.5% of GDP) as was expected earlier. (Amendments were made with taking into account the new forecast of the oil price of \$115 per barrel, however, that price fell sharply soon after that).

**Letter No. 02-03-09/1907 of May 29, 2012 of the Ministry of Finance of the Russian Federation** “On the Specifics of Application of Order No. 98n of September 19, 2008 of the Ministry of Finance of the Russian Federation After July 1, 2012” explained provisions of the draft which introduced amendments in the above Order of the Ministry of Finance.

After July 1, 2012, budget obligations are subject to accounting by territorial authorities of the Federal Treasury in the following order.

In accordance with provisions of Cl. 2.1 of Order No98n of September 19, 2008 of the Ministry of Finance of the Russian Federation “On the Procedure for Accounting of Budgetary Obligations of Recipients of Federal Budget Funds”, budgetary obligations which arose on the basis of public contracts on delivery of goods, fulfillment of work, rendering of services for public needs and agreements on delivery of goods, fulfillment of work and rendering of services or leasehold agreements, under which the first payment:

- was carried out before January 1, 2012 – are accounted for till January 1, 2013 in accordance with the earlier adopted procedure on the basis of documents accepted by the authorities of the Federal Treasury for payment of accounts payable issued by recipients of federal budget funds (agreements, bills and invoices);

- is carried out in the period from January 1, 2012 till July 1, 2012 – are accounted for till January 1, 2013 in accordance with decision of the recipient of the federal budget funds on the basis of payment documents or Information on the budgetary obligation taken (code of the form in accordance with KFD 0531702);

- will be carried out from July 1, 2012 – is accounted for in accordance with the mandatory procedure on the basis of the Information on the obligation.

In accordance with provision of Cl.2.1 of Order 98n (draft version), from January 1, 2013 accounting of budgetary obligations which arise on the basis of public contracts and agreements, including those which have not been fulfilled as of January 1, 2013 and under which payment was carried out until July 1, 2012 is done in compliance with Order No.98n.

It is to be noted that budgetary obligations which arise on the basis of public contracts and agreements which remain unfulfilled as of January 1, 2013 and whose accounting in 2012 was carried out on the basis of payment documents are subject to accounting exceptionally on the basis of the Information on the Obligation in 2013. ●

## DAGESTAN: A COMPLICATED SETTING PROCESS

I.Starodubrovskaya

*The development of the process of settling the ongoing conflicts in Dagestan has been rather inconsistent and controversial. At present, the initiative has effectively been snatched away from the government structures by religious activists. Although it is indeed very important to resolve the intra-confessional conflict, it is equally important to remember that the religious schism had deep social roots which in some or other form will persist in triggering confrontation in society.*

Recently, the North Caucasus republics have been increasingly focusing on finding ways to promote peace in society and to resolve those deeply rooted conflicts that have been shaping up the “institutional landscape” of those territories. From this point of view, it would be interesting to consider the two processes that have become a typical feature of the Republic of Dagestan in the first half-year 2012.

*Firstly*, some crisis phenomena have become increasingly visible in the activity of the Commission for the Adaptation to Peaceful Life of the Persons Who have Decided to Discontinue their Terrorist and Extremist Activity in the Territory of the Republic of Dagestan (hereinafter – the Adaptation Commission). The Commission was created in November 2010 under the supervision of Rizvan Kurbanov, then Vice Prime Minister of the Republic of Dagestan. The Commission was composed of the directors of the regional power structures, the top officials of some ministries, and representatives of civil society and the religious community of Dagestan. The goal of the Commission’s activity was to ease the ‘exodus from the forest’ for those who were ready to leave the illegal bandit formations and give up their weapons.

The results that have been achieved by the Commission since then are have given rise to some controversial opinions. On the one hand, according to the President of the Republic of Dagestan, over the year-and-a-half period since its creation, the Commission dealt with 37 persons, and the petitions submitted by 32 of them were satisfied. More than a hundred petitions submitted by citizens in connection with violation of their rights by law enforcement agencies were considered, and all of them were provided with legal advice and support<sup>1</sup>. The Commission’s activity was acknowledged by society, and there were some cases when *boyeviki* [the fighters] agreed to give up their weapons and submit to the authorities against the guarantees provided by the Commission’s Chairman Rizvan Kurbanov.

On the other hand, the Commission’s activity has been subject to increasing criticism which, in fact, was coming from two opposite camps.

The power structures are dissatisfied with the Commission because it has failed to establish any distinct criteria for determining those situations when an individual can be granted the right to claim the Commission’s support. Many comments appeared in the press in response to the opinion voiced by Alexey Savrulin, head of the Investigation Directorate of the Investigation Committee for the Republic of Dagestan: “In other words, it so happens that you may shoot and kill, and then come to the Commission and say: have pity on me, I am a good guy”. After the Commission’s meeting that effectively saw an open conflict flaring up between the heads of the Investigation Directorate and the Commission, with a rather active participation of the Republic of Dagestan’s President<sup>2</sup>, both sides made public their views on the way the Commission was

1 Yulia Rybina. *V Dagestane boevikov adaptiruyut k miru*. [In Dagestan, *boyeviki* are being adapted to peace]. 20 April 2012, 07:29. <http://kavpolit.com/v-dagestane-boevikov-adaptiruyut-k-miru/>

2 Pankov I. *Komissia po adaptatsii ... general-maiora Savrulina*. [The Adaptation Commission ... of Major General Savrulin] // *Chernovik* [Draft Paper]. 27 April 2012. <http://www.chernovik.net/print.php?new=13461>. This is by no means the first conflict of this type with the power structures that occurred in the framework of the Adaptation Commission. The Commission has also experiences some disagreements with the leaders of the IMF for the Republic of Dagestan.

functioning<sup>1</sup>. Alexey Savrulin presented a long list of conditions that were to be satisfied before the petition submitted by a person who had decided to discontinue his terrorist and extremist activity could be satisfied, including: voluntary submission, with giving up of weapons, to law enforcement agencies; active collaboration with law enforcement agencies; full recognition of one's guilt, etc. Among those who had passed through the Adaptation Commission, Savrulin could point out only two or three such individual (his opponents insisted that there were as many as ten). The power structures' opponents claim that the most important factor must be the very fact of a person's repentance and discontinuation of any participation in illegal bandit formations, and so "the main – if not the only – grounds for satisfying a petition by the Commission must be the contribution of the petitioner to the ideological struggle against the spread of terrorism and extremism, irrespective of the actual circumstances of his capture, the number of crimes committed by him, the gravity of those crimes, etc."<sup>2</sup>. It is evident that, given all these critical disagreements between its members, the smooth running of the Adaptation Commission's operation – as well as its general image – has become questionable.

At the same time, some experts would like the current policy to be more radical – they view adaptation as a not quite understandable substitute for amnesty. Essentially, their criticism is aimed against the absence of any distinct guidelines in the Adaptation Commission's activity that would be acceptable to all the sides in the conflict, clearly defined guarantees for the former "fighters", and clear understanding as to what is actually meant by adaptation. From that point of view, one noteworthy example is the experience of the Chechen Republic. "Our closest neighbor Chechnya is now perceived by many experts as a successful example of the implementation of the practice of "removing from the forest" a considerable part of "the underground"... The return to peaceful life for many of those former *boyeviki* in reality meant something else, because most of them were immediately enlisted in the special combat units created for struggling against those who had stayed 'in the forest' and did not want to make peace"<sup>3</sup>.

*Secondly*, the process of intra-confessional dialogue between Dagestan's religious activists has become much more active. On 29 April 2012, the central mosque in Makhachkala hosted a meeting of the Sunna Scholars Association of Dagestan and the Dagestani Spiritual Muslim Administration<sup>4</sup>. *Ahlu-s-Sunnati* are represented by Salafi scholars (until recently known as Wahhabi), who denounce violent methods of struggle for the victory of Islam. The confrontation between Sufism<sup>5</sup> and Salafism<sup>6</sup> has been a reflection of one of the most fundamental differences in Dagestani society, or probably across the entire North Caucasus region. Not so long ago, representatives of 'official Islam' in Dagestan sometimes said that he who kills a Wakhabi would go to Paradise. At the same time, the most frequent targets for terrorist attacks were not only the law enforcement officials but also some eminent Sufis (sheiks). Against this background, the recently held meeting whose purpose was to promote peaceful dialogue appears to be a landmark of fundamental importance. In the resolution summing up the meeting's results it is stipulated that Muslims are forbidden to speak evil of one another, to spy and report on Muslims, and that the Dagestani must not be prevented from going abroad to study at Islamic higher educational establishments.

Following the meeting at Makhachkala's central mosque, similar events aiming at peaceful settlements between different Islamic movements were organized in other Dagestani districts. Thus, on 11 June 2012, several meetings were held in Tsumadinsky District with the participation

1 . *Protivorechii net... ..est' predlozhenia!* [There are no controversies... there are proposals!] // *Chernovik* Editorial Board. 4 May 2012. <http://www.chernovik.net/print.php?new=13486>; V chem e rol' Komissii? [What is the Commission's Role?] // *Chernovik* [Draft Paper]. 18 May 2012. <http://chernovik.net/news/492/REPUBLIC/2012/06/20/13552>.

2 V chem zhe rol' Komissii? [What is the Commission's Role?] // *Chernovik* [Draft Paper]. 18 May 2012. <http://chernovik.net/news/492/REPUBLIC/2012/06/20/13552>.

3 Kurbanov R., Saidova Zh. *Adaptatsia stroptivyykh*. [Adaptation of the Defiant] // *Kavkazskaia politika*. [Caucasian Policy]. 27 February 2012, 15:34. <http://kavpolit.com/adaptaciya-stroptivyyx>

4 Ageev M. *Za ummu. Bez posrednikov*. [For *Ummah*. Without Intermediaries] // *Chernovik* [Draft Paper]. 4 May 2012. <http://chernovik.net/news/490/MONOTHEOS/2012/05/19/13501>

5 Sufism is defined as a mystical dimension of Islam; it implies commitments of murids (the believers) to the sheiks who have access to superior mystical knowledge. It develops in the framework of Islamic religious orders (*tariqas*).

6 Salafism is an Islamic religious movement that calls for a return to the fundamentals, to Islam as it existed in the times of the Prophet and the four Caliphs, and renounces later innovations.

of Mufti of Dagestan, the district authorities and local Salafis<sup>1</sup>. The adopted resolution essentially followed the spirit of the Makhachkala resolution of 29 April, while it was by no means its exact replica because it added some new aspects to the proposed settling of the existing situation, including: “consider the possibility of creating a fund for providing aid to the families that have suffered from intra-confessional conflicts”; “consider the possibility of a joint appeal to the Ministry of Justice that the law on Wahhabism be abolished”; “discontinue the practice of accusing Muslims of keeping religious literature, because this fact must not serve as the grounds for accusing a person of engaging in extremist activities”. Probably, similar meetings will also take place in other districts across the Republic.

Is it really to be believed that the recent steps towards settling the intra-confessional conflict can fundamentally reverse the situation in the Republic, and so put an end to armed confrontation? It seems that such a conclusion would be premature. The participants in the dialogue themselves admit that by no means all the representatives of the existing religious groups actually took part in it. But even this fact is probably not the most important one. Many experts argue that the religious confrontation in Dagestan – and probably across the entire North Caucasus – has some deep social roots. They point to other causes: poverty, unemployment, and so on. We believe that the most important cause is the unavailability of “social lifts” for young people who cannot properly implement their abilities and talent. The tough confrontation between Salafis and Sufis in a situation when the latter were identified with the official authority created fertile soil for using religious fundamentalism as a protest movement ideology of an essentially social character.

The efforts to end the religious confrontation, on the one hand, make it more difficult to use Salafi ideology as a foundation for a protest movement, while on the other, by focusing on purely religious issues, they tend to overlook the social aspect of the problem. *Ahlu-s-Sunnati* have clearly demonstrated that they do not want to get involved in the political processes in the Republic, as at the end of last year they refused to participate in the meeting against enforced disappearance of people (the popular belief being that the main culprit in this are the power structures), and they also got rid of those religious activists who displayed a more well-defined political standpoint. Since under the present conditions it is unlikely that the protest movement in Dagestan may replace religious ideology by some other ideology, the most probable scenario will be further deepening of the doctrinal split with regard to the “end of confrontation” issue in both the Salafi and Sufi camps.

At the same time, the achievements made so far must not be underestimated. While providing no ultimate solutions to the problem, they may nevertheless significantly alter the atmosphere of confrontation and schism that *per se* is capable of breeding violence. No doubt, the very best results could be achieved if the efforts of the government and non-governmental structures were to be made in one and the same direction. Experts have repeatedly suggested that the effect of the Adaptation Commission’s activity could have been much greater (and not only of the commission in Dagestan, but also of the other similar commissions established in the other North Caucasus republics) if its status were to be properly regulated at the federal level<sup>2</sup>. So far these suggestions have been disregarded, which was one of the reasons why the Adaptation Commission in Dagestan had to live through a “legitimacy crisis”. In such a situation, the ability of religious activists to adequately respond to those challenges that the government had not yet been able to stand up to (largely because of lack of proper coordination between the strategies of the federal and regional bodies) may result in further deterioration of the state authority in that region. ●

1 Ageev M. *So vtoroi popytki*. [As a Second Attempt.] // *Chernovik* [Draft Paper]. 15 June 2012. <http://chernovik.net/news/496/News/2012/06/20/13690>

2 We have also expressed our opinion on this issue. See Starodubrovskaya I. *Lekarstvo ot strakha: kakaya politika mozhet snizhat' konfliktnost' na Severnom Kavkaze*. [Remedy from Fear: Which Policy May Lower the Probability of Conflict in the North Caucasus.] // *Ekonomicheskaja politika* [Economic Policy], 2012, No 2 (April), p. 122-124.