



RUSSIAN ECONOMY: TRENDS AND PROSPECTS 11'2012

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

The Social and Political Background

The major political events of November were: the dismissal of Minister of Defense Anatoly Serdiukov; the investigation launched against his close associates in the top echelons of the RF Ministry of Defense; and a number of sensational denouncements of corruption by the VIPs – including former Deputy Minister of Regional Development Roman Panov (who was consequently arrested), the top managers of Rostelecom, and the former topmost officials from the RF Ministry of Agriculture. The active coverage of these scandalous developments by the mass media indicates that the authorities are eager to boost their popularity by initiating an ostentatious anti-corruption campaign. According to public opinion research agencies, the approval ratings of the authorities were on the decline throughout the second half of 2012.

The ouster of Serdiukov as Minister of Defense and his replacement by Sergei Shoigu also demonstrates that Russia's political leadership is striving to achieve a compromise with the military top brass who were utterly displeased with Serdiukov. Such a compromise will apparently mean suspension of the implementation of some of Serdiukov's reforms. Thus, the first consequence of his sacking will be the softening of the RF Ministry of Defense's approach to the defense industry. It should be noted that, as far as defense purchases were concerned, Anatoly Serdiukov was known to be relatively rigorous in his demands with regard to the prices and quality of armaments to be bought. He also lobbied for the purchase of armaments from alternative overseas sources. In 2010, Russia's state defense order was not fulfilled because of disagreements over prices. In recent years the defense order issue has become the bone of contention for the Russian ruling elite. Seen against the background of a steady rise in budget allocations to the defense industry, the sacking of the Defense Minister actually means that the interests of the defense industry have prevailed over the trend towards comprehensively rearming Russia's armed forces.

However, the anti-corruption campaign does not promise Russia's political leadership an easy way to gain laurels. The anti-corruption investigations are aggravating the inter-clan conflicts in the corridors of power, while society is clearly waiting for criminal proceedings to be initiated against top officials and VIPs, and not against some relatively unimportant figureheads. But most likely, the political leadership is still not ready to fulfill these expectations.

The Macroeconomic Background

November saw no changes in the most important external factors that had largely been determining the macro-economic situation in Russia. The price of Brent crude oil continued to fluctuate in the range of 105 to 111 USD per barrel. As a result, the Russian stock market and foreign exchange market remained in the doldrums. Over the second half of November, the ruble was strengthening against the US dollar. Having compensated for its earlier fall, the ruble returned to its mid-October level (31.06 Rb per USD as of 30 November). The bi-currency basket obligingly followed suit (Rb 35.17 as of 30 November). The MICEX Index hovered around 1,400 points (± 40 points).

The withering of the effect of the recent tariff indexation for housing and utilities services determined a deceleration in the rate of inflation in October and November. Over the course of October, prices rose by 0.5%; in November, they grew by 0.3%. Thus, Russia's inflation rate in November 2012 was lower than in November 2011 (0.4%), the annual rate of increase in prices dropped to 6.4%, while the inflation accumulated since the beginning of the year amounted to 6.0%. The rate of inflation was considerably restrained by the shrinkage of money supply: as of 1 October 2012, the annual M2 growth rate was 14.9% vs. 21.4% as of 1 October 2011. Although the rate of inflation is expected to increase in December, the annual rate of inflation cannot be expected overshoot the official forecast (7%), while being slightly higher than in 2011 (6.1%). At the same time, it should be

noted that in October, Russia's level of inflation was once again 3.4 pp higher than that of European inflation (EC-27).

In October, the excess reserves of commercial banks continued to dwindle: over the course of that month they shrank by 2.6% – to Rb 822.2bn. The shortage of liquidity did not abate, as evidenced by the rise in borrowing from the RF Central Bank. Like last year, the main source of replenishing liquidity were the Bank of Russia's Lombard loan auctions.

According to the RF Central Bank's preliminary estimates, over the course of the first nine months of 2012, Russia's net capital outflow amounted to \$ 61bn (vs. \$ 60bn over the same period of 2011). The outflow reduction forecasted by the Bank of Russia did not materialize. In the last few years, the major cause for the capital outflow from Russia was the financial watchdog's reluctance to interfere in the functioning of the foreign exchange market. If the current trends persist, Russia's current account surplus in 2012 will be approximately the same as in 2011, which means that her capital outflow will also remain at last year's level. In other words, Russia's capital outflow in 2012 will, most likely, amount to between \$ 75bn and \$ 85bn.

The Real Sector of the Economy

The upsurge in investment activity registered in the first half of 2011 and the first half of 2012 was succeeded by its sharp deceleration in July and August 2012. This drop in investment activity resulted in a shrinkage of the growth rate of fixed asset investment in Q3 2012 – to 101.4% by comparison with the same period of the previous year. However, in October 2012, the growth rate of fixed asset investment amounted to 104.9% by comparison with October 2011; and the volume of construction work and the volume of newly commissioned housing returned to their previous levels (105.1% and 111.0% respectively). On the whole, over the period from January through September 2012, fixed asset investment grew by 9.5%. In January–September 2012, the volume of foreign investments in the Russian economy amounted to only 85.6% of their volume registered in the same period of 2011. At the same time, it should be noted that this drop affected, almost exclusively, short-term credits (up to 180 days), while direct investments grew by about 4.6% over the course of January–September 2012. The volume of long-term credits was also on the rise.

Over the course of 2012, Russia's consumer market remained one of the major factors contributing to her economic growth. It is expected that, by the end of the year, it will grow by 6.1% (vs. 7.0% in 2011). As compared with October 2011, in October 2012 the real disposable income index and the real wage index amounted to 102.4% and 105.2% respectively. As compared with the same period of 2011, in January–October 2012 these indices amounted to 103.5% and 108.8% respectively. Although the rise in incomes and wages was significantly higher than in the previous year, the consumer demand growth rate gradually declined with each successive quarter; in October, total retail trade turnover rose by 103.8% on October 2011 (vs. 9.1% in 2011).

Over the course of 2012, the rate of industrial growth demonstrated a steady downward trend: in October 2012, the industrial production index amounted to 101.8% by comparison with October 2011; the same index for the mineral resources extraction sector – to 102.1%; in the processing industries – to 103.0%. Over the first 10 months, the production index for the basic types of economic activity amounted to 2.9% (against 5.6% for the period of January–October 2011); and industrial production growth amounted to 2.8% (against 5.1% in 2011). The rate of slowdown was most noticeable in machine-building – the sector which in the previous period displayed significant growth. In October 2012, the production index for machines and equipment amounted to 101.8% (against 100.5% for the period of January–October 2011).

The surveys conducted by the Gaidar Institute also point to the pessimistic mood among industrial enterprises. Major industrial indicators, including demand, output and prices, once again began to demonstrate a downward trend. According to available data, weak sales expectations clearly outnumber sales growth expectations. The slump in demand was followed by a decline in the rate of output: the October shrinkage in the rate of output is comparable with that in June–July 2012, when this index had hit its record low since mid-2009.

Bearing in mind the existing trends, it is highly doubtful that Russia may actually manage to achieve the annual industrial output growth of 103.6% envisaged in the RF Ministry of Economic Development's forecast for 2012. ●

THE POLITICAL AND ECONOMIC RESULTS OF NOVEMBER 2012

S.Zhavoronkov

In November 2012, RF Minister of Defense Anatoly Serdiukov, accused of abetting corruption in his ministry, was sacked from office; former Deputy Minister of Regional Development was arrested; criminal proceedings against the managers of Rostelekom and the former top officials of the RF Ministry of Agriculture began to be pursued more vigorously. All those developments were comprehensively covered and commented on by the news media, which indicates that the authorities are anxious to increase their popularity by demonstrating a resolve to press ahead with both self-purification and war on corruption. Although the post of Minister of Defense was given to Sergey Shoigu, one of the few politicians with high approval ratings, it is unlikely that he will pursue any radical reforms in his sphere of competence. The RF Government managed to dissuade Vladimir Putin from transferring state-owned energy assets into the control of Rosneftegaz, a conglomerate headed by Igor Sechin.

November 2012 turned out to be a rather hectic month because of a sharp rise in tensions in Russia's corridors of power. The loudest event of November was the dismissal of yet another minister – the second cabinet member who had lost his job since the creation of the new RF government in May 2012. It is noteworthy that this time the sack was given to Anatoly Serdiukov, who was deprived of the post of Minister of Defense, occupied by him for five years in a row. This ministerial post is one of the crucial positions within the RF Government, most important both politically and financially, especially bearing in mind the enormity of Russia's defense budget. Anatoly Serdiukov, once a newcomer from St. Petersburg, had been appointed head of the RF Federal Tax Service just in time to preside over the conclusion of the *Yukos* affair. He had gained prominence due to his marriage to the daughter of former Prime Minister (now Deputy Prime Minister), Viktor Zubkov, and had been considered a protégé of Igor Sechin. It was difficult to say anything definite about him. However, his ministerial career made him a public figure much in the public eye. In the autumn of 2008, Anatoly Serdiukov announced that Russia was launching a major military reform. That reform consisted in a switchover from a four-link command and control system (military district – army – division – regiment) to a three-link one (military district – operational command – brigade); in a reduction in the number of military districts from 6 to 4; and in the integration of the Air Force, the Navy and anti-missile defense units into the said military districts. Also, the material provision of the Armed Forces, including catering, was now to be entrusted to civilian agencies. As regards military education, Serdiukov's professed aim was to drastically reduce the number of military educational establishments by merging and enlarging them. But his most dramatic move was to begin a major reduction of Russia's officer corps (its numerical strength was cut from 335 thousand to around 220 thousand; more cuts were promised, but their implementation was postponed in 2011). The number of senior non-commissioned officers (*praporshchiks*) was also reduced. On the whole, the numerical strength of the Armed Forces was cut by approximately 150 thousand. For the first time in Russia's post-Soviet history, Serdiukov sharply reduced the number of appointments held by officers in the rank of General, and also began to reduce the number of military units and cantonments (the latter reduction, which was to take place in the nearest future, was initially planned to be very drastic – by a number of times; but whether or not it will ultimately be carried out is no longer clear in the present circumstances). Instead of demanding an increase in allocations for military personnel money allowances, Serdiukov successfully lobbied for technical re-equipment and rearmament of the Armed Forces. In 2007, Russia adopted a seven-year rearmament program worth 5 trillion rubles. In 2010, its cost rose four-fold, to 20 trillion rubles. Serdiukov considered it to be permissible to purchase armaments abroad, and was not afraid to quarrel and litigate with Russian suppliers. In 2010, the state defense order was not fulfilled due to price disagreements, and it can be said that in those years the state defense

order gave rise to a number of permanent conflicts within Russia's elite, which could be resolved only by personal interventions on the part of Vladimir Putin. Also, Serdiukov failed to finally do away with a number of well-known and long-standing army problems, including the provision of officers with housing and the issue of fires at military depots (designed to hide the theft of arms, some of which would be later used in attacks on Russian soldiers in the North Caucasus). In the RF Ministry of Defense, Anatoly Serdiukov enjoyed the support of his appointees, Chief of the General Staff Nikolai Makarov and Commander of the Airborne Forces Vladimir Shamanov, a highly popular hero of the Second Chechen War, and a large number of similar-minded civilian officials recruited by him from the ranks of the RF Tax Service. For all these reasons, and also owing to his brutal character, Serdiukov became very unpopular among military men and people with army backgrounds, who pejoratively called him the "furniture salesman" (before becoming a civil servant, Serdiukov had actually spent some time trading in furniture). However, it is apparent that only a minister slavishly following the orders of the existing military apparatus and the military-industrial complex and hiding their obvious crisis and low combat readiness could have become popular with them. It was crystal clear that the numerical strength of both the army and its officer corps should be reduced; that a considerable proportion of military men, including those in the archaic cantonments, were busy doing practically nothing; that the quality of military education and of the military industrial complex's products was low; and that embezzlement on a grand scale was taking place in the military-industrial complex, well hidden from prying eyes behind a veil of secrecy. However, apart from reducing the army to a reasonable size, Serdiukov's other achievements did not really amount to much. Scandals concerning the quality of products issued by the defense-industrial complex continued without respite against the background of demands that Russia's budget should be increasingly sacrificed to the nebulous goddess called "army rearmament". Budget allocation for this expenditure item had mysteriously increased four-fold, but the planned results remained unachieved because industry simply could not cope with such an amount of orders. The army continued to be rocked by corruption scandals involving people close to Serdiukov – for example, Vladimir Shamanov was caught red-handed while attempting to use his subordinates in the interests of his son-in-law, a businessman wanted by the police (!) for alleged links to organized crime¹. Finally, the RF Investigative Committee initiated a criminal case for embezzlement in *Oboronservice*, a company headed by one of Serdiukov's favorites, former head of the Property Management Department of the RF Ministry of Defense Elena Vasil'eva. Several persons were arrested, Elena Vasil'eva was put under house arrest, while Anatoly Serdiukov was disgracefully dismissed. Serdiukov's sacking was followed by him being lambasted by Russian television, and it is noteworthy that he has not been offered any consolation job as yet. His enemies had turned out to be too numerous for him to retain his post, and he had also lost the goodwill of Viktor Zubkov and Igor Sechin, with whose protégées he had been at constant loggerheads. Apparently, some of the reasons for Serdiukov's downfall were election-related: bearing in mind the rise in internal political tensions, the minister who deeply irritated society had become a liability to Russia's top leadership.

The post of Minister of Defense was given to Sergei Shoigu, who had been appointed head of Moscow Oblast only six months before his latest promotion. Shoigu is one of the few officials with consistently high approval ratings – he earned his spurs during his term as Minister for Emergency Situations. In 1999, Shoigu was one of the public leaders of *Unity*, the then party of power; later on, he was removed from active politics and mothballed for the time being. In 2012, when the ruling party was in need of charismatic politicians, Shoigu was returned to the political arena. The post of Chief of the General Staff was given to Nikolai Makarov's former deputy, Commander of the Central Military District Valery Gerasimov. His appointment can be considered a compromise between the 'old team' and the new one. Several trusted allies of Shoigu received the posts of deputy ministers (thus, the important position of Deputy Minister of Defense in charge of financial matters was received by Ruslan Tsalikov). Thus, for now, Shoigu enjoys considerable freedom of

¹ It is quite an amusing fact that Valery Shamanov, who had been returned from oblivion by Anatoly Serdiukov and then saved by him from being dismissed for his involvement in his son in law's affair, expressed his gratitude to the fallen patron in a manner most typical of today's Russian generals: Shamanov was one of the first to publicly approve Serdiukov's sacking.

action, but time is clearly working against him, for the current situation in the army leaves no room for relaxation.

One of the leaders of *United Russia*, Andrei Vorobiev, was appointed Acting Governor of Moscow Oblast, where the next gubernatorial election is scheduled to take place next September. For Shoigu, Vorobiev is not an outsider – Andrei’s father was his long-term deputy. At the same time, Andrei Vorobiev, member of a wealthy family renowned for its fishing businesses and for being business partners of Gennady Timchenko, is an independent figure: he has replaced almost one-third of Moscow Oblast’s ministers. As regards the electoral campaign in the said oblast, it promises to become one of the top electoral events of next year (in case any strong candidate competitive against Vorobiev should emerge). Unlike Shoigu, Vorobiev lacks an outstanding approval rating, while his many years of work as a party bureaucrat is a virtue not highly appreciated by the electorate.

Serdiukov’s dismissal did not, however, put an end to all conflicts. In November, the police arrested head of Perm Krai’s Government Roman Panov, the former Deputy Minister of Regional Development under Viktor Basargin, who had followed his boss to the Perm Krai after Basargin’s being appointed its Governor. As regards Viktor Basargin, he is known to be one of the protégées of Moscow Mayor Sergei Sobyenin. The RF Ministry of Internal Affairs charges Panov with embezzling a sum of nearly Rb 100m allocated for building facilities and objects for the recent APEC summit. Investigators believe that the thefts were carried out via the conclusion of unnecessary and heavily overpriced insurance contracts for the performance of construction work.

The next targets of the Russian crime busters were the businessman Konstantin Malofeev and President of *Rostelekom* Alexander Provotorov (Malofeev’s former subordinate), whose homes were searched in connection with the criminal case for fraudulently obtaining a more than \$ 200m loan from VTB Bank. The loan was spent on purchasing the Nutritek food company at a price which, according to the VTB Bank, was several times higher than the company’s actual value. The loan has never been repaid. At the same time, Governor of Smolensk Oblast Aleksey Ostrovsky announced that he had revoked his plan to appoint Konstantin Malofeev Member of the Federation Council for Smolensk Oblast, despite having lobbied for him in the course of the recent municipal elections. Malofeev had won at those elections, which opened a way for him to become a senator. A few days earlier, the RF Government had suggested that Alexander Provotorov should be replaced as head of the Rostelekom state-owned company by another person, but Head of the Presidential Executive Office Sergei Ivanov refused to coordinate that personnel decision of the Government.

Finally, Elena Skrynnik, who had been dismissed in May from the position of RF Minister of Agriculture (and had not been offered another job – a very bad omen indeed), was called as a witness in the criminal case for fraud in the Rosagrolizing company, that she had headed prior to her appointment to the ministerial post. Russian state television then announced that it would show a number of incriminating documentaries concerning her alleged misdeeds (her protégée, the former head of a department of the Ministry of Agriculture Oleg Donskikh, is charged with embezzling more than Rb 500m by means of a number of fictitious supplies of equipment to agricultural enterprises via *Rosagrolizing*).

This dramatic exacerbation of tensions within Russia’s ruling elite, including the use of power structures, is by no means an unprecedented phenomenon in the post-Soviet history of Russia¹. What is new, however, is the public-relations component of this process: the authorities are positioning themselves as a structure ready for self-purification. At the same time, the arrested suspects are not the kingpins of the ongoing corruption scandals, but their aides, deputies, etc, while the “first persons”, in fact, remain untouchable. Opposition supporters believe that, as far as public relations are concerned, the fact that yesterday’s leaders, who were appointed by Vladimir Putin and stood side by side with him, are now being officially branded as “crooks and thieves”, can

1 In 2007, Russia’s law enforcers arrested Alexander Bulbov, one of the heads of the State Anti-Narcotics Agency (*Gosnarkokontrol*), and RF Deputy Minister of Finance Sergei Storchak (later on, Bulbov received a conditional sentence, while Storchak was released); Mayor of Moscow Yuri Luzhkov was removed from office, and his wife sold her business, while his team was mostly dispersed; and the year 2011 saw the emergence of the famous criminal case against Moscow Oblast prosecutors, which caused an extremely acute conflict between the RF Investigative Committee and the RF General Prosecutor’s Office (in fact, this case is now effectively being closed).

be both advantageous and disadvantageous for the authorities. Thus, for example, the dismissal of Luzhkov and the self-destruction of the myth concerning the superb efficiency of the Moscow government greatly contributed to the subsequent sharp rise in protest moods, which was first registered by sociologists and then spilled over into the streets of Moscow.

November 2012 saw a partial resolution of yet another intrigue – the controversy around the future of the state-owned assets in the field of electrical power production and distribution. The assets in question were *FSK* [Federal Grid Company], *Holding MRSK* [Interregional Distribution Grid Company], and *RusGidro* [Federal Hydro-generating Company]. In spring 2012, it had become clear that the new head of *Rosneft* and Vladimir Putin's closest ally Igor Sechin was planning to impose his control over the said companies on the pretext that they were in dire need of additional capitalization. His idea was that *Rosneftegaz*, the owner of a controlling block of shares in *Rosneft*, which did not transfer its dividends to the budget, should buy out the state-owned blocks of shares in those companies and create a new juridical person, owned by *Rosneftegaz*. Having got Putin's approval for *Rosneft's* purchase of TNK-BP, Igor Sechin stumbled on this issue because Putin traditionally stuck to the force-balance principle in dealing with his close associates, when none of these officials can successfully lobby on any issue he or she is eager to promote. The RF Government reached a negative conclusion regarding those projects, President Putin supported its decision, and, as a result, *RusGidro* retained its independence, while *Holding MRSK* and *FSK* merged into a single state-owned company under a new name, *Rossiiskie Seti* [Russian Grids]. The final results of that intrigue will become clear when the authorities reveal the name of the head of this new company. However, in any case, the logic requiring the existence of big companies and their financing from the budget has clearly gained the upper hand over the principle of semi-mystical “privatization”, so frequently spoken about in Russia's corridors of power.

In November, the Ministry of Economic Development submitted to the RF Government a draft law on the protection of the rights of entrepreneurs. It should be reminded that the draft law was designed to implement one of Putin's pre-election initiatives. The fate of this legislative innovation was rather strange: it began with the creation of the post of Business Ombudsman, which was given to the leader of *Business Russia*, Boris Titov, and only then the authorities started to discuss which powers should actually be vested in the Business Ombudsman. Vladimir Putin promised Mr. Titov that he would enjoy the widest powers, including the right to suspend doubtful normative acts issued by state agencies pending the decision of a court of justice. Then it turned out that his right extended only to the normative acts issued by local self-government bodies. Moreover, this right was worded as follows: “*the Business Ombudsman shall have the right to pass recommendations concerning the suspension*” [of normative acts] to the very bodies that have adopted the acts he wants to be suspended. The punishment for violation of his recommendations remained unspecified. The rest of the Business Ombudsman would be confined to writing letters to one or other official, who would then decide how to respond to them. Bearing in mind the personality of Boris Titov and his extreme caution in any public discussion, we have reasons to believe that the role of Business Ombudsman will be very modest indeed.

In November 2012, Russian courts of justice passed their decisions on two loud political cases. To begin with, the first of the “Bolotnaya cases” was finally brought to court (the Maxim Luzyanin case)¹. As Luzyanin had pleaded guilty, his case was considered under a special procedure. In spite of this, he was sentenced to 4.5 years' deprivation of liberty in a general-regime penal colony. This sentence was to be a clear indication that those arrested for the disturbances on Bolotnaya Square (approximately twenty persons) should not hope for their judges' leniency, because their sentences would be intended to send a signal to society that the authorities were determined to ruthlessly retaliate for any future use of force, however minuscule, by participants of protest rallies. The second court case was that of mixed martial arts world champion Rasul Mirzaev², which

1 The cases of the persons charged with organizing mass disturbances and using force against public officials in the course of the opposition march on 6 May 2012.

2 In the course of a quarrel, Rasul Mirzaev hit a young Muscovite, who died four days later in hospital. Prosecutors called for two years' limitation of liberty at the place of Mirzaev's registration in the Kizliar district of Dagestan, and the court passed the corresponding sentence, although unpremeditated manslaughter (the offence incriminated to Mirzaev) can punishable with up to three years' deprivation of liberty. Moreover, the professional boxer Mirzaev could well have been charged with premeditated murder.

ended in his release. From the very beginning, his case had gained much notoriety because of the suspect's personality and the unprecedented appeal for leniency made on his behalf by the State Assembly of Dagestan. It cannot be imagined that the Moscow legislature could have come forth with a similar appeal for mitigating the sentence to be passed on a Russian murderer. The authorities hesitated for a long time over how to deal with that case – at first Mirzaev was taken into custody (according to the existing judicial practice, the measure of restraint which consists in putting a person into custody means, among other things, actual deprivation of liberty for one or other term); then he was released on bail only to be taken into custody once again. Then, at last, Mirzaev was released and deported to his historical homeland. Thus, unlike the outcomes of the other two loud court cases dealing with ethnic crime – the Yuri Volkov murder case and the Yegor Sviridov murder case – the authorities preferred to heed public opinion in the North Caucasus rather than in Moscow. ●

INFLATION AND MONETARY POLICY

N.Luksha

The effect of September indexation of housing and public utilities prices began to subside, leading to a slowdown of inflation in October: as per the month results, the CPI equaled the same period of the last year and amounted to 0.5%. In November, the growth rate of consumer prices remained unchanged and on November 19 amounted to 0.3%. As a result, the cumulative inflation since the beginning of the year on that date amounted to 6% (against the relevant indicator of 5.6% last year). Thus, as per the year results, inflation is likely to be within the projected value, the upper level of which is 7%. According to tentative estimates of the RF Central Bank, the net capital outflow from the country within ten months of the current year reached \$61bn (vs. \$60bn the relevant period of 2011).

Reduced growth rate of prices for paid services in October has led to a slowdown in consumer inflation to 0.5% (the same indicator was recorded in October last year). After the September one-percent increase, in October prices for commercial services increased only by 0.1%. Growth price rate has slowed down in educational services from 5.1 to 0.6%, in housing and public utilities from 2.4 to 0.4%, and fitness services from 2.3 to 0.6%. There is still a decline in healthcare and recreation services (3%), passenger transportation (-1.3%), international tourism (1.4%) and insurance services (-0.1%). At the same time, the demand for the services of cultural organizations has grown, which prices got up by 0.8%.

In October the growth rate in food prices has matched the previous year level, amounting to 0.5%, having significantly increased as compared with September (+0.1%). Prices for fruit and vegetables continued to decrease (-2.2%), as well as for sugar (-2.9%), although the rate of decline has slowed more than twice. The greatest increase in prices, which, however, was lower as compared with September, was observed in sunflower oil (+4.3%) and eggs (+3.5%). Also a rapid growth was noted in prices of bread and bakery products (+1.9%), as well as pasta (1.6%).

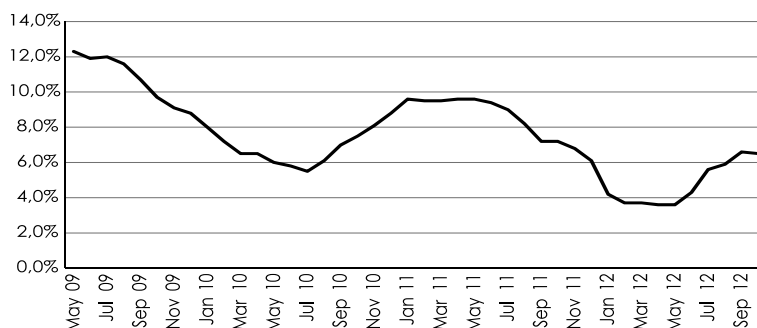
In October, the growth rate of non-food prices remained unchanged and amounted to 0.7%. Like in previous month, the utmost growth was observed in gasoline (+2.4%) and tobacco (1.3%). With the onset of cold weather prices for seasonal footwear has increased (+1%). The only cheapening items in October among non-food goods were still video and audio appliances (-0.2%).

In September, the annual inflation (October 2012 against October 2011) made 6.5% (Fig. 1). The relevant indicator of the last year was 7.2%.

In October the core consumer price index¹ has again declined to the level of August (+0.6%).

In November, weekly growth rates of consumer prices did not exceed 0.1%: as a result, the CPI indicator as of 19 days of the month made 0.3% (against 0.4% in 2011). Cumulative inflation since the beginning of the year to November 19 reached 6%, which is 0.4 p.p. higher than the indicator of the same period last year.

By the end of the year the rate of inflation traditionally accelerates. As usual, significant budget expenditures and pre-holiday upsurge in consumer demand become the main factors of price growth. Nevertheless, most likely, inflation will be stay within the updated



Source: RF Statistical Service.
Fig. 1. The Growth Rate of the CPI in 200-2012 (% year to year)

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

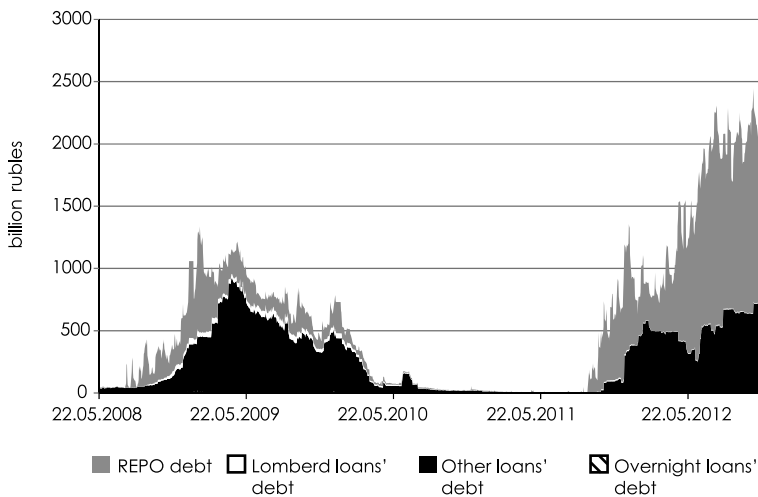


Fig.2. Arrears of commercial banks with the Bank of Russia in 2008–2012

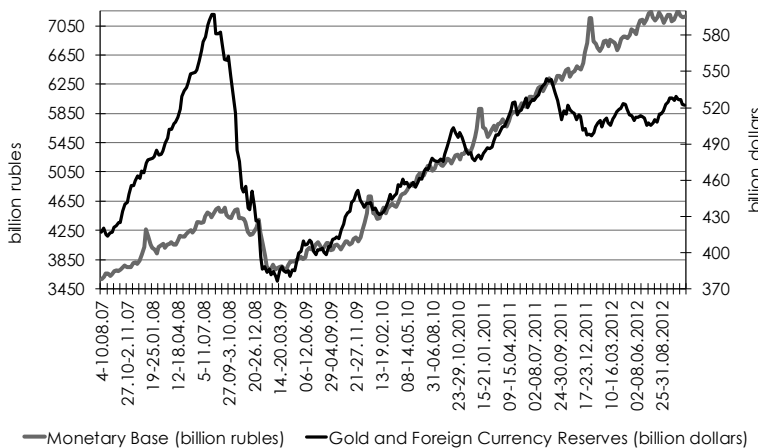
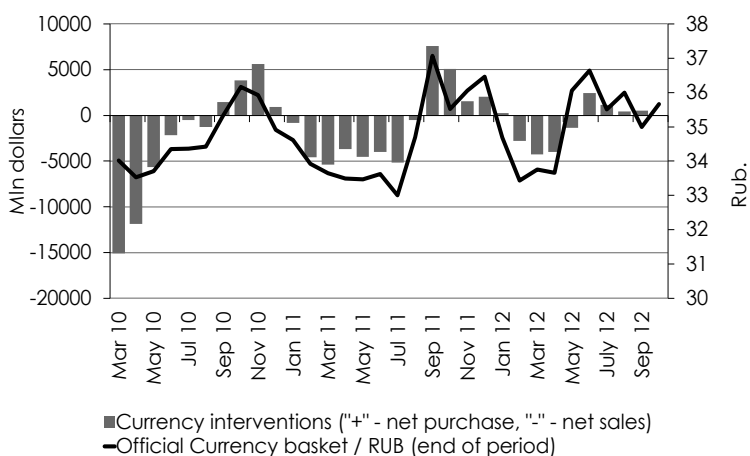


Fig.3. Changes in the Monetary Base and in the Gold and Foreign Currency Reserves in 2007–2012



Source: RF Central Bank, author's estimates.
Fig. 4. Central Bank Currency Interventions and Dynamics of Ruble Exchange Rate in March 2010 – October 2012

official forecast. In the revised version of the “Guidelines for the Consistent Monetary and Credit Policy for 2013–2015”, submitted by the RF Central Bank to the State Duma at the beginning of November 2012 the forecasted for 2012 inflation rate is increased from 6 to 7%, which matches the estimates of the Ministry of Economic Development of Russia and Gaidar Institute. Significant constraint factor of inflation will be the continued decrease of monetary supply: M2 growth rate in annual terms has slowed down from 21.4% as of October 1, 2011 to 14.9% on October 1, 2012.

Like in previous two months, in October the monetary base in broad definition has continued to decline: over the month it decreased by 0.5% to Rb 8,045.6bn. The basic reason for the monetary base decrease was the reduction of commercial banks’ deposits with the banks. Over the month, they have been reduced by 5.6% to Rb 720.9 bn. Other components of monetary base in broad definition were growing: commercial banks’ deposits with the RF Central Bank – by 11.6% to Rb 101.3bn, mandatory reserves – by 0.6% to Rb 413.9bn.

In October, the excessive reserves¹ of commercial banks were still decreasing: Over the month they decreased by 5.4% to Rb 822.2bn. The liquidity deficiency is sustained, as evidenced by the growth dynamics of borrowing from the RF Central Bank (Fig. 2). The main sources of its completion, as in the past year, remain the Bank of Russia auctions against guarantee of securities.

In October the monetary base in narrow definition (cash plus mandatory reserves) remained virtually unchanged, having made Rb 7223.3bn (-0.2%) (Fig. 3).

In October the Bank of Russia practically did not participate in the foreign exchange trading. The RF CB entered the market with currency net sales, but their volume has significantly decreased – by 22-fold as compared with September. Net foreign exchange interventions in October amounted to only \$23.64m (Fig. 4).

1 Under the excessive reserves of commercial banks with the RF 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.

According to tentative estimates of the Bank of Russia, within ten months of the current year, net capital outflow reached \$61bn, exceeding the outflows of the same period last year by \$1bn. Thus, in October, the outflow of capital from Russia has not stopped and reached from \$3bn (RF CB assessment) to \$5bn (estimates of the Ministry of Economic Development).

An essential reason for the outflow of capital from Russia in recent years has been the Regulator effort to minimize the intervention in the currency market. In this situation, the surplus of the current account balance of payments is leveled by the deficit of the capital operations account and financial instruments. With the stable foreign reserves, capital outflow is correlated with the in-

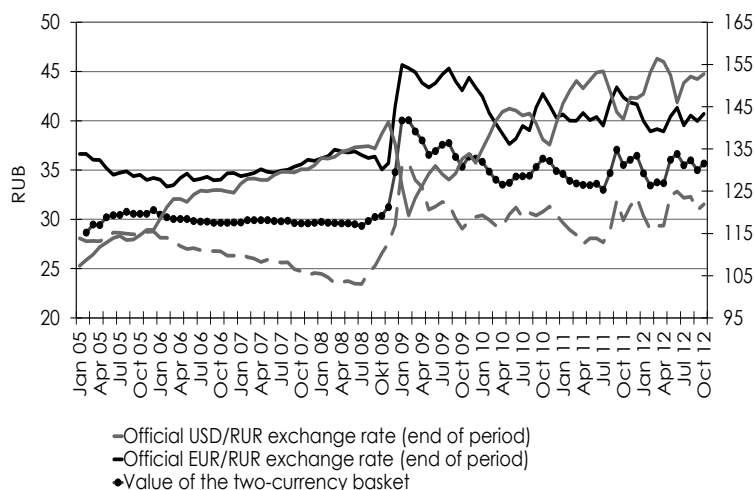
flow of currency into the country as a result of export-import operations. Herewith, sustained ruble nominal exchange rate reflects the balance of supply and demand in the foreign exchange market. Thus, if current trends are kept up, the surplus of the current account balance of payments in 2012 will be approximately equal to the value of 2011, which means also comparable to the last year outflow level. In other words, the outflow of capital from Russia in 2012 is likely to be \$75–85bn.

Over the month from mid-October the amount of international reserves by November 16 decreased by 1.4% to \$522.2bn. Foreign exchange and gold reserves decline was due to currency revaluation, as well as lower prices of gold. Over ten months of the current year international reserves increased slightly – by 5.6% or \$28bn. Over the same period last year, the reserves have increased by 9.6% or \$46bn.

In October, ruble real effective exchange rate after the September decline rose by 0.8%. As a result, the ruble real effective exchange rate index has grown to 152.74¹ (Fig. 5).

Since early November, the dollar exchange rate against ruble has downgraded by 1.3% to 30.13 Rb/\$ (as of November 24). The dynamics of the Euro against ruble rate in the first half of the month reflected the dynamics of the European currency against dollar. Due to the publication of poor statistical data on the Eurozone economy and uncertain position of the European Commission on the issue of providing financial assistance to Greece, Euro was gradually declining, having reached on November 13 the two-month minimum in the world market. As a result, over 24 days of November the European currency has decreased by 1.4% to Rb40.14/Euro. During the same period, the two-currency basket was downgraded by 1.3% to Rb35.18.

On November 7 the Bank of Russia has made minor amendments to the draft Guidelines for the Consistent State Monetary Policy for 2013 and the period of 2014 and 2015. The estimated net capital outflow was adjusted from \$65 to \$67bn, and the amount of international reserves by the year end – from \$505 to \$508bn. ●



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

Source: RF Central Bank, author's estimates.

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

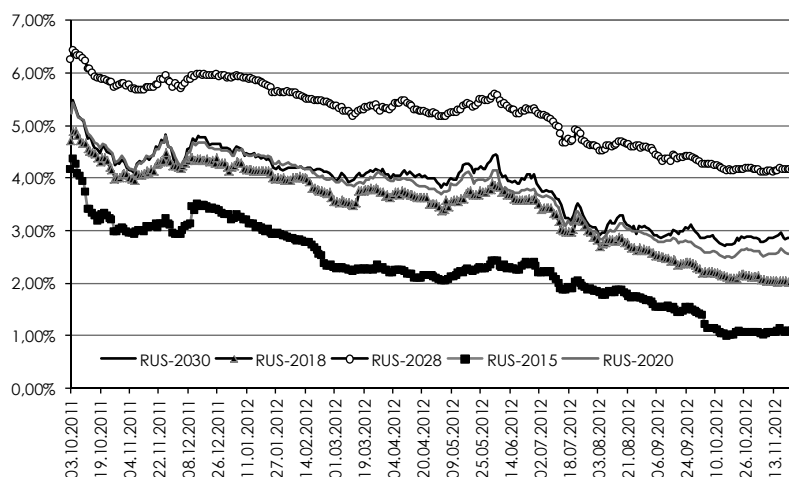
1 The level of January 2002 is accepted as 100%.

FINANCIAL MARKET

N.Burkova, E.Khudko

The “Big Twenty” fears of a slowdown in the global economy, downgrading of France credit rating and volatility of oil prices have led to deterioration in the Russian financial markets in November 2012. Herewith, the average daily market turnover of governmental securities has decreased most significantly (by 40%). Lower reduction rates were noted in the stock market average daily volume (by 7%) and the futures market of the Russian Federation (by 9%). For the domestic market of corporate bonds November was a period of stabilization, despite the difficult external economic situation. The volume and market index has also moderately increased. The situation has improved in the issuers’ performance of their obligations, no real defaults were declared in November.

Government securities market



Source: “Finmarket” Information Agency data.

Fig. 1. Yields to maturity of the Russian Eurobonds with maturity in 2015, 2018, 2020, 2028 and 2030

In November the volatility of global financial markets has resulted in slow development of the Russian market: investors’ activity in the government securities market has decreased, despite the decline in the yield to maturity of securities in this sector (within 0.2-5.5%). Growth of 0.7% showed only Eurobonds RUS-15, one of the shortest securities in the market (Fig. 1).

Within the period from October 30 to November 23, 2012, the total turnover in the secondary market of government bonds amounted to Rb 54.8bn with an average daily turnover at the level of Rb 3/05bn, which means the decline of the average monthly turnover by 40% as compared with the preceding period.

From October 30 to November 23 of the current year there were held four auctions (five auctions a month earlier) in federal loan bonds (OFZ) placement in the primary market (Table 1). The total actual amount of placement made 84% of the planned volume (against 92% in the preceding month). There were no auctions on additional OFZ issues placement in the secondary market.

Table 1

OFZ PLACEMENTS IN THE PRIMARY MARKET

Auction date	Emission	Emission volume, RB m	Emission volume at face value, RB m	Average weighted yield
31.10.2012	ОФЗ-26208-ПД	30 000.00	29 798.00	7.22
07.11.2012	ОФЗ-26209-ПД	35 000.00	33 405.00	7.42
14.11.2012	ОФЗ-26207-ПД	25 000.00	9 027.00	7.72
21.11.2012	ОФЗ-26208-ПД	35 000.00	32 544.00	7.07
31.10.2012	ОФЗ-26208-ПД	30 000.00	29 798.00	7.22
Total:		125 000.00	104 774.00	

Source: Russian Ministry of Finance.

Stock market

Factors of the Russian stock market dynamics

The Russian stock market in November was affected by the information on the growth of unemployment rate in the Eurozone, poor economic statistics of Japan, reduction of France rating from AAA to AA1 with an “adverse” forecast by Moody’s international agency, slowing of global economic growth and the RF economy in Q3 2012. Some support to the Russian market in the middle of the month was provided by such factors as the preservation of key interest rates by the European Central Bank and the Banks of England and Japan at the same level, and the reduction of unemployment in the U.S.

Since the beginning of the year the global market has increased by 2–38%, except for the Chinese market, whose basic stock index Shanghai Composite has declined by 6% (Table 2 and Fig. 2).

Table 2

DYNAMICS OF THE GLOBAL STOCK INDICES

Index	Value (as of 25.11.2012)	Dynamics within the month (%)*	Dynamics from the year beginning (%)
MICEX (Russia)	1 413.15	-1.31	2.12
RTS (Russia)	1 432.24	-0.20	3.85
Dow Jones Industrial Average (USA)	13 009.68	-0.74	7.28
NASDAQ Composite (USA)	2 966.85	-0.71	14.69
S&P 500 (USA)	1 409.15	-0.20	12.27
FTSE 100 (UK)	5 819.14	0.41	4.00
DAX-30 (Germany)	7 309.13	1.47	22.12
CAC-40 (France)	3 528.80	3.52	7.88
Swiss Market (Switzerland)	6 715.09	1.72	11.21
Nikkei-225 (Japan)	9 366.80	4.90	5.61
Bovespa (Brazil)	57 574.03	0.70	0.74
IPC (Mexico)	41 919.55	0.24	12.78
IPSA (Chile)	4 143.25	-2.68	1.91
Straits Times (Singapore)	2 989.28	-1.33	14.48
Seoul Composite (South Korea)	1 911.33	1.05	3.60
ISE National-100 (Turkey)	71 004.31	0.42	37.92
BSE 30 (India)	18 506.57	-0.69	20.58
Shanghai Composite (China)	2 027.38	-1.53	-6.39
Morgan Stanley Emerging&Frontier Markets Index	786.53	0.56	7.87

* versus index values as of October 29, 2012.

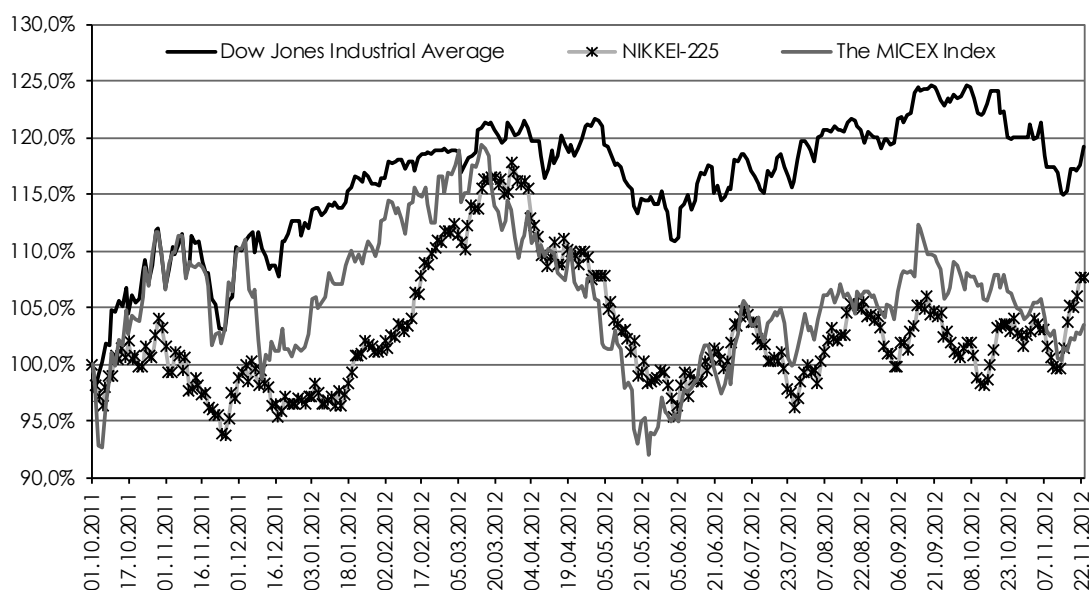
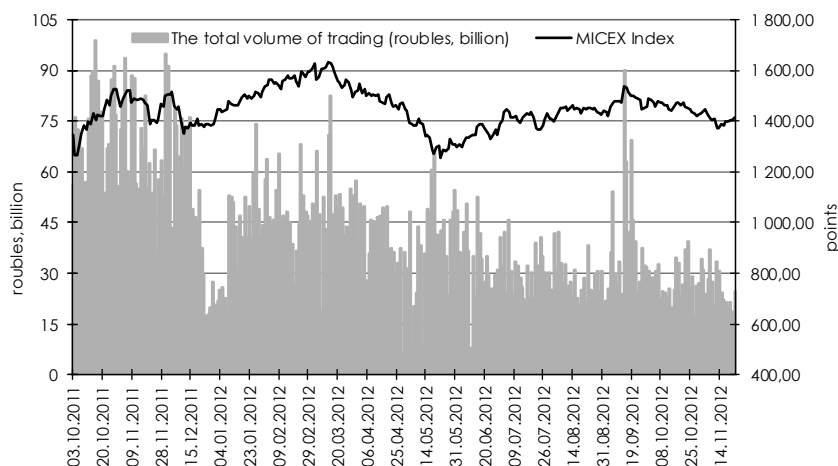


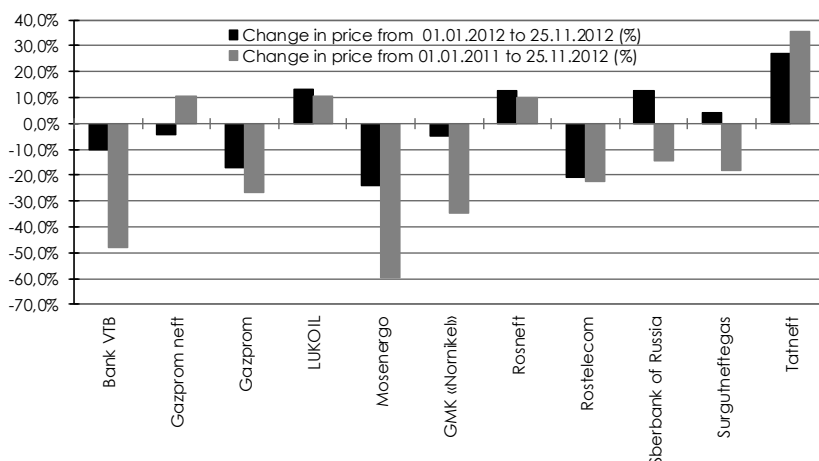
Fig. 2. Dynamics of the main USA, Japanese and Russian stock indexes (in % to the date 01.10.2011)

Stock market situation development



Source: OAO MICEX.

Fig. 3. Dynamics of MICEX Index and trading volume



Source: OAO MICEX

Fig. 4. Dynamics of the Russian Blue Chips

terms of capitalization were as follows: Gazprom – Rb 3,354bn (against Rb 3,569bn on October 29, 2012), Rosneft – Rb 2,556bn (against Rb 2,439bn), Sberbank of Russia – Rb 1,916bn (against Rb 1,976bn), LUKOIL – Rb 1,604bn (against Rb 1,604bn) and Surgutneftegas – Rb 937bn (against Rb 978bn).

Futures and Options Market

In FORTS market, the average daily activity of investors from October 30 to November 25, 2012 has decreased by 9% as compared with the previous month. Herewith, the leaders in terms of trading in futures were contracts for the RTS index, followed with a significant lag by the contracts for Rb/\$ rate, for Euro/\$ rate, for the securities of Sberbank of Russia and Brent crude. Prices of the recent transactions, concluded for futures contracts for Rb/\$ rate with the date of execution on December 15, 2012 were mostly within the range of Rb/\$ 31.2–31.9, i.e., ruble weakening (by 0.2–2.5%) is expected by market participants as compared with the indicator of November 25, 2012 (to Rb/\$ 31.13), and with the date of execution on March 15, 2013 – within the range of Rb/\$ 31.7–32.4. Prices of recent transactions concluded on futures contracts for Rb/Euro rate with the execution date on December 15, 2012 were mostly in the range of Rb/Euro 40.2–4, i.e., a depreciation of the ruble by 0.2–2.1% is expected as compared with the indicator of November 25, 2012 – Rb/Euro 40.14, and with the date of execution on March 15, 2013 – within Rb/Euro 40.7–41.7.

Within the month, the maximum value of the MICEX index was demonstrated on November 6, having reached 1,446.5 p. (versus 1,490.2 p. in the preceding month). The minimum value of the MICEX index at 1,372.2 p. has been reached on November 14 (against 1,431.9 p. in the preceding month) (Fig. 3).

Overall, in the period from October 30 to November 25, 2012, the MICEX index has declined by 1.3% (from November 26, 2011 to November 25, 2012, the MICEX index has increased by 0.2%), and the turnover of auctions included in the MICEX index reached Rb 494,9bn. Average daily activity of investors in the stock market in November has decreased by 6.7% as compared with the previous month.

Since the beginning of the year through November 25, 2012 the leaders in the value growth among the “blue chips” were securities of Tatneft, which value has increased by 27.2, while the leaders of decline, like a month earlier, were Mosenergo securities, downgraded by 23.8% (Fig. 4).

According to the OAO MICEX, on November 25 of this year, five leaders of the domestic market in

The value of the futures contract for RTS index (based on prices of recent transactions) with the execution date on December 15 was within 1360–1440 p., i.e., market participants expect a 0–5% decline against the indicator of November 25, 2012. By March 15, 2013 market participants expect the RTS index value to be in the range of 1,380–1,430 points. Prices of recent transactions in futures contracts for the MICEX index with the date of execution on December 15, 2012 were in the range of 1,380–1,440 points, i.e., market participants in general expect a decline of MICEX index in the range of 0–2.3%, as compared with November 25, 2012. Options enjoyed a far less demand, from October 30 to November 25, 2012 their trading turnover made about Rb 219.4bn (versus Rb 381.3bn in futures). The leaders in terms of trading turnover were the marginal options for futures contracts on the RTS index.

Corporate bonds market

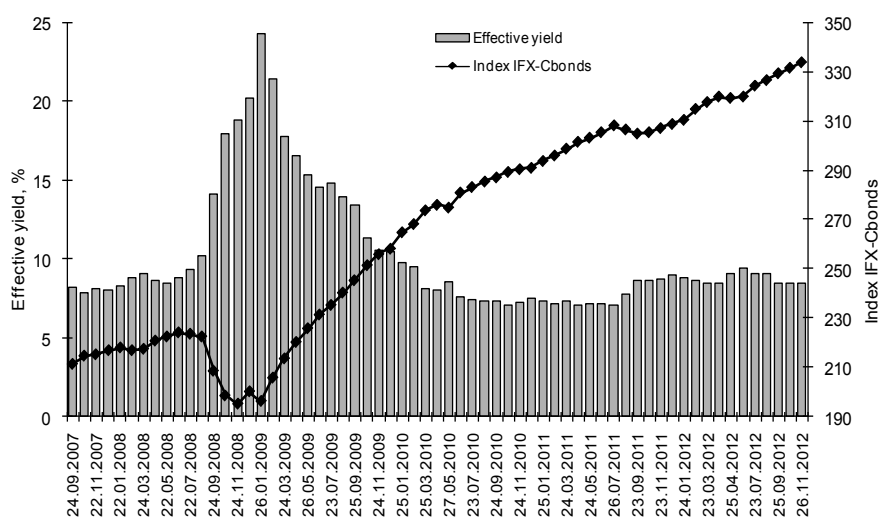
In November the volume of domestic corporate bonds market in Russia (at par value of circulating securities denominated in local currency) has grown again, though not so significantly as in preceding month, and reached the level of Rb 3,980.3bn, which is by 1.4% more than its value at the end of October¹. The growth of the market capacity is exclusively with an increased number of bond issues (865 issues of corporate bonds were offered in the national currency against 850 emissions at the end of the previous month), whereas the number of emitters recorded in the debt sector has decreased (333 emitters against 342 companies in October). In circulation there remain a number of bonds emissions issued in US dollars and one bonds issue in Japanese yen.

Investment activity in the secondary market of corporate bonds in November has decreased. Thus, from October 30 to November 23, the total volume of transactions in the MICEX amounted to Rb 116.3bn (for comparison, from September 25 to October 29, the trading turnover was equal to Rb 144.0bn), and the number of transactions within the period under review made 221.8000 (against 29.300 in the previous period)².

Index of the Russian corporate bond market IFX-Cbonds continued its steady growth trend. By the end of November of the current year its value increased by 2.4 points (or 076%) as compared with the value of late October. The average weighted yield of corporate bonds remains unchanged for two consecutive months and at the made 8.48% in late November against 8.48% at the end of preceding month (Fig. 5). Stabilization of the indicator to some extent a result of mutual leveling of positive and negative effects in both, foreign and domestic markets.

Problems of the Eurozone continue to exert pressure on global financial markets. Until now, EU countries still cannot agree on a financial plan of Community for 2014–2020, and economic activity in the Eurozone continues to decrease. “Greek problem” has aggravated again, while there is an outstanding problem of “fiscal breakdown” in the U.S., which can occur as early as 2013. In the second half of November, the sources of negative news were rating agencies: Standard & Poor’s has downgraded the sovereign credit rating of Hungary and the national central bank, Moody has decreased France rating.

As positive news of the world market one can note a higher-than-expected GDP growth rates in leading EU countries.



Source: Cbonds data.

Fig. 5. Dynamics of the Russian corporate bonds market index and average weighted yield

1 Rusbonds Information Agency data.
2 Finmarket Information Agency data.

The portfolio duration indicator of corporate bonds continued to decrease at the same rate as in October of the current year, and in late November made 547 days, which is by 28 days less than at the end of previous month.

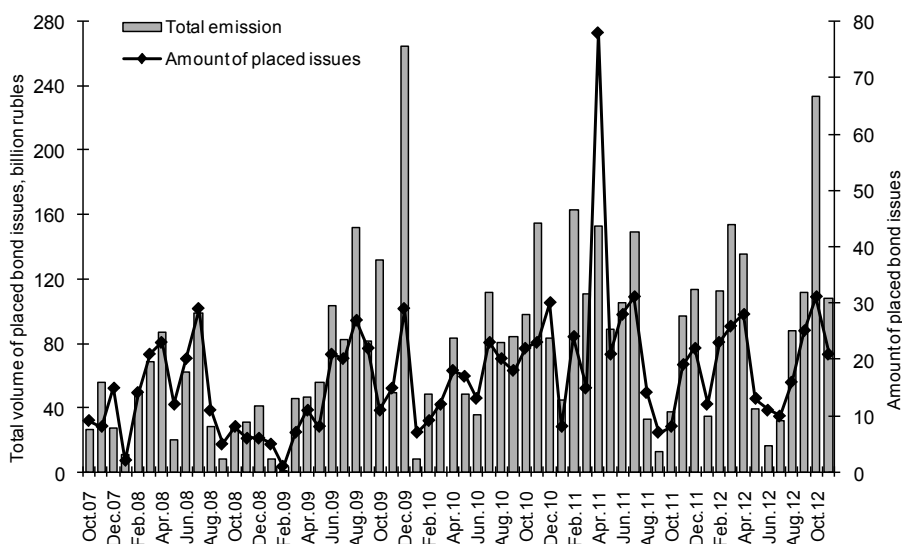
Despite the sustained weighted average yield in the bond market, the yield of the most liquid bond issues was growing, which was especially expressed in financial sector. However, the most severe volatility of the yield on various bond issues, both downward and upward, was demonstrated over the past months the issuers of financial sector: “MDM Bank” and “Russian Agricultural Bank”.

As expected last month, issuers have shown significant activity in the debt segment of the market, despite the stabilization of the market rates and fairly adverse external background. Thus, in the period from October 25 to November 26 this year, 26 issuers have placed 68 bond issues at the total face value of Rb 305.2bn (for comparison, from September 26 to October 24, there were placed 48 issues of bonds at face value of Rb 192.0bn). About half of registered issues were stock bonds. For the first time ruble bonds were placed by the International Financial Corporation (IFC, investment branch of the World Bank Group) for a total amount of Rb 23bn.

However, the activity of investors in the primary market is far less than indicators of issues placements, which may be due to the volatility external market situation. From October 25 to November 26 of current year companies placed 27 bond issues totaling to Rb 107.9bn (from September 26 to October 24, there were placed 31 loans worth Rb 233bn) (Fig. 6). However, even these indicators have exceeded the average level of primary placements made this year. The largest bond issues were placed by ZAO NC “Rosneft” (2 bonds series worth Rb 20bn), OAO “ALROSA” (2 bonds series amounting to Rb 10bn), ZAO “UniCredit Bank” (2 bonds series in the amount of Rb 10bn) and OAO “Rostelecom” (one series worth Rb 10bn)¹. Exchange bonds again made more than a half of registered issues. Again, there were placed several long-term loans: three issuers have raised funds for 10 years, one issuer – for 12 years, and OAO “Glavnaya Doroga” has placed bonds with maturity term up to 17 years.

In November this year, FFMS of Russia has recognized as invalid eight bond issues due to the non-placement of any securities, followed by rejection of state registration². However, this indicates not the lack of investment demand at the bond market, but rather the changes of borrowing programs of issuers themselves, given that in November there were cancelled securities of such companies as “RusHydro” oil company “Alliance”, “TMK”.

From October 25 to November 26 of the current year, sixteen emitters were to pay off their issues for the total amount of



Source: Rusbonds data.

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

issues for the total amount of Rb 107.7bn. However, one emitter failed to fulfill its liabilities to the bondholders in due time and announced a technical default. In December 2012, fifteen corporate bond issues totaling to Rb 61.4bn are expected to be paid off³.

The situation with the announcement of actual default (when the issuer is unable to pay return to securities holders even in a few days after the due date of liabilities) has changed to the better against the previous month. Thus, in the period from October 25 to Novem-

1 Rusbonds data.

2 FFMS of Russia data.

3 Rusbonds data.

ber 26, all issuers have fulfilled their current liabilities or repaid the nominal value of bonds, and early redemption of the securities on offer were accomplished by all issuers in due time or at least within the framework of a technical default¹.

Finally, it should be noted that a new kind of securities – infrastructure bonds can be soon found at the bond market. At the legislative level, this issue has already been discussed a few years ago, but there was no further development so far. In mid-November this year, Russian President authorized the Ministry of Finance of Russia and the Russian government to prepare proposals on the use of pension savings to issue infrastructure bonds before the end of the year². ●

1 Cbonds data.

2 Interfax.

REAL ECONOMY: TRENDS AND FACTORS

O.Izryadnova

The increase in investments in fixed assets of 4.9% versus October 2011 was a positive aspect of October 2012. As a result the workload in construction (105.1%) and housing construction (111.0%) started to grow again.

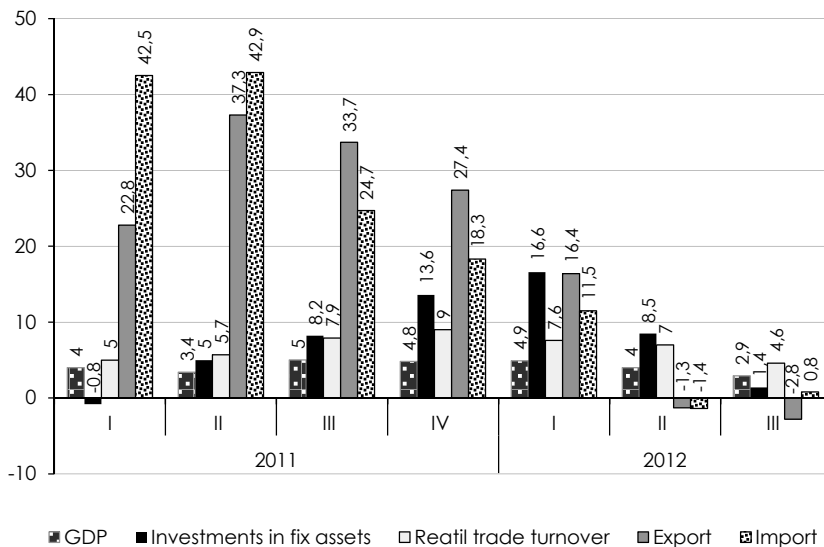
This October the industrial production index made 101.8% versus October 2011, being 103.0% in the manufacturing industry. The dynamics of the manufacturing industry development is influenced by the weakening of the machine-building and adjacent metallurgy complexes production growth rates. Besides, the drop in the agriculture production volumes by 13.3% versus October 2011 has a negative effect on the economy growth rates.

This year the macroeconomic situation was formed against the background of the gradual slowdown of both the internal and external demand growth rates.

It was the nature of the investment activity that had a prevailing influence on the internal demand. The upsurge of the investment activity from Q3 2011 to Q2 2012 was succeeded by the abrupt slowdown of July–August, resulting in the slowdown of the investments in fixed assets growth rates in Q3 2012 down to 101.4% versus the corresponding period of the previous year.

It should be noted at the same time that the attractiveness of the Russian economy for foreign investors has decreased. In January–September 2012 the Russian economy received foreign investments at the level of only 85.6% of January–September 2011. The contraction resulted from the shrinking of the total volume of the trade credits, credits issued by foreign governments and international financial organizations, as well as banking credits. It is of notice, that direct foreign investment went up by 4.6% as compared with January–September 2011, but their share in the total volume of the foreign investments is insignificant (10.7%) and remains below the pre-crisis level. In January–September 2012 \$109.4bn of investments was directed abroad from Russia, which is 13.0% above the figure of January–September 2011. The volume of the Russian investments abroad exceed the volume of investments in Russia by non-residents by \$5.3bn.

In October 2012 the growth rates of the investments in fixed assets made 104.9% versus October



Source: Federal State Statistics Service.

Fig. 1. GDP, Investment in Fixed Assets, Retail Trade Turnover and Foreign Trade Components Growth Rates in 2011–2012, as Percentage to the Corresponding Quarter of the Previous Year

2011, the workload in construction recovered (105.1%) as well as the implementation of the housing (111.0%). On the whole over the period of January–October 2012 investments in fixed assets went up by 9.5%, exceeding by 3% the figure of the corresponding period of the previous year. It is traditional for the Russian economy that the investment activity grows at the end of the year, but one can hardly expect that the investment growth rates this year exceed the level of the previous year.

Influence of the consumer demand on the dynamics of the economic development this year has been connected with the characteristic features of the inflation and population's incomes dynam-

ics. The index of consumer prices in the period from the beginning of the year to October 2012 made 105.6% versus 105.2% in the corresponding period of 2011, the prices for foodstuffs having increased by 6.1% (2.7% in the corresponding period of 2011), for non-food goods – by 4.4% (5.7%), for paid services – by 6.8% (8.3%).

In October 2012 the index of real incomes of the population made 102.4% and that of real wages – 105.2%, being 103.5% and 108.8%, correspondingly, in January–October 2012 as compared with the analogous period of the previous year.

It should be noted that in the current year the real incomes of the population and the real wages exceeded considerably the figure of January–October 2011, while the quarter-by-quarter dynamics of the consumer demand was characterized by the gradual slowdown. Retail trade turnover growth rates over January–October 2012 made 106.1% (versus 106.6% over the corresponding period of 2011), being 103.8% (109.1%) in October as compared with the corresponding period of the previous year.

The structure of the consumer prices having changed, starting with July 2012 the growth rates of the demand for foodstuffs has been observed to decrease dramatically. In October 2012 the foodstuffs market turnover exceeded the figure of October 2011 by only 0.5% (the increase of 4.9% was observed as a result of H1 2012). The increase in the non-food goods market turnover in October 2012 made 6.9% as compared with 11.8% a year ago. This was accounted for by, firstly, the slowdown of the real incomes of the population growth rates and real wages starting with September 2012, and, secondly, the change in the consumer behavior: the proportion of expenses for the goods purchase and the proportion of savings in the incomes of the population decreasing, starting with Q3 2012 the trend towards the expansion of the proportion of expenses for foreign currency purchase has been intensifying.

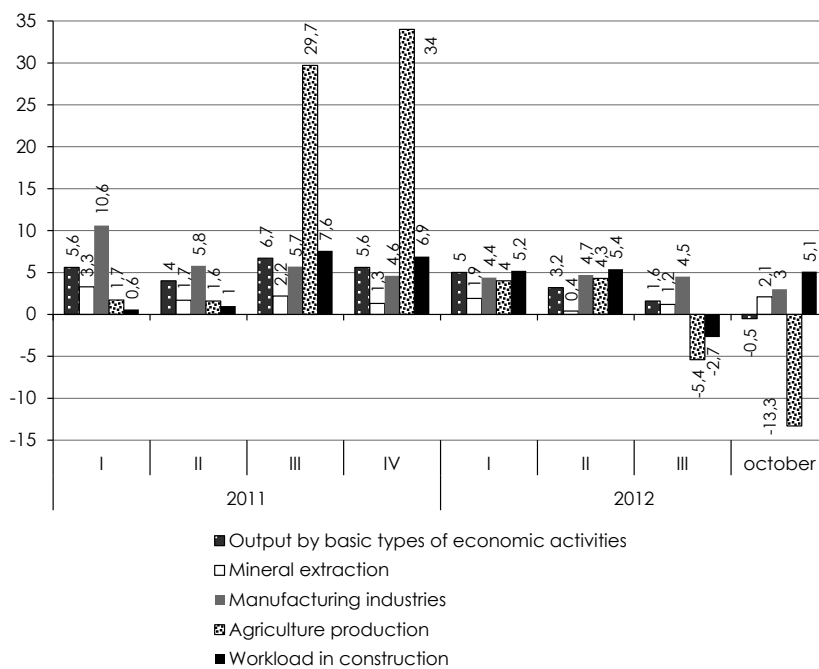
Throughout 2012 the consumer market acted as one of the main factors supporting the economic growth, its expected expansion as a result of the year being estimated to be at the level of 106.1% versus 107.0% in 2011, which, in its turn, is connected with the trend for the real wages growth acceleration by 9.1% and the real incomes of population growth acceleration by 3.5% versus 2011.

This year the external demand is observed to contribute less in the economic dynamics, the growth rates of foreign trade turnover slowing down substantially (*Fig. 1*). It should be noted that throughout the year the influence of the foreign trade component on the economic development growth rates has been changing.

Whereas in Q1 2012 the net export acted as a factor accelerating the GDP growth rates versus the corresponding period of 2011, the contraction of export in Q2–Q3 2012 by 2% and import – by 0.3% as compared with the corresponding period of the previous year has, in contrast, resulted in the strengthening of the trend for the economic development slowdown.

The commodities market is characterized by the slackening of the dynamics by the main types of the economic activity.

Throughout the year the industrial production growth rates have been slowing down steadily: in October industrial production index made 101.8% versus October 2011, mineral extraction index – 102.1%, manufacturing industries index – 103.0%.



Source: Federal State Statistics Service.

Fig. 2. Dynamics of Goods and Services Output by Basic Types of Economic Activity in 2011–2012, as Percentage to the Corresponding Period of the Previous Year

Dynamic recovery of the machine-building production in the post-crisis period had a considerable effect on the aggregated indices of the manufacturing industries, but in the current year the growth rates slowed down in all the types of machine-building production complex. In October 2012 as compared with October 2011 the index of machinery and equipment production made 101.8% (100.5% in January–October), of electric, electronic and optic equipment production – 109.8% (105.6%). Of transport vehicles and equipment production – 013.6% (115.8%). Transport vehicles and equipment production is supported by the positive dynamics of the passenger cars production that at the moment compensates for the contraction in trucks and some types of railway equipment production.

In October 2012 as compared with the previous month the majority of intermediate goods production industries were characterized by the production acceleration, however estimating the significance of this growth one should not forget about the low level of basic figures.

Among the consumer goods production industries, it is only the foodstuffs production that was characterized by the steady positive dynamics. However, analyzing the development of the foodstuffs production, one should take into account the prospects of its provision with agriculture raw materials. In October 2012 the agriculture production made 86.7% in October 2012 versus the corresponding figure of 2011.

Taking into account the existing trends of January–October 2012, this year the attainment of the industry growth rate at the level of 103.6% as included in the forecast by the RF Ministry of Economic Development is becoming doubtful. ●

RUSSIAN INDUSTRY IN OCTOBER 2012

S.Tsukhlo

A detailed analysis of the October data of the surveys carried out by the Gaidar Institute¹ showed that the main indices of the demand, output and prices in industry started to slow down again. Employment rate is falling too because due to low wages and salaries workers quit their jobs and there is no confidence that even stagnating output volumes can be ensured.

The Industrial Optimism Index points to a halt of growth in positive sentiments in industry (Fig. 1). The latest industry forecasts do not promise a change for the better in the situation until the end of 2012 (Fig. 2).

THE IEP INDUSTRIAL OPTIMISM INDEX, 2005–2012

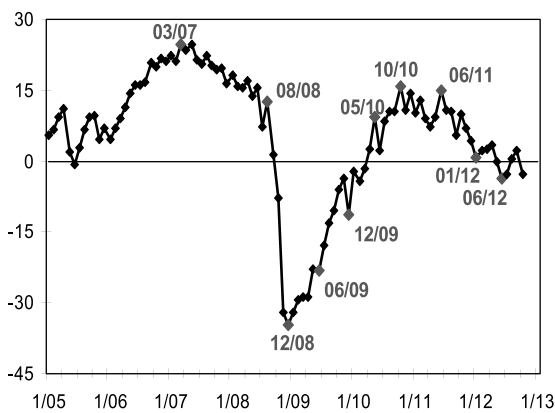


Fig. 1

THE INDUSTRY FORECASTS INDEX, 2005–2012

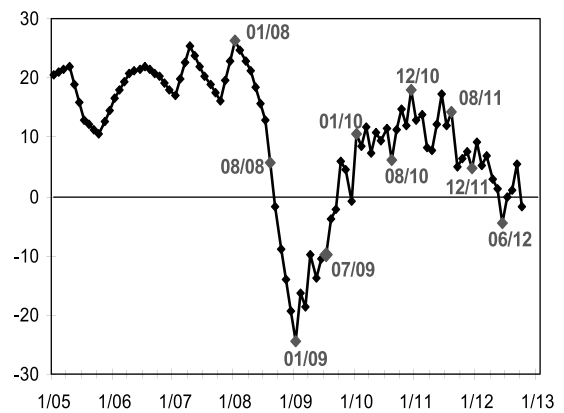


Fig. 2

The Demand on Industrial Produce

The initial data on the dynamics of the demand showed growth in the downfall rates to – 19 points. The more intense drop in sales after the dramatic phase of the crisis was registered before only in January 2010, 2011 and 2012. However, with the seasonal factor cleared such a sharp drop was smoothed to – 15 points. So, the October result turned out to be better than in July 2012 when the demand dipped dramatically. A lack of positive changes in the dynamics of the demand gave rise to a higher discontent with its volumes. At present, the “below the norm” estimates account for 49%, while the best result of the year (41%) was registered in April.

The dynamics of the forecasts of the demand does not suggest optimism, either. The initial data became 11 points worse, while that cleared of the seasonal factor, 7 points worse and got negative one again (Fig. 3).

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

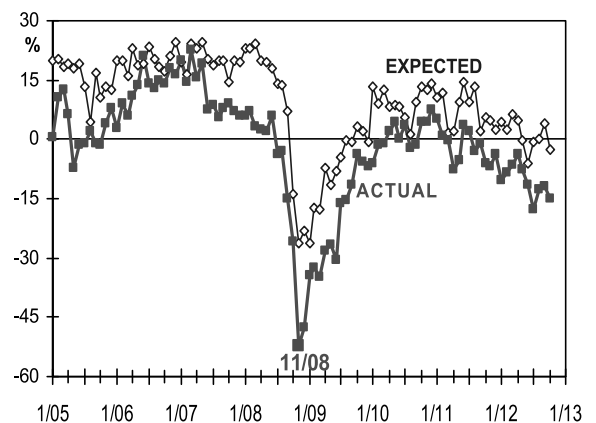


Fig. 3

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

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

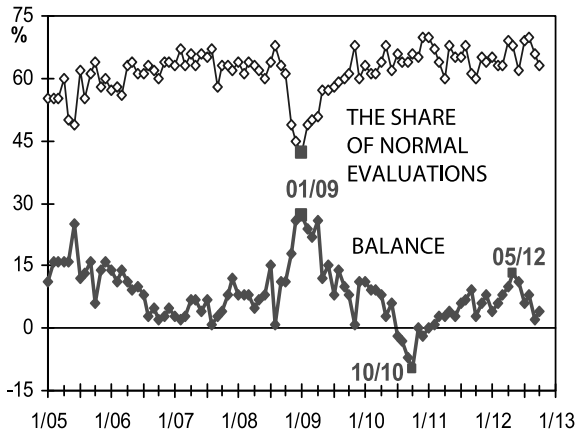


Fig. 4

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

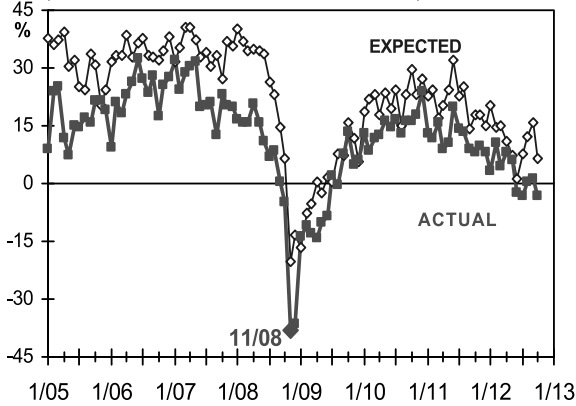


Fig. 5

CHANGES IN SELLING PRICES (BALANCE=%GROWTH-%REDUCTION)

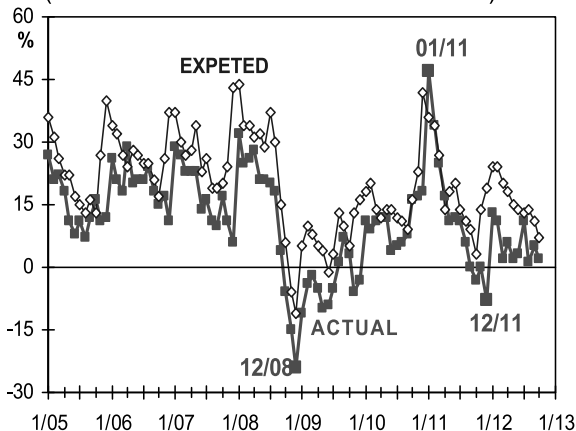


Fig. 6

In industry (on the basis of all the data) expectations of a decrease in sales prevail over forecasts of their growth.

Stocks of Finished Products

The balance of estimates of stocks of finished products got worse (increased) by 2 points as compared to the September level, but preserved the most modest values in the past year and a half (Fig. 4). The above points to the fact that the policy of management of stocks is carried out carefully and it is confirmed by answers of enterprises to the direct question about the measures which were actually taken by them for preparation to the second wave of the crisis. Enterprises’ plans show their intension to stick to that policy: the balance of the expected changes in the index currently amounts to 12 points. In the beginning of the 2nd quarter, it was equal to 23 points and reflected industry’s readiness to reduce the existing surplus of stocks which happened to be the 34-month maximum. The industry succeeded in it; by the end of the 3rd quarter the balance of estimates of stocks fell by 11 points.

The Output

Following the demand, the dynamics of the output dipped, as well. The above dynamics was virtually the only indicator on which basis analysts and officials judge on the state of the industry. The initial rate of change in the index fell to -7 points. In the past three years, the more intense drop was registered only in January 2010, 2011 and 2012. With the seasonal factor cleared, the output downfall rate in October is comparable with the results of June–July 2012 when the worst values of that index were registered since the mid-2009 (Fig. 5).

The output plans underwent explicit negative changes: initial plans lost 17 points and became negative ones, while those cleared of the seasonal factor, 10 points and remained (so far?) in the positive zone. Downward revision of the initial output plans to such a low level was usually registered in the previous post-crisis years one or two months later (that is, in November–December). As a result, rapid growth in optimism in the 3rd quarter (the balance of plans grew by 15 points then) was replaced by pessimism which was untypically low to October.

Prices of Enterprises

Russian industrial enterprises remain to be cautious about their pricing policy. After quite a logical spike of prices in July caused by the government decision on price increase by natural monopolies, in August–October their dynamics returned to the mini-

imum growth. The main factors behind that are the weak demand in industrial produce and preparation efforts to the second wave of the crisis.

Enterprises' forecasts show that they are prepared to keep in check their prices in future. In October, their expected growth rates lost another 5 points and fell to the 12-month minimum (*Fig. 6*).

Actual Dynamics and Lay-Off Plans

In October, the number of the employed in industry kept decreasing. In 2012, that process began as early as June and reached its peak in July and September–October. Forecasts of change in employment reached the negative zone in June, while in October attained the level of November 2009–2011. The number of workers at industrial enterprises will keep going down (*Fig. 7*).

Enterprises stopped to be content with such a situation. First, in the second half of 2012 a lack of personnel was a factor behind slow-down of output with 30% of enterprises. Second, late in 2012 enterprises became less provided with the personnel. At present, in industry there are more enterprises experiencing personnel shortages than those with a surplus of workers.

At first sight, the latest values of the above indices are not beyond the frameworks of the ones which were typical of late. However, if the dynamics of the main indices of industry is taken into account the evaluation of the situation with the personnel will change. Two year ago, the industry reported the highest growth rates of demand and output after the 2008–2009 crisis. At present, the situation is quite different: the demand and output do not grow and the optimism index shows that sentiments in the industry get worse. Forecasts point to growth in pessimism again. The number of the employed in industry is decreasing and there is less confidence with enterprises that they will manage to find workers to maintain even such output volumes.

Enterprises' Investment Plans

In October, investment plans of the industry became negative ones, that is, enterprises plan a total reduction of capital investments in the forthcoming months (*Fig. 8*). However, such a result is a logical continuation of the trend of slowdown of growth in investments, which trend was formed in enterprises' plans as early as May 2012. If officials and analysts express discontent with such results, enterprises, on the contrary, demonstrate growth in satisfaction. Late in the 3rd quarter, 63% of enterprises were satisfied with volumes of their investments; in the 1st quarter of 2012 that index amounted to 59%. There is no contradiction in such mixed dynamics of volumes and their evaluations if other indices of surveys carried out by the Gaidar Institute are taken into account.

First, in industry there are still a lot of enterprises with excessive capacities. In the 4th quarter of 2012, they accounted for 23%. The result of the 3rd quarter was more impressive: 30%. At the height of the crisis (the 1st quarter of 2009), the share of enterprises with excessive capacities amounted to 43%.



Fig. 7

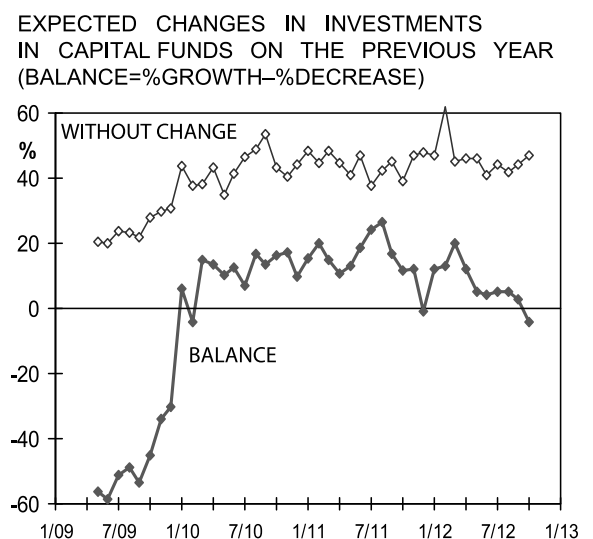


Fig. 8

Second, a lack of equipment inhibits growth in output with only 13% of enterprises and it is rated the 8th in the rating of 13 monitored troubles. That is the best result in the past eleven quarters. Six months ago, lack of equipment was regarded as a trouble by 17% of enterprises, but even the subsiding investment activity permitted to diminish by 4 points the effect of that factor on the dynamics of the output. Third, at present the insufficient demand is regarded as a trouble by 59% of enterprises and its negative effect on the Russian economy is invariably growing. In such a situation, it appears illogical to expect revival of investment activities. ●

THE STATE BUDGET

T.Tishchenko

As of 1 November 2012, the federal budget was executed with a surplus of 1.4% of GDP. The size of federal budget revenue over the period of January–October 2012 amounted to Rb 10,455.4bn, or 20.9% of GDP, that of federal budget expenditure – to Rb 9,735.8bn, or 19.5% of GDP.

On 30 October 2012, the RF Government submitted to the RF state Duma a draft law on introducing alterations in the 2012 federal budget, whereby the expected GDP volume by the year's results was to increase from Rb 60,590.0bn to Rb 61,238.0bn, the expected volume of federal budget revenue was to be increased by Rb 237.6bn, and that of federal budget expenditure – by Rb 212.2bn; the forecasted federal budget deficit was to be decreased to Rb 42.7bn.

Meanwhile, the increase in the size of budget expenditure planned for 2012 may turn out to be higher than that of the federal budget's revenue base, because the movement of federal budget revenue in the second half-year of 2012 points to a steady decline in the revenue volumes as a share of GDP displayed by nearly all the indices of tax-generated and other types of revenues.

Analysis of the Main Parameters of Federal Budget Execution in January–October 2012

Federal budget revenue as a share of GDP over the period of January–October 2012 dropped by 0.4 p.p. of GDP on the same period of 2011, while the size of oil and gas revenues increased by 0.1 p.p. of GDP. The size of federal budget expenditure as a share of GDP rose by 1.5 p.p. of GDP. Revenue growth in absolute terms amounted to Rb 1,214.2bn, whereas the size of expenditure increased by Rb 1,896.1bn. As a result, the federal budget was implemented with a surplus of Rb 719.6bn, which is by 1.8 p.p. of GDP below the level recorded in the same period of 2011. The volume of the non-oil and gas deficit amounted to Rb 4,556.6bn (9.1% of GDP), which is by 1.9 p.p. of GDP above the level registered in the first 10 months of last year (*Table 1*).

Table 1

MAIN PARAMETERS OF THE RF FEDERAL BUDGET IN JANUARY–OCTOBER 2011–2012

	January–October 2012		January–October 2011		Deviation, p.p. of GDP
	bn Rb	% of GDP	bn Rb	% of GDP	
Revenue, including:	10,455.4	20.9	9,241.2	21.3	-0.4
Oil and gas revenues	5,276.2	10.5	4,535.3	10.4	0.1
Expenditure, including:	9,735.8	19.5	7,839.7	18.0	1.5
interest	293.3	0.5	226.4	0.5	0.0
non-interest	9,442.5	19.0	7,613.3	17.5	1.5
Federal budget surplus (deficit)	719.6	1.4	1,401.5	3.2	-1.8
Non-oil and gas deficit	-4,556.6	-9.1	-3,133.8	-7.2	-1.9
GDP estimate	49,799		43,314		

Source: RF Ministry of Finance; RF Federal Treasury; Gaidar Institute's estimates.

The movement of federal budget revenue over January–October 2012 (*Table 2*) displays an increase in of PIT receipts (by 0.3 p.p. of GDP) and a slight growth of receipts of domestic excises – by 0.1 p.p. of GDP on the same period of last year. The receipts of domestic VAT and federal budget revenues from foreign trade, expressed as shares of GDP, demonstrate a decline over the first 10 months of 2012 on the period on January–October 2011 – by 0.2 p.p. and 0.4 p.p. respectively.

Table 2

RECEIPTS OF THE MAIN TAXES IN THE FEDERAL BUDGET IN JANUARY–OCTOBER 2011–2012

	January–October 2012		January–October 2011		Deviation, p.p. of GDP
	bn Rb	% of GDP	bn Rb	% of GDP	
1. Tax receipts, including:					
Tax on profits of organizations	322.5	0.6	287.9	0.6	0.0
VAT on goods sold in RF territory	1,602.8	3.2	1,485.1	3.4	-0.2
VAT on goods imported into RF territory	1,360.5	2.7	1,195.9	2.7	0.0
Excises on goods produced in RF territory	277.3	0.5	191.9	0.4	0.1
Excises on goods imported into RF territory	42.2	0.0	36.0	0.0	0.0
Tax on mineral resources extraction	2,016.7	4.0	1,637.7	3.7	0.3
2. Revenues from foreign trade	4,036.5	8.1	3,683.2	8.5	-0.4

Source: RF Federal Treasury; Gaidar Institute's estimates.

It can be noted that the downward trend displayed by the movement of federal budget receipts of tax and non-tax revenues as shares of GDP became evident already on the basis of the results of the first 8 months of 2012 (*Table 3*). Its manifestations were the somewhat lower receipts of the tax on mineral resources extraction, export customs duties, domestic VAT (no more than by 0.1–0.2 p.p. of GDP each). By the results of the period of January–October 2012, this trend became more prominent.

Table 3

MOVEMENT OF FEDERAL BUDGET REVENUE IN 2012, % OF GDP

Index	Results of year's first 7 months	Results of year's first 8 months	Results of year's first 9 months	Results of year's first 10 months
Federal budget revenue, including:	22.1	22	21.3	20.9
tax on profits of organizations	0.7	0.8	0.7	0.6
VAT on goods sold in RF territory	3.5	3.3	3.3	3.2
VAT on goods imported into RF territory	2.8	2.9	2.8	2.7
excises on goods produced in RF territory	0.6	0.6	0.6	0.5
excises on goods imported into RF territory	0.1	0.1	0.1	0.0
tax on mineral resources extraction	4.3	4.2	4.1	4.0
2. Revenues from foreign trade	8.7	8.6	8.3	8.1
Percentage of forecasted volume of federal budget revenue for 2012, %	57.1	65.9	74.0	82.5

Source: Gaidar Institute's estimates.

Over the last four months of 2012, the federal budget receipts from all the main tax and non-tax sources demonstrated a decline, including revenues from foreign trade – by 0.6 p.p. of GDP; revenues from tax on mineral resources extraction and domestic VAT – by 0.3 p.p. of GDP; revenues from tax on profit, VAT on imports, excises – by 0.1 p.p. of GDP. By the results of the first 10 months of 2012, federal budget received 82.5% of the forecasted amount of revenues, while this index for the same period of 2011 was 89.7%.

According to the forecast published by the RF Ministry of Finance¹, the amounts of federal budget revenue received in November and December 2012 are going to be Rb 1,134.2bn and 1,325bn respectively. However, these estimates were not confirmed by the monthly reports on tax and non-tax receipts (in July, receipts amounted to Rb 1,045.5bn; in August – to Rb 1,107.9bn; in Septem-

1 Information published on the RF Ministry of Finance's website.

ber – to 1,032.4bn; in October – to 1,070.0bn), while no further potential exists for increasing tax receipts and revenues from foreign trade. Possibly, some additional revenue may be generated by property privatization or by sale of assets, but no relevant information concerning such transactions has been released so far.

Thus, it is highly probable that the RF Government's expectations of receiving an additional revenue in the amount of Rb 237.6bn in the year's last two months will prove to be unrealistic. The result will be an increase of federal budget deficit as demonstrated by the year's results to a level above the forecasted value stipulated in the draft law on the 2012 federal budget.

Growth of expenditure (*Table 4*) over the January through October period of 2012 on the same period of last year was displayed by the item "National Defense" – by 0.4 p.p. of GDP; "National Security and Law-enforcement Activity" – by 0.5 p.p. of GDP; "Education" – by 0.2 p.p. of GDP; "Health Care" – by 0.1 p.p. of GDP; and "Social Policy" – by 0.6 p.p. of GDP. The federal budget expenditure items "Housing and Utilities Sector" and "Interbudgetary transfers" declined, as demonstrated by the results of the first 10 months of 2012, by 0.2 p.p. of GDP each on the period of January–October 2011. The other items of federal budget expenditure over the first 10 months of 2012 remained at the same level as in January–October of last year. The cash-based execution of the federal budget in the first 10 months of 2012 amounted to 76.0% of the per annum budget allocations for 2012.

Table 4

EXECUTION OF FEDERAL BUDGET EXPENDITURE IN JANUARY–OCTOBER 2011–2012

	January–October 2012		January–October 2011		Deviation, p.p. of GDP
	bn Rb	% of GDP	bn Rb	% of GDP	
Expenditure, total, including:	9735.8	19.5	7839.7	18.0	1.5
Nationwide issues	609.7	1.2	543.1	1.2	0.0
National defense	1345.7	2.7	1036.7	2.3	0.4
National security and law-enforcement activity	1283.5	2.5	890.8	2.0	0.5
National economy	1271.0	2.5	1093.7	2.5	0.0
Housing and utilities sector	87.1	0.1	169.8	0.3	-0.2
Environment protection	18.6	0.0	11.7	0.0	0.0
Education	515.3	1.0	388.5	0.8	0.2
Culture and cinematography	65.3	0.1	54.3	0.1	0.0
Health care	444.4	0.8	330.2	0.7	0.1
Social policy	3228.2	6.4	2516.7	5.8	0.6
Physical culture and sports	36.0	0.0	33.2	0.0	0.0
Mass media	63.4	0.1	50.4	0.1	0.0
Government debt servicing	293.3	0.5	226.4	0.5	0.0
Interbudgetary transfers	474.2	0.9	494.1	1.1	-0.2

Source: RF Federal Treasury; Gaidar Institute's estimates

As reported by the RF Ministry of Finance, the residuals of the Reserve Fund and National Welfare Fund as of the end of October 2012 amounted to Rb 1,934.1bn and Rb 2,748.7bn respectively.

In October 2012, the volume of foreign government debt slightly declined (by \$ 800m), thus amounting as of the end of October to \$ 40.5bn. The volume of domestic government debt increased by Rb100bn and amounted as of 1 November 2012 to Rb 3,930.8bn.

Draft Law on Introducing Alterations in the 2012 Federal Budget

On 30 October 2012, the RF Government submitted to the RF State Duma a draft law on introducing alterations in the 2012 federal budget, whereby the forecasted GDP volume by the year's results was to increase from Rb 60,590.0bn to Rb 61.238.0bn, the forecasted volume of federal budget revenue was to be increased by Rb 237.6bn to Rb 12,914.6bn, and that of federal budget expenditure – by Rb 212.2bn to Rb 12,957.3bn; the forecasted federal budget deficit was to be decreased to Rb 42.7bn. So, the federal budget surplus observed over several months in a row and the low probability of any significant downward movement of hydrocarbon prices on the world market

until the year's end prompted the RF Government to make some upward adjustments to the parameters of federal budget revenue and expenditure.

According to the draft law, the overall volume of budget allocations for the fulfillment of public standard obligations in 2012 is to be cut by Rb 12.6bn; at the same time, the amount of expenditure earmarked for the preparation to the 2014 Winter Olympics and the support of the military-industrial complex has been increased. Some additional budget funding is allocated to the Open-end Joint-stock Company Russian Railways – for the implementation of transport infrastructure projects for the Sochi 2014 Winter Olympic Games (an increase by Rb 35bn – to Rb 49.4bn) and the development of the transport network in the Moscow region (an increase by Rb 25.9bn – to Rn 43.2bn).

The financial support of the enterprises of the military-industrial complex that have recently been transformed into joint-stock companies is becoming stronger. Thus, for example, while in the initial version of the law on the 2012 federal budget it was planned to allocate to the JSC *Proizvodstvennoe ob'edinenie "Severnoye mashinostroitel'noe predpriatie"* ["Industrial Amalgamation 'Northern Machine-building Enterprise'"] a total of approximately Rb 260m to cover the interest on the loans issued to that company by *Vneshekonombank* [Bank for Development and Foreign Economic Affairs] the new draft law already envisages that it should receive budget subsidies in the amount of Rb 2.8bn, which will enable it to pay interest on as well as to redeem its debt. Budget support is also granted to some other companies belonging to the military-industrial complex: OJSC *Ob'edinennaya sudostroitel'naya korporatsiya* [United Shipbuilding Corporation] (Rb 3.7bn), OJSC *Oboronprom* (Rb 5.4bn), OJSC *Ob'edinennaya aviastroitel'naya korporatsiya* [United Aircraft-building Corporation] (Rb 2.4bn).

Thus, the RF Government continues to increase the volume of support granted to the military-industrial complex and to disregard the fact that the problems existing in that sphere cannot be solved by simply injecting more budget funding, while doing nothing in terms of implementing new managerial approaches oriented to improving the performance level.

Execution of the Consolidated Budget of RF Subjects in January–September 2012

As reported by the RF Federal Treasury, the consolidated budget revenue of RF subjects in the first 9 months of 2012 amounted to 12.9% of GDP, which is by 2.1 p.p. of GDP below its level recorded in the same period of 2011 (*Table 5*). In absolute terms, federal budget revenue growth amounted to Rb 70.8bn. The consolidated budget expenditure of RF subjects in January–September 2012 dropped on the same period of last year by 0.2 p.p. of GDP and amounted to 12.3% of GDP. As shown by the results of the first nine months of 2012, the consolidated budget of RF subjects is executed with a surplus of 0.6% of GDP (Rb 251.2bn), which is by 1.6 p.p. of GDP lower than the same index for the first nine months of 2011.

Table 5

MAIN PARAMETERS OF THE CONSOLIDATED BUDGET OF RF SUBJECTS
IN JANUARY–SEPTEMBER 2011–2012

	January–September 2012		January–September 2011		Deviation, p.p. of GDP p.p. of GDP
	bn Rb	% of GDP	bn Rb	bn Rb	
Revenue, including:	5,688.5	12.9	5,617.7	14.7	-2.1
tax on profits of organizations	1,445.1	3.2	1,511.9	3.9	-0.7
PIT	1,566.2	3.5	1,378.5	3.6	-0.1
VAT, domestic	0.2	0.0	0.2	0.0	0.0
excises, domestic	331.3	0.7	278.6	0.7	0.0
tax on aggregate income	205.7	0.4	158.5	0.4	0.0
tax on property	554.3	1.2	503.0	1.3	-0.1
gratis transfers from other budgets of RF budgetary system	1,126.4	2.5	1,210.4	3.1	-0.6
Expenditure, including:	5,437.3	12.3	4,786.1	12.5	-0.2
Consolidated budget surplus (deficit)	251.2	0.6	831.6	2.2	-1.6
GDP estimations	44,077		38,209		

Source: RF Federal Treasury; Gaidar Institute's estimates.

By comparison with the same period of last year, the first nine months of 2012 saw a decline in the RF subjects' consolidated budget's revenues from the majority of taxes, including from tax on profit – by 0.7 p.p. of GDP; from personal income tax (PIT) – by 0.1 p.p. of GDP; from tax on property – by 0.1 p.p. of GDP; while its interbudgetary transfer receipts dropped by 0.6 p.p. of GDP. So far as the budgets of RF subjects are concerned, their tax receipts from VAT, domestic excises and tax on property, expressed as shares of GDP, registered over the course of the first 9 months of 2012 remained at the same level as last year.

The execution of the consolidated budget expenditure of RF subjects (*Table 6*) over January–September 2012 amounted to Rb 5,437.3bn, or 12.3% of GDP, which is by 0.2 p.p. of GDP below the corresponding index for the first nine months of last year.

Table 6

EXECUTION OF THE CONSOLIDATED BUDGET EXPENDITURE OF RF SUBJECTS
IN JANUARY–SEPTEMBER 2011–2012

	January–September 2012		January–September 2011		Deviation, p.p. of GDP
	bn Rb	% of GDP	bn Rb	% of GDP	
Expenditure, total, including	5437.3	12.3	4786.1	12.5	-0.2
Nationwide issues	342.5	0.7	315.7	0.8	-0.1
National defense	0.2	0.0	0.2	0.0	0.0
National security and law-enforcement activity	57.0	0.1	176.2	0.4	-0.3
National economy	962.2	2.1	767.1	2.0	0.1
Housing and utilities sector	536.5	1.2	538.7	1.4	-0.2
Environment protection	11.9	0.0	9.9	0.0	0.0
Education	1391.5	3.1	1109.1	2.9	0.2
Culture and cinematography	173.2	0.3	147.5	0.3	0.0
Health care	890.6	2.0	743.5	1.9	0.1
Social policy	892.6	2.0	812.5	2.1	-0.1
Physical culture and sports	90.6	0.2	85.1	0.2	0.0
Mass media	24.9	0.0	21.4	0.0	0.0
Government debt servicing	48.8	0.1	45.4	0.0	0.0
Interbudgetary transfers	12.4	0.0	11.7	0.0	0.0

Source: RF Federal Treasury; Gaidar Institute's estimates.

A slight increase, on the period of January–September 2011, in the amount of consolidated budget expenditure over the period under consideration was displayed by the item “Education” – by 0.2 p.p. of GDP; and “National Economy” and “Health Care” – by 0.1 p.p. of GDP each. The shrinkage, this year, in the amount of regional budget expenditure allocated to the item “National Security and Law-enforcement Activity” – by 0.3 p.p. of GDP – occurred as a result of the transfer, from the year 2012 onwards, of the powers to fund the police force from the regional to federal level. The items “Nationwide Issues”, “Housing and Utilities Sector”, “Social Policy” demonstrated a decline, in January–September 2012 on the same period of last year, in the amount of allocated expenditure – by 0.1–0.2 p.p. of GDP. The other expenditure items of the consolidated budget of RF subjects over the first 9 months of 2012 remained at the same level as last year.

The amount of government debt of RF subjects as of the end of September 2012 amounted to Rb 1,121.3bn, which is by nearly Rb 6bn higher than the previous month's index. ●

RUSSIAN BANKING SECTOR

M.Khromov

In October, the only source of growth of banks' fund raising were government agencies, including the Central Bank. All other sectors acted as net beneficiaries. As a result, banking sector own liquidity (liquid assets less funds of monetary authorities) reached the minimum level in both, absolute terms and as a percentage of the total assets of the banking sector.

In the autumn months the growth rate of bank assets¹ has stabilized at the level around 2% per month. Annual growth rates remain in the range of 20-21%. Stability of October growth rate against September (2.3% vs. 1.9%) was accompanied with a fairly sharp segmentation by individual groups of banks. The greatest consistency was noted in the group of medium and small banks², which assets growth rate remained practically unchanged (2.9% in September, 2.7% in October). Among the major banks, the highest growth rates of assets were noted in Sberbank, accelerated from 0.4% in September to 4.2% in October, which allowed the growth rate of assets of the largest state-owned banks to grow in general from 1.2% to 2.8%. On the contrary, growth rates in assets of foreign and large private banks in October have slowed down. The growth rates of assets of the first group of banks decreased from 1.1% to 0.2%, and of the second group – from 2.5% to 0.9%.

Overall, in the banking sector the growth rate of raised funds in October reached 2.6%. The balance value of capital net worth has increased only by 1.5%. As a result, capital adequacy continued a gradual decline (from 13.1% to 13.0%), due to an advanced growth of operating assets over the capital net worth dynamics³. Herewith, the Russian second largest bank VTB was able to increase its regulatory capital and improve capital adequacy from 12.1 to 13.2% as a result of placement its subordinated Eurobond loan. Therefore, at the background of the Sberbank capital adequacy sustainability, the decline of capital adequacy in other banks was more noticeable.

The aggregate profit of the banking sector in October made Rb 84bn, which corresponds to the return on total assets of 2.2% in annual terms, and equity – 18%, roughly equal to the values of the last 12 months. The positive trend observed in October was a marked growth in profit before provisions for possible losses up to Rb 106bn, which exceeds the average monthly level in the current year.

Raised funds

The inflow of funds to the *deposits of individuals* with the banks remains low. The increase in deposits of individuals with the bank accounts in October made only Rb 81bn or 0.6%. The annual growth rate remained at 19.1%. The leaders in terms of the deposit base growth within several consecutive months are small and medium banks. In October they were able to extend the amount of raised funds of individuals by 1.9% or Rb 67bn. That is, making only 27% of the deposits market, small and medium banks in October ensured over 80% of the growth. The growth rate of deposits with the 30 largest banks in terms of capital net worth amounted to only 0.1% for the month. Since the beginning of the year the growth rate of funds of individuals with the small and medium banks has exceeded the relevant indicator of 30 largest banks (16.2% vs. 8.5%). This is the result of differences in interest rate policy of the large and small banks. Thus, the average actual yield of deposits of individuals with Sberbank for three quarters of 2012 made 4.5% per annum, 6.7% with other banks among the top 30, and 8.2% with other banks. Herewith, the small and medium banks' interest on deposits is greater than in Sberbank, although the volume of deposits with the first ones is less than 60% of total deposits with Sberbank.

1 Estimated under Form No.0409134.

2 With the exception of 30 largest banks in terms of capital net worth.

3 Estimated under Form No.0409134.

The rate of household savings in bank deposits in October amounted to 3.9% of incomes, which is less than since the year beginning (4.3%). However, it is early to talk about a steady decline in savings growth rate: in 2012, the individuals are placing with the banks a larger share of income than in the corresponding period of 2011.

More alarming, in our view, can be considered the fact that this year the growth of deposits of individuals with the banks was steadily giving way to the growth of the outstanding liabilities on loans. Over 10 months, net household savings in the banking system have declined by Rb 691bn, including Rb 137bn in October. A larger redistribution of banks assets in nominal terms in favor of population over 10 months was observed only during the 2008 crisis (Rb 845bn), but then it was due to the outflow of clients, who were scared of the large-scale banking crisis. Only in September–October 2008, clients have withdrawn from the banks more than Rb 540bn. In 2012, the transition to a net borrowing of individuals from the banks took place in a more favorable financial market situation with no signs of panic among bank clients. This indicates a change in the savings behavior of households and the transition to a new credit consumption pattern, much more pronounced than in the boom of retail lending in 2006–2008.

The inflow of funds of *corporate clients* to the bank accounts for the second consecutive month exceeds the relevant indicator of deposits of individuals in absolute terms. In October 2012 the accounts of corporate clients increased by 1.9% (Rb 203bn), while the annual growth rate for October made 17.1%.

For the fourth consecutive month businesses and organizations prefer to accumulate funds in foreign currency accounts. Thus, over July–October 2012 the volume of ruble corporate accounts decreased by 0.3%, having increased by 1.2% in October, while the amount of foreign currency accounts in dollars rose in four months to 18.6 %, including 4.2% in October. The most rapid rate in October were noted in corporate funds on time deposits in foreign currency, namely by 5.5% in dollar terms.

The maximum growth rate of corporate clients' funds as broken down by major groups of banks in October were reached by Sberbank (5.3%) and small and medium banks (4.8%)

Foreign liabilities of the banking sector grew in October by \$3.3bn. The total growth of foreign loans was made solely by large state-owned banks. Sberbank foreign liabilities increased over the month by \$2.8bn, and those of other major state banks – by \$1.4bn. Respectively, private banks have reduced the amount of foreign loans nearly by \$1bn.

Investments in foreign assets for the second consecutive month exceeded the growth of foreign liabilities, amounting to \$7.7bn in October. Here the state banks also play the key role. Sberbank and other major state-owned banks ensured \$7.2bn of foreign assets increase. This means that banks act as net creditors to the external market (\$4.4bn in October, \$ 2.9bn of which were ensured by state-owned banks).

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	12.11	03.12	06.12	07.12	08.12	09.12	10.12
Liabilities, Rb bn	20125	28022	29430	33805	35237	41628	41533	44266	45090	45523	45861	47096
Own assets	15.3	14.1	19.3	18.7	18.5	16.9	17.5	16.8	16.8	16.9	16.9	16.7
Loans of the Bank of Russia	0.2	12.0	4.8	1.0	0.9	2.9	3.5	5.1	5.7	5.3	5.1	5.4
Interbank operations	4.1	4.4	4.8	5.5	5.2	5.7	5.1	4.8	4.8	5.0	5.1	5.1
Foreign liabilities	18.1	16.4	12.1	11.8	10.9	11.1	10.2	11.3	11.4	11.4	11.0	11.1
Private deposits	26.2	21.5	25.9	29.6	30.4	29.1	29.4	29.4	28.8	28.9	28.7	28.2
Corporate deposits	25.8	23.6	25.9	25.7	24.3	26.0	25.7	24.0	23.5	23.1	23.3	23.2
Accounts and deposits of state agencies and local authorities	1.5	1.0	1.0	1.5	3.5	2.3	1.4	1.5	1.7	2.3	2.5	2.7
Securities issued	5.8	4.1	4.1	4.0	4.0	3.7	4.8	4.5	4.5	4.6	4.8	5.0

Source: Central Bank of Russia, IEP estimates.

Investments

Bank's *retail lending* growth rates remain at maximum post-crisis levels. In October, the volume of outstanding liabilities on loans to individuals increased by 2.8%, and within 12 months – by

41.7%. Accordingly, if in the previous review we noted the slowdown in retail lending, given the results of October, it makes sense to talk about stabilization of growth. The annual growth rate after the June peak of 42.5%, in the next 4 months remained in the range of 41.2–41.7%.

The quality of retail loan portfolio indicators of the banking sector remained unchanged in October. Currently the share of overdue debt makes 4.5%, and the ratio of provisions for outstanding liabilities on loans – 6.3%.

Among the market segments of lending to individuals the fastest growth rate are noted in the outstanding liabilities on unsecured loans. Thus, over the 12 months from October 2011 to September 2012¹, the outstanding liabilities of individuals on unsecured bank loans increased by 58%, while the growth rates of secured loans are much lower: 30% on housing purchase (including mortgage), 24% on car loans.

The latter circumstance causes understandable concern of regulatory authorities. The Bank of Russia plans to adopt a number of measures aimed at limiting the growth rates of portfolios of unsecured loans to individuals. Thus, from March 1, 2013 it is planned to double the rate of provisions for unsecured consumer loans, and from July 1 to increase the risk factors on consumer credits for assessment of the banks' capital adequacy of own funds standard (H1).

Measures proposed by the Bank of Russia focus mainly on slowing growth in the segment of unsecured loans with high interest rates on loans. Provisions for consumer loans, unsecured by dwellings or vehicles now account for about 7% of the debt on these loans or Rb 280bn. However, it is planned to increase only the provisions for loans free from overdue liabilities or those with overdue liabilities not exceeding 30 days. The amount of provisions for such loans, formed by banks on all types of loans, is now Rb 43bn, wherein the share of unsecured accounts, according to our estimates, makes about 80%. Besides, the new provisions requirements should be applied only to the new loans, credited from January 2013. Provisions rate increase will make from 1 to 3 p.p., and the banks can increase lending rates on unsecured loans for the same amount to compensate for increasing provisions. With the average annual interest rate on short-term loans at 25% it will be noticeable, but will be hardly critical for the outstanding liabilities dynamics. Therefore, this measure is unlikely to radically change the retail loan market.

Another measure is aimed at limiting the interest rates on loans. From July 1, 2013 loans to individuals at higher rates will be included with increased coefficients in the formula for calculating capital adequacy standards. Thus, for ruble loans higher rates will be regarded the annual rates exceeding 25%. Up to the level of 35% per annum the mark-up factor will be equal to 1.1 (that is, the risk for this loan will be 10% higher than for the “cheap” loans), from 35% to 45% the mark-up factor will be 1.4, from 45 to 60% – 1.7, and for more than 60% – 2. That is, those banks will have to apply double rate in the assessment of capital adequacy for the most expensive loans. To make an overall assessment of the effect of this measure on the banking sector, more detailed information is required on individual banks, than that disclosed by the Bank of Russia. Based on the open forms of the bank statements for Q3 2012, the average yield on loans to individuals exceeded 25% per annum in 43 banks. That is, these banks will have either to reduce the capital, or review their interest rate policy. In reality, the number of banks, which have at least one expensive loan in its assets is much more, so this measure, of course, will affect a wide range of banks, which will have either to reduce the retail lending yield, or to look for additional sources of revenue for their capital.

Corporate segment of the credit market in terms of growth rates falls behind the retail credit market. In October loans to nonbank enterprises and organizations grew by 1.5%, and over 12 months by 18.5%. Indicators of corporate lending quality has improved slightly over the last month. The share of overdue loans decreased from 4.9 to 4.8%, and the ratio of provisions formed for possible losses to the loan portfolio – from 7.8 to 7.7%.

Liquidity and government support

Liquidity of the banking sector (the ratio of liquid assets in the total assets) in October has reduced by 1 p.p. to 4.5%. This is the minimal level over the past five months, but it is higher than the historical minimum of 4.1%, which was recorded at the end of May this year.

¹ At the time of this review preparation, the data on certain types of retail loans for October are not published yet.

Herewith, the own liquidity of banks, with the exception of loans from the Bank of Russia and the Ministry of Finance of Russia deposits continues to decline. Thus, based on the end of October results, the amount of funds received by banks from the RF Central Bank and the Ministry of Finance of Russia, exceeded the value of the liquid assets by more than Rb 1 trillion. Within the month the scope of government support to the banking sector increased by Rb 280bn, Rb 174bn of which were the assets of the Bank of Russia, and the balance (Rb 106bn) were deposits of the Ministry of Finance of Russia.

Table 2

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

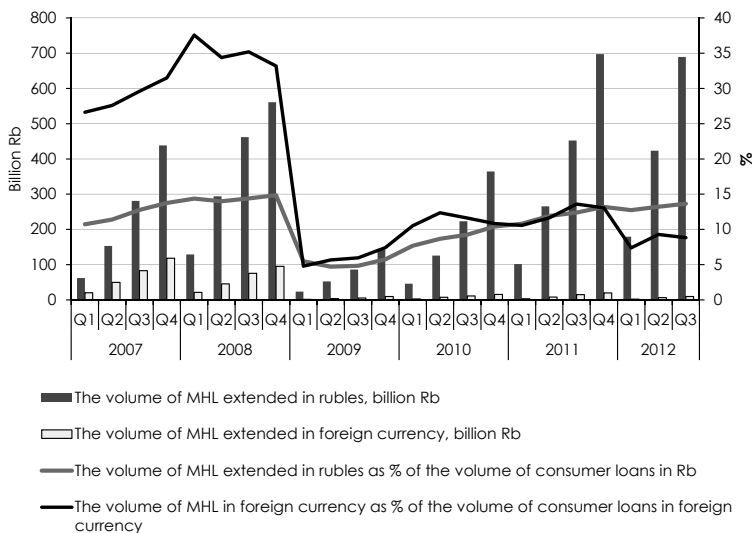
	12.07	12.08	12.09	12.10	06.11	12.11	03.12	06.12	07.12	08.12	09.12	10.12
Assets, Rb bn	20125	28022	29430	33805	35237	41628	41533	44266	45090	45523	45861	47096
Cash and precious metals	2.5	3.0	2.7	2.7	2.2	2.9	2.4	2.5	2.5	2.5	2.6	2.6
Deposits with the Bank of Russia	6.9	7.5	6.9	7.1	4.5	4.2	3.2	3.0	3.2	2.9	2.8	2.7
Interbank operations	5.4	5.2	5.4	6.5	6.4	6.4	6.2	5.8	5.7	5.9	5.8	6.1
Foreign assets	9.8	13.8	14.1	13.4	13.8	14.3	14.2	14.2	14.5	14.0	13.9	14.3
Individuals	16.1	15.5	13.1	13.0	14.0	14.4	15.3	16.0	16.1	16.5	16.8	16.8
Corporate sector	47.2	44.5	44.5	43.6	45.3	44.0	44.4	43.6	42.7	43.7	43.4	42.9
Government	4.1	2.0	4.2	5.1	5.8	5.0	4.9	3.8	3.4	3.4	3.3	3.2
Property	2.2	1.9	2.7	2.6	2.5	2.3	2.4	2.3	2.3	2.3	2.3	2.3

Source: Central Bank of Russia, IEP estimates. ●

MORTGAGE IN THE RUSSIAN FEDERATION

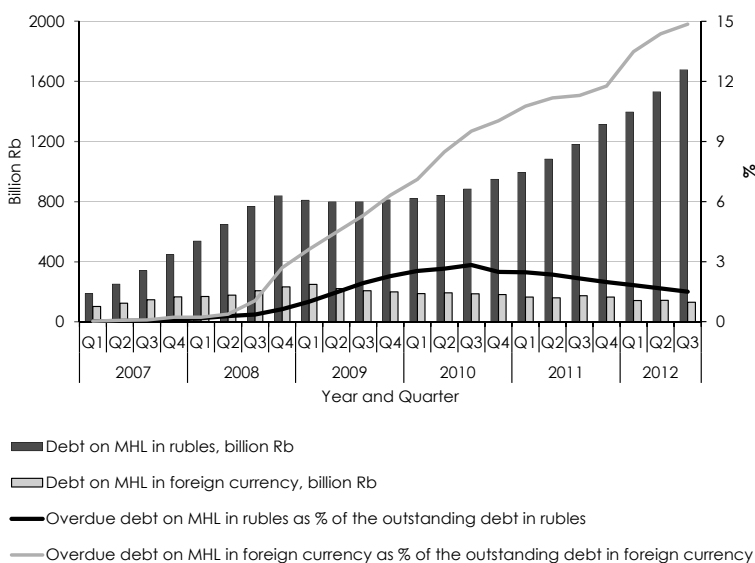
G.Zadonsky

Within three quarters of 2012, the volume of mortgage housing loans (MHL) (Rb 698.59bn) exceeded by 50% that extended in the respective period of 2011. With growth in lending volumes, a decrease in the overdue debt on MHL in rubles both in monetary terms and as a percentage of the outstanding debt (1.5% as of October 1, 2012) and growth in the share of the overdue debt on MHL in foreign currency in the foreign currency debt (14.86% as of October 1, 2012) points to the fact that the quality of MHL in rubles keeps getting better, while that of MHL in foreign currency is deteriorating.



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

Fig. 1. Dynamics of lending to individuals within a quarter with a cumulative result



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

Fig. 2. Dynamics of the outstanding and overdue debt on mortgage housing loans

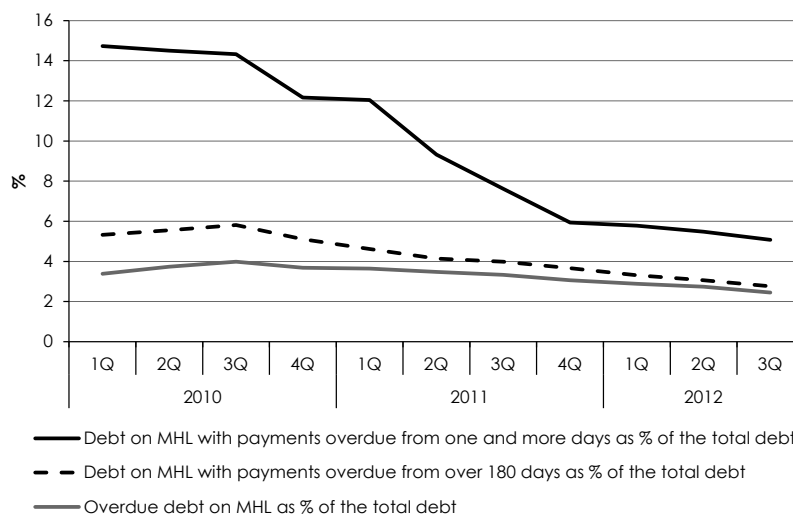
According to the data of the Central Bank of the Russian Federation, within three quarters of 2012 credit institutions extended 514,403 housing loans (HL) for the amount of Rb 729,214bn, including 475,823 mortgage housing loans (MHL) for the amount of Rb 698.59bn of which number 474,634 MHL were extended in rubles for the amount of Rb 689,096bn and 1,189 loans, in foreign currency for the amount of Rb 9,494bn (Table 1). As of October 1, 2012, the volumes of MHL in rubles as a percentage of the respective volumes of ruble consumer loans amounted to 13.64% which figure is 1.25 p.p. higher than that as of October 1, 2011, while volumes of MHL in foreign currency as a percentage of the consumer loans in foreign currency, to 8.84% which figure is 4.75 p.p. lower than in the respective period of 2011 (Fig. 1). Within three quarters of 2012, the volume of MHL extended in monetary terms exceeded by 50% that of the respective period of 2011.

As of October 1, 2012, the outstanding debt on MHL amounted to Rb1.81 trillion (in the 1st quarter of 2012 it was Rb 1.54 trillion, while in the first half-year, Rb 1.24 trillion), including Rb 1.68 trillion on loans in rubles (Fig. 2). As of the end of the 3rd quarter of 2012, the outstanding debt on MHL in rubles grew by 41.95% as compared to the respective period of 2011, while the overdue debt decreased in the same period by 1.63% and amounted to Rb 25.17bn. or 1.5% of the outstanding debt (Fig. 2). As of October 1, 2011, the outstanding debt on loans in foreign

currency (Rb 129.07bn) decreased by 25.67% as compared to the end of the 3rd quarter of 2011. As of October 1, 2012, the volume of MHL in foreign currency as a percentage of the total volume of MHL decreased to 1.36% against 3.28% as of October 1, 2011. The share of the debt on MHL in foreign currency in the total debt fell from 12.81% as of October 1, 2011 to 7.14% as of October 1, 2012. In the same period, the overdue debt decreased by 2.05% and amounted to Rb 19,179bn or 14.86% of the outstanding debt on loans in foreign currency which figure is 3.58 p.p. higher than in the respective period of 2011 (*Fig. 2*). So, the debt quality of MHL in rubles keeps getting better, while that of loans in foreign currency is deteriorating.

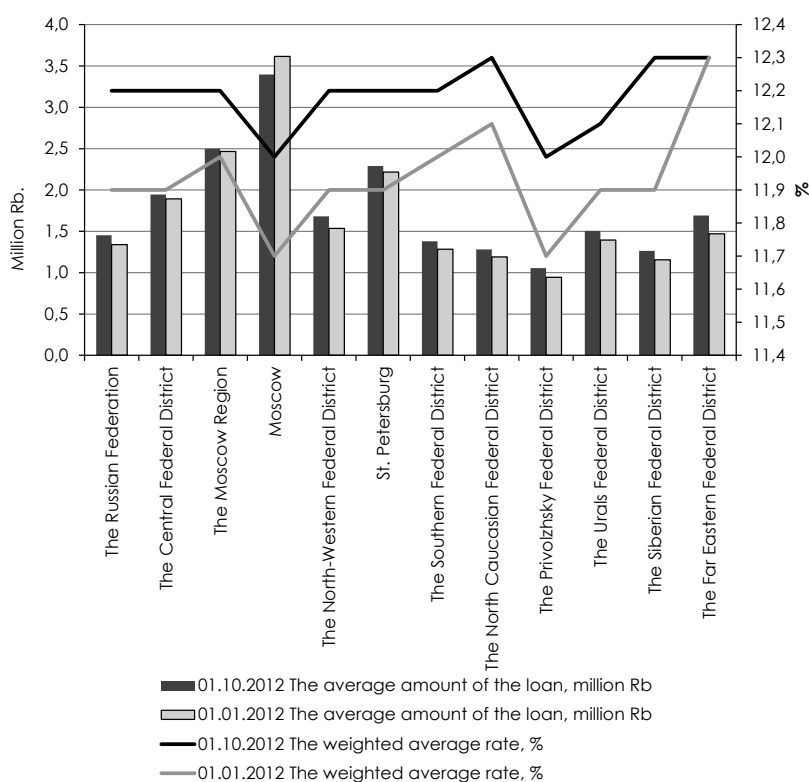
As of October 1, 2012, the total overdue debt on MHL amounted to Rb 44,345bn or 2.45% of the outstanding debt which is 0.88 p.p. lower than that as of October 1, 2011 (*Fig. 3*). According to the data of the Central Bank of the Russian Federation, the share of the debt on MHL with payments overdue from one or more days in the total debt as of the end of the 3rd quarter of 2012 decreased by 2.54 p.p. as compared to the respective period of 2011 and amounted to 5.08%. The share of the debt on MHL with payments overdue for more than 180 days (defaulted loans) in the total debt decreased in the same period by 1.23 p.p. and amounted to 2.76%.

In 2012, the weighted average rate on MHL in rubles extended from the beginning of the year increased in the Russian Federation as a whole from 11.9% to 12.2%, while that on loans extended within a month, from 11.6% to 12.3%. The above trend is typical of all the regions, except for the Far Eastern Federal District (*Fig. 4*). The average amount of the loan in the Russian Federation increased from Rb 1.34m to Rb 1.45m. It is to be noted that it rose in all the regions, except for Moscow. However, the average amount of the loan in Moscow (Rb 3,398m) still exceeds a great deal that index in other regions. In particular, as of October 1, 2012 it exceeds by 130% the average amount of the loan in the Russian Federation. The lowest



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

Fig. 3. Dynamics of the overdue debt



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

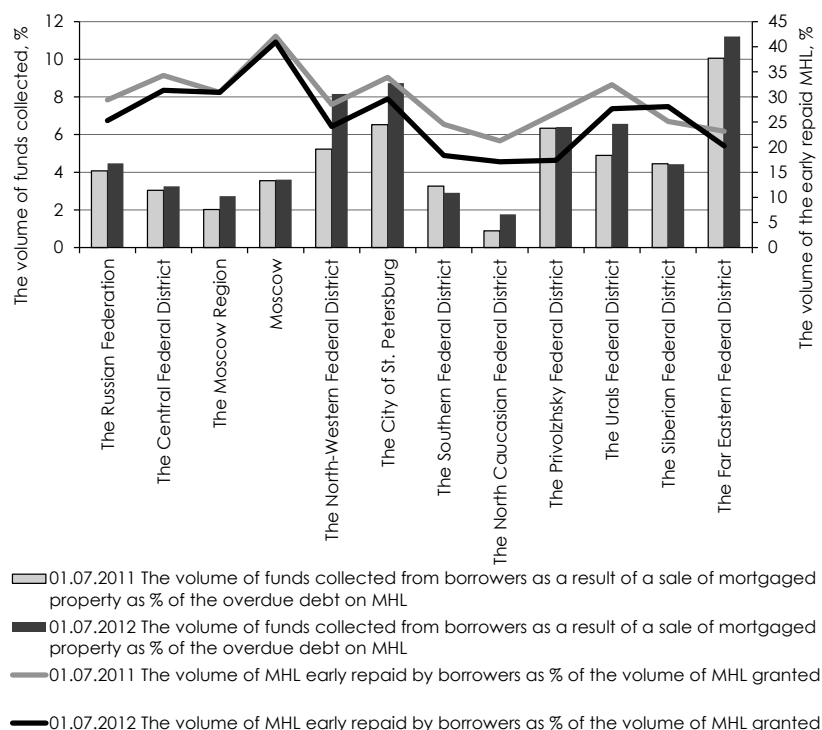
Fig. 4. The weighted average data on mortgage housing loans in rubles extended from the beginning of the year

values as regards both the average amount of the loan (Rb 1,056m) and the weighted average rate (12.0%) were registered in the Privolzhsky Federal District (*Fig. 4*).

According to the data of the Central Bank of the Russian Federation, as of October 1, 2012 the weighted average period of lending as regards MHL in rubles extended from the beginning of the year amounted to 14.9 years and decreased as compared to the 1st quarter of 2012 (14.7 years) and the first half-year of 2012 (14.8 years). As of October 1, 2012, the weighted average period of lending as regards MHL in foreign currency extended from the beginning of the year amounted to 11.6 years, while that in the 1st quarter of 2012 and the first half-year of 2012, to 12.6 years and 12.8 years, respectively.

According to the data of the Central Bank of the Russian Federation, as of July 1, 2012 the volume of MHL early repaid by borrowers in the Russian Federation in general increased in money terms by 35.13% as compared to July 1, 2011. In the same period, the volume of MHL early repaid by borrowers in the volume of MHL granted decreased by 4.10 p.p. and amounted to 25.3% (*Fig. 5*). Both growth in the volume of MHL early repaid by borrowers in monetary terms and a decrease in the relative volume of early repaid loans in the same period are typical of all the regions of the Russian Federation, except for the Siberian Federal District where the volume both in monetary terms and as a percentage of the volume of loans granted increased (*Fig. 5*). Moscow is still the leader as regards the relative volume of early repaid MHL which volume amounted to 40.95% as of July 2012 (*Fig. 5*).

As of July 1, 2012, in the Russian Federation in general the volume of funds collected from borrowers as a result of sale of mortgaged property increased in money terms by 16.7% as compared to July 1, 2011. Growth in the volume in money terms took place in all the regions of the Russian Federation, except for the Privolzhsky Federal District and the Siberian Federal District. As of July 1, 2012, the volume of funds collected from borrowers as a percentage of the overdue debt amounted in the Russian Federation in general to 4.48%, which is 0.41 p.p. more than that as of July 1, 2011. As of July 1, 2012, growth in that index is typical of all the regions, except for the Southern Federal District and the Siberian Federal District (*Fig. 5*).



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

Fig. 5. Dynamics of the early repaid MHL and the volume of funds collected from borrowers as a result of sale of mortgaged property by the region

In the first half-year of 2012, the volume of refinancing of MHL with a sale of the pool of loans (rights of claim as regards MHL) amounted to Rb 30.71bn which is 18.23% more than in the first half-year of 2011. In the same period, the share of the refinanced loans in the volume of MHL granted decreased by 2.35 p.p. and amounted to 7.15%.

In the 3rd quarter of 2012, OAO AHML repurchased by all the products 12, 390 mortgages worth Rb 17.13bn which is 16.03% more than in the 2nd quarter of 2012. In January–October 2012, OAO AHML repurchased 36,650 mortgages worth Rb 49.07bn which is Rb 5.6bn less than the 2010 record result. The above entitles us to believe that the record index will be surpassed on the basis of the results of 2012.

The State Duma Committee on Financial Markets considered a number of amendments to the

draft law passed in the first reading; it was proposed by means of the above amendments to make insurance of MHL mandatory on behalf of the creditor if the amount of the loan exceeded 70% of the cost of housing to be purchased, legislatively restrict the maximum amount of the mortgage loan (no more than 90% of the cost of the housing to be purchased) and exempt the received insurance compensation from the income tax payment.

The Federal Financial Markets Service of the Russian Federation registered issues of mortgage-backed bonds of three series of ZAO Ipotekhnny Agent AHML 2011-1 for the total amount of Rb 5.3bn and class “A” and class “B” housing mortgage-backed bonds of ZAO Ipotekhnny Agent ITB 1 (Investtorgbank) for the total amount of Rb 3.3bn.

Late in October, the government of the Moscow Region and AHML signed an agreement under which Rb 15bn would be spent on building of commercial apartment houses for 3,000 families within the next five years in the Moscow Region. Under the AHML program, from summer 2012 a commercial apartment house has been under construction in the Nizhny Novgorod Region for employees of enterprises of the military-industrial complex in Arzamas. ●

FOREIGN TRADE

N.Volovik, K.Kharina

In September 2012, mixed dynamics of the main Russian foreign trade indices was observed: insignificant growth in the export and a decrease in the import (as compared to September 2011). Russia's accession to the WTO has resulted neither in sharp import growth, nor abolishment of restrictive measures against goods from Russia.

In September 2012, mixed dynamics of the main indices of the Russian foreign trade was observed. In September 2012, the Russian foreign trade turnover calculated on the basis of the methods of the balance of payments amounted to \$70.9bn which is 0.6% lower than the same index of 2011. It is to be noted that the export of goods from Russia in September 2012 increased by 0.5% to \$44bn on September 2011. In September 2012, the import of goods to Russia as compared to the same period of 2011 decreased by 2.3% to \$26.9bn. Such dynamics of the foreign trade indices contributed to growth in export surplus which increased in September 2012 by 5.2% to \$17.1bn as compared to September 2011.

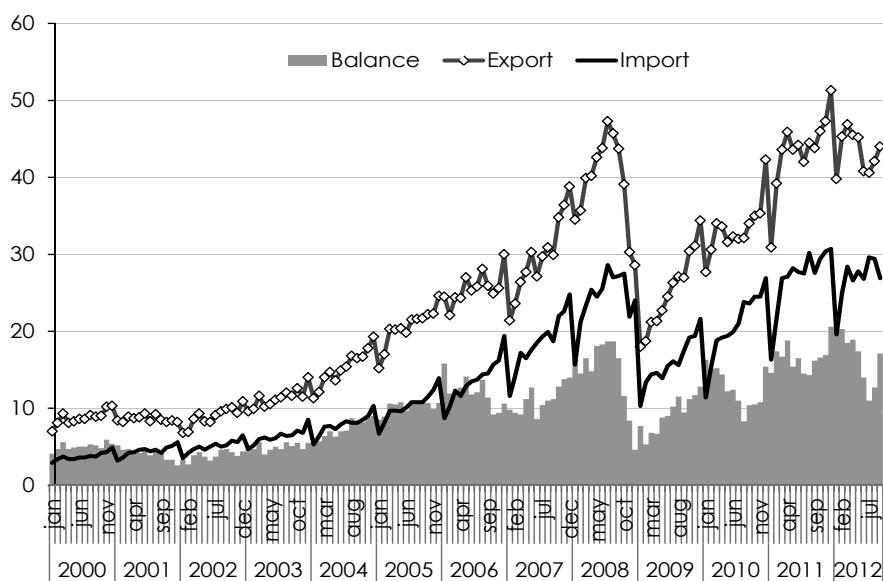
The dynamics of the export is still determined by fluctuations in the market situation which remains favorable for Russian exporters. Oil prices are still under effect of the following two factors: political tensions in the Middle East and the state of the world economy.

In September, the average price of the Brent oil amounted to \$112.95 a barrel, that is, it remained virtually at the level of September 2011. It is to be noted that on September 15, 2012 it rose to \$116.92 a barrel which is the maximum price from May 2012.

In September 2012, the price on Urals oil on the global market amounted to \$111.6 a barrel which is the mere 0.1% higher than the level of the same period of 2011. As compared to August 2012, the price on Urals oil fell by 1.4%.

The average oil price in the period of monitoring from October 15 till November 14, 2012 included, amounted to \$108.9 a barrel (from September 15 till October 14, 2012 the price on oil

amounted to \$110.7 a barrel). As result, by Resolution No. 1201 of November 22, 2012 the export duty on oil in Russia was lowered to \$396.5 a ton in December 2012 from \$404.5 a ton in November 2012. In December, the preferential oil duty will amount to \$193.3 a ton against \$199.4 a ton in November. In December, the duty on oil products, except for petroleum, will amount to \$261.7 a ton against \$267.0 a ton in November. In December 2012, the protective duty on petroleum in the amount of 90% of the rate on oil – which duty was introduced by the government from May 2011 for pro-



Source: The Central Bank of the Russian Federation.

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

tection of the domestic market of the Russian Federation – will amount to \$356.8 a ton against \$364.1 a ton in November.

In the second half-year of 2011, the global situation on the nonferrous metals market started to get worse: metal stock at warehouses sharply increased, their consumption in the real sector of the economy fell and prices started to go down. After insignificant growth early in 2012, prices on non-ferrous metals kept falling. In September 2012, though the above trend prevailed, there was a turning point on the horizon. Though in September 2012 as compared to September 2011, prices on aluminum, copper and nickel decreased by 10%, 2.3% and 15.2%, respectively, they increased by 11.9%, 9.9% and 7.6%, respectively as compared to August 2012.

Table 1

MONTHLY AVERAGE GLOBAL PRICES IN SEPTEMBER OF THE RESPECTIVE YEAR

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Oil (Brent), USD per barrel	26.18	28.26	27.1	42.68	61.7	62.1	75.9	104.7	68.64	77.76	109.97	113.4
Natural gas, USD per 1m of BTU	3.79	3.08	3.97	4.41	6.58	8.77	8.54	14.85	7.13	8.28	10.85	11.08
Petroleum, USD per gallon	0,757	0,797	0,832	1.26	1,958	1,596	2.03	2.63	1,768	1.94	2.73	3.05
Copper, USD per ton	1452.9	1498.3	1816.4	2892.6	3858.0	7602	7656.5	6990.9	6195	7709.3	8314.8	8087.7
Aluminum, USD per ton	1342.6	1294.7	1415.0	1726.0	1840.0	2473	2392.9	2525.8	1833	2202.4	2296.7	2064.1
Nickel, USD per ton	5040.9	6592.5	9996.1	13298	14228	30131	29605	17795	17462	22643	20392	17288

* The market of Europe, average contract price, franco-border.

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

In September 2012, the FAO Food Price Index rose by 3 points as compared to the same index in August (from 213 points in August to 216 points in September). Such growth reflects appreciation of prices on dairy and meat products and grain. Prices on sugar and vegetable oil kept going down.

According to the data of the Bank of Russia, in January–September 2012 Russia's foreign trade turnover amounted to \$630.8bn which is 3.3% higher than the level of January–September 2011. It is to be noted that growth rates of both export and import were almost the same: the export increased by 3.5% to \$390.4bn, while the import, by 3% to \$240.4bn. The export surplus remained a positive one, that is, \$150.1bn (in January–September 2011 it was \$144.0bn). Growth in export supplies was still justified by positive price dynamics (mainly by prices on energy resources), while growth in import took place as a result of an increase in the physical volume.

Table 2

INDICES OF THE PHYSICAL VOLUME AND FOREIGN TRADE PRICES IN JANUARY–SEPTEMBER 2012
(JANUARY–SEPTEMBER 2011 = 100)

	Index of the physical volume	Price index
EXPORT		
Total	99.7	103.5
Far abroad	101.6	102.4
CIS	89.3	110.4
IMPORT		
Total	104.8	97.3
Far abroad	107.6	97.2
CIS	88.7	98.4

Source: The Ministry of Economic Development of the Russian Federation.

Thanks to growth in export prices with a decrease in prices on import, in January–September 2012 trade conditions for Russia in general were favorable. The trade conditions index amounted to 106.4. However, it was much lower than in January–September 2011 (119.3).

On October 23, 2012, the World Trade Organization (WTO) published the detailed statistics on the volumes of trade flows and tariff rates in 2011¹ according to which data growth in the volume of the global trade in commodities amounted to 5% with global GDP growth of 2.5%. For the sake of comparison, in 2010 those indices amounted to 13.8% and 3.8%, respectively. In the pre-crisis 1990–2008 period, the average annual growth rates of trade in commodities were at the level of 6%.

In September 2012, the WTO revised the 2012 global trade growth forecast downward to 2.5%. According to the WTO's previous forecast made in April 2012, growth of 3.7% was expected in 2012. The 2013 forecast was revised downward from 5.6% to 4.5%.

In 2011, the world's largest commodities exporter (in monetary terms) was still China whose export volume rose by 20% and amounted to \$1,898bn. The share of China in the global export amounts to 10.4%. The United States of America with the export volume of \$1,480bn is rated the second, while Germany which exported \$1,472bn worth of goods, the third. The Russian Federation with \$522bn worth of the export moved to the 9th place from the 12th place it held in 2010.

As regards the volume of import, the United States was rated the first – the US purchased \$2,266bn worth of goods from abroad – while China, the second (its import amounted to \$1,743bn). Germany was rated the third; it imported \$1,254bn worth of goods. The Russian Federation moved from the 18th place (in 2010) to the 17th place; it imported \$324bn worth of goods.

On October 29, 2012, the Department of Customs and Tariff and Non-Tariff Regulation of the Eurasian Economic Commission carried out a preliminary analysis of the effects of the WTO membership on the import of goods to Russia on the basis of the results of September 2012.

It was stated in the report of the Eurasian Economic Commission that no sharp growth in import because of a reduction of the level of tariff protection was registered. On the contrary, the volume of import goods in monetary terms from far abroad to Russia decreased by 8.6% as compared to August 2012, while that from the CIS states, by 7.6%.

A decrease in import volumes concerned most of the goods. So, in September 2012 as compared to the previous month the import of chemical products, textile goods and footwear and engineering products decreased by 6.4%, 16.3% and 14.6%, respectively. It is to be noted that import supplies of food products and primary products for their production increased by 7% as compared to August 2012. Probably, it was related to the fact that in expectation of reduced import customs duties importers brought in a smaller volume of goods, while after the new customs tariff came into effect they started to import food more actively, thus, saving the money on it.

The highest growth rates were observed as regards vegetable oil (59.5%). It can be explained by a twofold increase in the volume of import of palm oil as a result of reduction of the duty rate.

In September, the monetary volume of imported dairy products rose by 23.5% on August due to a reduction of import customs duties on some goods, for instance, processed and hard cheese.

Due to expectations of further increase in excise duties, import deliveries of tobacco products rose by 32.2%.

Import deliveries of pork rose by 16.9% as a result of both reduction to the nil of the import customs duty on that type of meat imported within the limits of the quota set by Russia and a decrease of 10 p.p. in the custom duty on deliveries beyond that quota.

Russian meat producers believe that the situation in that sector changed dramatically: in Russia prices on forage rose sharply, while prices on pork fell. Producers turned to the Ministry of Agriculture of the Russian Federation with a request to protect the Russian pork market by means of measures of customs and tariff regulation, that is, restore the specific rate of import customs duty on the imported pork which is brought to Russia beyond the quota in the amount of no less than 1.5 euro per kilo (at present the ad valorem portion of the duty has been reduced from 75% to 65%, while the specific rate canceled), and abolish a privilege for Brazil – which in the past few years has become the main supplier of pork to the Russian Federation – as regards payment of import customs duties. At present, Brazil enjoys a special regime: only 75% of the existing customs tariff is paid on import of meat from that country.

Though a return to the specific portion of the customs duty is not in conflict with the WTO rules, the decision is to be approved by importer-countries. It is to be noted that if the specific component is introduced again the ad valorem portion of the duty is to be reduced.

¹ http://www.wto.org/english/news_e/news12_e/stat_23oct12_e.htm

However, protectionist sentiments in the world economy have recently been on the rise. In 2012, according to the WTO over 100 new restrictions have been introduced and it is to be noted that G20 accounted for most of those restrictions (71 new restrictive measures were introduced only in the period from May till October 2012)¹.

The Eurasian Economic Commission has prepared the first review of the analysis of restrictive measures against the Customs Union. According to the above review, 106 restrictions are in effect against goods from the member-states of the Customs Union: Russia, Belarus and Kazakhstan. The above restrictions introduced in different years include antidumping investigations, discriminating excise duties, special technical measures, as well as economic and political sanctions against Belarus. ●

1 http://www.wto.org/english/news_e/news12_e/igo_31oct12_e.htm

HOW THE FEDERAL BUDGET IS PLANNING TO FINANCE EDUCATION

T.Klyachko

The federal budget for 2013 and the planning period 2014–2015 has already been given the label “anti-social”: the rising volume of budget allocations to the “guns” brings down that of allocations to “butter” – including “educational butter”.

Main Indices of Section 07 “Education” of the Draft Federal Budget for 2013 and the Planning Period 2014–2015.

It is suggested that the volume of budget expenditure allocated to education in 2013 and the planning period 2014–2015 should be as follows – *Table 1*.

Table 1

FEDERAL BUDGET EXPENDITURE, TO BE ALLOCATED TO EDUCATION IN 2013
AND PLANNING PERIOD 2014–2015 (THOUSAND RB)

	2013	2014	2015
Education	605,667,539.40	547,728,956.50	572,587,621.70
Pre-school education	7,564,839.40	6,025,493.40	5,680,811.30
General education	67,380,787.50	19,325,189.90	19,047,611.50
Primary professional education	4,339,408.70	4,469,225.10	4,477,099.60
Secondary professional education	3,603,306.10	3,625,696.80	3,792,059.10
Professional training, retraining and qualification improvement	6,407,546.90	6,437,240.10	6,469,233.90
Higher and postgraduate professional education	477,238,473.70	484,106,114.10	513,536,938.00
Youth policy and children’s health	5,293,104.70	5,297,267.20	1,035,565.20
Applied scientific research in education sphere	12,521,722.20	9,426,335.00	9,824,604.70
Other issues in education sphere	21,318,350.20	9,016,394.90	8,723,698.40

So, it is planned that the amount of federal budget expenditure allocated to education will be 0.91% GDP in 2013, 0.74% of GDP in 2014, and 0.69% of GDP in 2015. In other words, the size of federal budget expenditure on education as share of GDP will shrink by nearly one-quarter towards the end of the planning period.

The share of federal budget expenditure allocated to education in total budget expenditure will also decline – from 4.5% in 2013 to 3.6% in 2015 (in 2014 – 3.9%).

The Structure of Federal Budget Expenditure Allocated to Education Planned for 2013–2015, by Education Level

Over the period of 2013–2015, it is planned to significantly alter the structure of federal budget expenditure allocated to education (*Table 2*).

As seen from *Table 2*, the structure of federal budget expenditure allocated to education will undergo the following principal changes in 2013–2015:

- there will be a dramatic drop – more than threefold – in the overall share of expenditure allocated to general education – from 11.1% to 3.3%;
- the decline in the share of expenditure allocated to youth policy will be even more impressive – by 4.5 times;
- there will be a slight increase in the share of expenditure allocated to primary and secondary professional education – by 0.1 p.p.;

- the share of expenditure allocated to pre-school education will be slightly decreased – from 1.2% to 1.0%;
- the share of expenditure allocated to professional training, retraining and qualification improvement will remain practically unchanged;
- there will be a marked (more than twofold) decline in the shares of expenditure allocated to applied scientific research in the education sphere (by 20%) and to other issues in education sphere;
- the main beneficiary of the intended alterations in the structure of federal budget expenditure allocated to education will be the sphere of higher and postgraduate education, whose share will increase from 78.8% to 89.7% (or by 10.9 p.p.).

Table 2

PLANNED STRUCTURE OF FEDERAL BUDGET EXPENDITURE TO BE ALLOCATED TO EDUCATION
IN 2013–2015, %

	2013	2014	2015
Education	100.0	100.0	100.0
Pre-school education	1.2	1.1	1.0
General education	11.1	3.5	3.3
Primary professional education	0.7	0.8	0.8
Secondary professional education	0.6	0.7	0.7
Professional training, retraining and qualification improvement	1.1	1.2	1.1
Higher and postgraduate professional education	78.8	88.4	89.7
Youth policy and children's health	0.9	1.0	0.2
Applied scientific research in education sphere	2.1	1.7	1.7
Other issues in education sphere	3.5	1.6	1.5

It should be noted that the size of federal budget expenditure allocated to general education will decline in absolute terms from Rb 67.4bn in 2013 to Rb 19.3bn in 2014, and then to Rb 19.0bn in 2015. As general education is funded at the municipal level (while subventions earmarked for teachers' salaries and tuition costs are transferred from regional budgets to municipal budgets), the aforesaid reduction in the amount of federal budget expenditure allocated to general education will mean that the burden imposed on the budgets of RF subjects will be increased, although only slightly – by a little more than 2% (however, for many regions this increased burden will be quite noticeable).

There will be a sharp decline in the size of federal budget expenditure allocated to youth policy and children's health – from Rb 5.3bn in 2014 to Rb 1.0bn in 2015. Thus, youth policy will no longer be a priority for the federal center.

Comparison between the Draft Budget for 2013 and the Planning Period of 2014–2015 and the Budget for 2012 and the Planning Period of 2013–2014.

A comparison of the draft federal budget for 2013 and the planning period of 2014–2015 with the federal budget for 2012 and the planning period of 2013–2014 has revealed a significant improvement of some parameters of federal budget expenditure allocated to education against the same parameters of the 2012 and the budget projections for the period of 2013–2014 (prior to their alteration as of 5 June 2012) (*Table 3*).

As seen from *Table 3*, the most marked improvement can be noted with regard to the parameters of federal budget expenditure allocated to higher and postgraduate education.

At the same time, it should be noted that even in the case of higher and postgraduate education, the increase in the amount of federal budget expenditure allocated to this item in 2014 turns out to be lower than the planned inflation growth rate (growth of budget expenditure in nominal terms is planned to be 1.4%, while the inflation growth rate is expected to be 5.5%); in 2015, the rate of growth in the amount federal budget expenditure allocated to higher and postgraduate education will be slightly ahead of that of inflation – the former will increase by 6%, while the latter – by 5%. The allocations to the other items of federal budget expenditure will either decline, or their growth will be lower than the planned increase in the inflation rate.

Table 3

PLANNED FEDERAL BUDGET EXPENDITURE TO BE ALLOCATED TO EDUCATION IN THE DRAFT FEDERAL BUDGET FOR 2013
AND THE PLANNING PERIOD OF 2014–2015 AND THE FEDERAL BUDGET FOR 2012 AND THE PLANNING PERIOD OF 2013–2014 (THOUSAND RB)

	Draft Federal Budget for 2013–2015				Federal Budget for 2012 and Planning Period of 2013–2014			
	2013	2014	2015	2012	2013	2014	2014	
Education	605,667,539.40	547,728,956.50	572,587,621.70	586,295,076.20	538,959,154.60	478,418,293.00		
Pre-school education	7,564,839.40	6,025,493.40	5,680,811.30	6,533,560.80	6,792,006.00	5,768,612.70		
General education	67,380,787.50	19,325,189.90	19,047,611.50	91,514,042.80	67,296,731.40	30,192,949.40		
Primary professional education	4,339,408.70	4,469,225.10	4,477,099.60	4,665,253.00	4,203,471.30	4,394,709.90		
Secondary professional education	3,603,306.10	3,625,696.80	3,792,059.10	5,072,627.80	4,346,390.70	4,301,538.10		
Professional training, retraining and qualification improvement	6,407,546.90	6,437,240.10	6,469,233.90	6,606,550.40	6,690,087.20	6,679,757.40		
Higher and postgraduate professional education	477,238,473.70	484,106,114.10	513,536,938.00	421,505,960.20	415,971,081.10	411,742,266.60		
Youth policy and children's health	5,293,104.70	5,297,267.20	1,035,565.20	5,454,697.30	5,414,783.40	5,518,583.60		
Applied scientific research in education sphere	12,521,722.20	9,426,335.00	9,824,604.70	20,567,880.60	6,200,265.80	737,567.20		
Other issues in education sphere	21,318,350.20	9,016,394.90	8,723,698.40	24,374,503.30	21,854,337.70	9,082,308.10		

PENSION REFORM: INTERMEDIATE RESULTS

V.Nazarov

*Over several recent months, the key issue in the discussion on the **Strategy of Long-Term Development of the Pension System of the Russian Federation** prepared by the RF Ministry of Labor was reform of the funded component of pension.*

The critics of the mandatory funded component in Russia usually point to its following drawbacks: low yield on investment; absence of any funding sources for the transition period (the contemporary employed generation has to bear a “double burden”: provide financing for the contemporary generation of pensioners and accumulate resources for their own retirement), and lack of any mechanism that can guarantee a yield on accumulated pension savings.

At the same time, the approach that was initially suggested in the *Strategy's* draft – to lower to 2% the size of the insurance contribution tariff for the pension system's funded component (based on an insured person's decision) and to allot 4–6% to the “solidarity” component of the labor pension – was fraught with some significant risks:

- the lower tariff would have resulted in a significantly increased ratio of the cost of the funded component's administration to the size of contributions;
- Russia's international financial reputation would have seriously deteriorated, because in the eyes of investors the mandatory funded system's shrinkage is associated with a poor state of government finances and unstable investment climate;
- social tension would have heightened: a) the Public Opinion Foundation's latest survey has indicated that only 8% of those respondents whose labor pensions' funded component is held by independent pension funds are in favor of lowering the size of contributions to the funded component, while 44% are against that measure; b) perpetually changing ‘rules of game’ increase the overall feeling of instability.

In this connection, a compromise was found. On 23 November 2012, in the second and third readings, the RF State Duma approved the draft law “On Introducing Alterations in Some Legislative Acts of the Russian Federation on Issues of Mandatory Pension Insurance”. By the new law, it is established that:

- those citizens who have already chosen an independent pension fund or asset manager will retain the possibility to transfer the 6% mandatory pension insurance contribution to the funded component of their pension;
- only 2% will be deducted to the mandatory funded component of their pension from the earnings of those citizens who have not chosen any independent pension fund or asset manager (the so-called “silent ones”); while 4% of the tariff will be redistributed in favor of the insurance component of pension.

The entry into force of this decision is delayed until 2014. For an entire year (2013), people will be able to think over their choice as to where to allot the contribution in the amount of 4% of their earnings – to the funded or insurance part of the labor pension. It remains unclear how often they will be able to alter their decision, once made, after 1 January 2014. It seems that they can probably make this choice with regard to 4% of their earnings on an annual basis, for each successive year. All the previously paid contributions will remain in the system to which they have been originally paid. This restriction is explained by the fact that, in the distributive system, all available funding is immediately spent on the payment of pensions to the currently retired persons. To make it possible for citizens to transform into savings their monies paid into a distributive system, it will be necessary to create special state reserves – which will undermine the very idea of a distributive system, because money cannot be simultaneously spent on the contemporary generation of pensioners and reserved for future redistribution if the currently employed citizens change their mind and opt for the funded component.

The necessity to actually make a choice as to where to allot the remaining 4% of their earnings – to keep it as their own saving or to effectively spend it on the payment of pensions to the currently retired generation – may urge many people to shake off their habitual passivity and to make a choice between an independent pension fund and an asset manager. Under that scenario, the share of such people may increase from its current level of 15–20% to 40% of all insured persons born after 1967. In that case, no more than 0.5% of GDP may additionally go to the “distributive” component in 2014. If, however, people do not become more active in making their choice between an independent pension fund and an asset manager, the RF Pension Fund’s budget will increase by 0.7% of GDP.

As before, the issue of a radical improvement of investment cost-effectiveness and society’s demand for pension savings remains unresolved. A solution can be provided though implementing the following measures.

1. Expansion of the list of available instruments for investing pension savings, including a radical diversification of the ways to invest pension savings (while still keeping a considerable portion of the invested money on the Russian stock market).
2. Broader implementation of a “passive” strategy for investing pension savings (global asset investment):
 - if a citizen has failed to make an individual choice of an investment portfolio, the ‘by-default’ option in any independent pension fund must envisage investing in global assets; in this connection, the portfolios selected “by default” must be made subject to some additional constraints on the size of administrative costs;
 - the performance of independent pension funds and asset managers must no longer be estimated on the basis of their reporting a positive nominal yield by the results of each reporting period, because their compliance with this requirement has resulted only in lower yields. Instead, the performance evaluation criterion must become a comparison of a yield on investment with a change in the relevant index.

As a result, the following benefits will be achieved:

- high yields on pension savings over long-term periods due to the dominant role of stock in the structure of investment portfolios;
 - high investment safety due to investment diversification;
 - lower administrative costs due to a reduction in management expenses;
 - social justice (lower differentiation of the size of yield on mandatory pension savings for people with similar risk-proneness).
3. Applying the principle of a life cycle to pension saving investment. Capital markets’ history testifies to the fact that, over longer periods of time, investments in stock are not only associated with real positive yields, but represents the most cost-effective method of investing money. At the same time, stock markets are prone to significant fluctuations. A solution to that problem can be provided by means of implementing the principle of a life cycle in the management of pension savings when, while employed people are young, practically all their pension savings are invested in stocks; as people become older, the share of reliable bonds in their portfolios gradually increases. As a result, for a better part of their employment history, their savings are invested in the highest-yield instruments (chosen from among relatively liquid instruments); when retired, they are insured from the stock market’s volatility because a considerable portion of their portfolio is transformed into safe bonds.
 4. The creation of a system for insuring the safety of pension savings similar to that of bank deposit insurance.
 5. Expansion of the list of financial institutions allowed to participate in the formation of pension savings, by means of including therein insurance companies and credit institutions.
 6. Increasing the transparency of institutions participating in the formation of pension savings (improvement of the information disclosure procedure).
 7. Implementation of state-of-the-art risk-oriented methods of supervision and control over the quality of pension saving investment.
 8. Restriction of citizens’ access to their pension savings prior to their retirement age and the right of choice of annuity period (for life without the possibility of inheritance, or for a certain

period with the right to inherit). This will result in a significantly increased social demand for the funded pension system, because it will thus be turned into “saving for a rainy day” for the middle class, which people can use for the following purposes:

- to buy medical services or additional medical insurance for the participants in the funded system, or for their next of kin;
- to pay for the education of the participants in the funded system, or of their next of kin;
- to buy some socially important services – for the participants in the funded system, or for their next of kin;
- to buy immovable property or to use pension savings as a pledge in a housing mortgage loan.

Without improving the quality of the funded and distributive components of the pension system there will be no point for people in making a choice between the two. Under an ‘inertia-dominated’ scenario of development, the distributive component will be able to provide a pensioner with the size of annuity somewhere between the subsistence level and twice that amount, while the amount of savings will be increasing at a rate close to the growth rate of inflation, thus making it impossible to ensure a socially acceptable replacement coefficient. The situation can be radically changed only on condition of a significant improvement of the cost-effectiveness of pension savings investment and the implementation of decisions aimed at improving the ratio of the length of employment history to the length of retirement. ●

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

M. Goldin

In November 2012, at the meetings of the Presidium of the Government of the Russian Federation the following issues were discussed: the Report of the Ministry of Finance of the Russian Federation on Measures Aimed at Raising of Budget Security of Local Budgets and such amendments to the Budget Code of the Russian Federation as provide for an opportunity to award grants in the form of a subsidy to legal entities (except for public (municipal) entities), as well as non-profit organizations which are not government institutions.

On **November 1**, 2012, at the meeting of the Government of the Russian Federation the Report of the Ministry of Finance of the Russian Federation on Measures Aimed at Raising of Budget Security of Local Budgets which included the analysis of execution of local budgets in the 2006–2011 period and the 2012 planning data was delivered.

In the same report, the Ministry of Finance of the Russian Federation proposed that a portion of revenues from special tax regimes, some tax and non-tax revenues, as well as administrative fines for a failure to comply with local governments' regulatory legal acts should be transferred to local budgets.

According to the Ministry of Finance of the Russian Federation, the above measure will permit to reduce dependence of local budgets on target subsidies provided from regional budgets which situation limits the right of municipal governments to promptly allocate those funds for other important objectives.

On **November 23**, 2012, the draft federal law on Amendment of Article 78 and Article 78.1 of the Budget Code of the Russian Federation As Regards Provision of Grants was discussed.

The draft law was prepared in accordance with decisions passed at the meeting held on April 4, 2012 on the activities of the Presidential Committee on Modernization and Technical Development of the Russian Economy in order to create legal grounds for provision of grants to entities from the respective budget.

The draft law introduces such amendments to Article 78 and Article 78.1 of the Budget Code of the Russian Federation as provide for awarding of grants in the form of subsidies to legal entities (except for public (municipal) institutions), as well as non-profit organizations which are not government institutions.

So, with amendments approved subsidies may be provided on a legal basis in the form of grants not only to profit-making organizations, but also to non-profit ones.

It is to be noted that in the joint letter No. 02-01-04/2523 and No. 12064-AP/D05 of August 29, 2008 of the Ministry of Finance of the Russian Federation and the Ministry of Economic Development of the Russian Federation on Application of Article 78 and Article 78.1 of the Budget Code of the Russian Federation it was stated that recipients of budgetary funds (including non-profit organizations which are assets of infrastructure for support of the small and mid-sized business) which are not budget-funded entities may be granted funds from the budget (grants) in the form of a lump-sum, free of charge and non-repayable subsidy. Earlier, the above position was supported in the official response of the Government of the Russian Federation to draft Federal Law No. 41427-5 on Amendment of the Budget Code of the Russian Federation (in the above draft law it was proposed to establish in the Budget Code of the Russian Federation a new form of budgetary allocations on motivation payments).●

AN OVERVIEW OF NORMATIVE DOCUMENTS ON TAXATION ISSUES FOR OCTOBER–NOVEMBER 2012

L. Anisimova

The law on the federal budget for 2013 and the planning period 2014–2015 was approved by the RF State Duma in the third reading on 23 November 2012¹.

The domestic debt ceiling is set at the level of 10% GDP, the foreign debt ceiling – at about Rb 2.1 trillion. These figures are above the budget liquidity ceiling recommended by international organizations (10%). We believe this index to be very important, because it describes the ratio between the size of expenditure on debt servicing and redemption and the size of federal budget revenue. An accelerated growth of the value of this index reflects the budget's shrinking capacity to provide adequate funding for other types of current expenditures in the future. On the whole, the budget for 2013 has been drawn up with a slight deficit (0.8% of GDP) which, in a situation of a reinstated budget rule, is indicative of the government's intention to exercise real control over the economy's financial sustainability also at the macro-level.

In our opinion, at present the priority issues in the financial sphere are as follows: to ensure compliance with the principles of fiscal federalism in the tax and budget spheres; gradual discontinuation of the use of the tariffs set by natural monopolies in the capacity of pseudo-taxes that generate the government's revenue base outside of the domain regulated by the RF Tax Code; discontinuation of the practice of treating the tariffs for services rendered by natural monopolies as targeted mandatory payments and setting the housing and utilities tariffs without due regard for the recommendations of international organizations as to the share of these payments in the incomes of households.

Over October–November 2011, no significant alterations were introduced in existing legislation with regard to mandatory payment regulation. The RF Ministry of Finance's standpoint concerning the transfer of part of personal income tax (PIT) to the local budgets at the place of residence of employees has remained the same. RF Minister of Finance has confirmed the previous statements, explaining that the Ministry does not believe it to be feasible that the procedure for the payment of PIT should be altered. The motivation behind that standpoint is not that it would be difficult for technical reasons, but that the amount of subsidies transferred from the federal budget to some of the regions will become lower². It is evident that the possibility of reestablishing of the previously existing regions' own tax base and PIT redistribution will be repeatedly discussed at different points as more and more newly elected governors appear on the scene, because the issue of a new period in office for an incumbent governor will no longer depend solely on the RF President's decision – the citizens residing in a given region's territory will now also have their say.

The reason behind the exacerbating debate around the issue of tax revenues received by the regions is the lack of proper regulation of the federal center's and regions' financial powers to dispose of the revenue base and spending obligations of regional budgets. Thus, at the federal level it was decided to implement a one-time increase of the salary tariffs for the employees of budget-funded institutions across the entire territory of Russia, without taking into consideration the actual potential of regional budgets to ensure the implementation of that measure in each given region. The result was increased debts of the regional budgets³ (in 20 regions, the size of government debt by more than half exceeds that of budget revenue).

1 See kp.md/online/news/130367

2 "Siluanov postavil krest na predlozhenii Shoigu po NDFL. Uplata etogo naloga po mestu zhetelstva povredit investitsionomu potentsialu regionov, schitaet glava Minfina" ["Siluanov has brought to naught Shoigu's proposal concerning PIT. The payment of that tax at the place of residence will be detrimental to regions' investment potential, believes the head of the RF Ministry of Finance"]. See izvestia.ru of 3 October 2012.

3 E. Karpenko. Ot vrachei po regionam poidut "dyry". Defitsit regional'nykh biudzhetrov vyrastet s 50 mlrd rublei v 2013 g. do 1,8 trillion rublei v 2018 godu. [Because of physicians, financial black holes will be spreading across regions. The regional budget deficit will increase from Rb 50bn in 2013 to 1.8 trillion in 2018]. See Gazeta.ru of 20 November 2012.

The RF Ministry of Finance is prepared, at best, to restructure regional debts¹, but by no means – to write off these debts against the resources of the federal budget. The increasing tension experienced by regional finances as they are no longer able to sustain the same rate of growth of their financial resources at the expense of subsidies flowing to regional budgets from the federal budget, coupled with the tough attitude of the RF Ministry of Finance with regard to writing off the debts that the regions owe to the federal budget, may trigger the process of uncontrolled “sovereignization” of Russia’s territories. The Council of the Federation and the RF Audit Chamber, in view of the complexity of the situation faced by the regions, submitted a proposal to the RF Ministry of Finance that part of regional debt should be written off at the expense of the federal budget.

We believe it to be a priority in the present situation that the federal government’s participation in the handling of the regions’ own sources of budget revenue should be brought to a minimum, and that the revenue base of regional budgets should be restored. These are the fundamental principles of building the financial base of a federal state with a market economy.

The importance and complexity of that task is vividly illustrated by the issues that the European Union is currently trying to deal with – namely to elaborate the rules and principles for drawing up and executing a consolidated budget that would be acceptable to all. Russia has accumulated vast experience in that sphere – positive as well as negative. Thus, financial troubles became one of the main factors that triggered the “sovereignization” of the former USSR republics, while on the other hand, in the 1990s the Council of the Federation (whose members were elected governors, each burdened with their specific region’s problems) took upon itself the very important function of balancing the interests of businesses and the budgetary system at all its levels. By now Russia – in contrast to Europe – has already developed a single tax system for a market economy; there also exists the RF Budget Code. It seems that in the current phase of development it is necessary to define more precisely the relative powers of federal and regional authorities in drawing up and implementing the budgets of Russia’s territories. So far, there has been excessive command-type guidance on the part of the RF Ministry of Finance. In market conditions such an approach has no economic substantiation. Commodity producers act as independent economic entities; regional budgets cannot collect more taxes than is allowed by the law.

This country’s integrity can be maintained by ensuring approximately similar living standards throughout her entire territory. In order to equalize the population’s living standards, large amount of money must be allocated to the transfers from the federal budget to regions. The actual cost of living standards equalization becomes even higher due to the substantial debts owed by the regions to the federal budget. As the cost of debt servicing, as noted earlier in our overview, exceeds 10% of federal budget revenue, there remains only 50% of revenue for the funding of the rest of the federal government’s expenditure. So, the opportunities for the RF Government to undertake any financial maneuver in the framework of the federal budget are very narrow. That is why it is essential to abolish, wherever possible, most of the exemptions from those taxes that generate regional budget revenues, thus restoring the regions’ own revenue base.

Another evidence of the fact that even the heads of biggest metropolitan areas are experiencing shortage of cash has been the recent proposal of Mayor of Moscow Sergei Sobianin that the principle of taxation of losses, abolished by the 2000 tax reform, should be reestablished in Russia’s current fiscal system². The essence of his proposal is that taxpayers must pay a certain kind of levy in advance. If the company then gains profit, the levy will be recorded as the payment of tax; if it incurs a loss, the levy will then simply be retained in the budget. According to the authors of that proposal, this will make the companies that submit “zero” reports reveal their true amount of income.

In our opinion, this proposal must be rejected because it will replace the system based on taxation of incomes received over a reporting period by the one aiming at seizure of property irrespective of the actual results of a taxpayer’s economic activity. The business community has already

1 D. Ushakova. *Minfin otkazyvaetsia proshchat’ regionam dolgi*. [The RF Ministry of Finance refuses to forgive the regions’ debts]. See izvestia.ru of 17 October 2012.

2 S. Guneev. *Sobianin pridumal nalog na ubytki*. [Sobianin invented a tax on losses]. See lenta.ru or 29 October 2012. “*Vedomosti*”: *Mer Moskvy predlagaet vvesti sbor s malogo biznesa*. [“*Vedomosti*”: The Mayor of Moscow suggests that a levy on small-sized businesses should be introduced]. See news.rambler.ru 29 October 2012.

expressed its negative reaction to this initiative of the Mayor of Moscow. Regrettably, the RF Ministry of Finance chose to abstain from comment. We believe that this country's leading financial department must respond more actively to any proposals aimed at altering the basic principles that form the foundation of the taxation system in market conditions, because the absence of any distinctly expressed viewpoint with regard to that issue can be detrimental to the investment climate in the Russian Federation.

One more issue that has given rise to some acute problems in the current economic situation in Russia is that of the tariffs on services rendered by natural monopolies.

We have repeatedly drawn attention to the distinct trend towards replacing the taxes established by the RF Tax Code by the rising tariffs on natural monopolies' services. There are several reasons behind this policy. One of them is the need to do away with the traditional practice to set a very low price on utilities (the heritage of the Soviet era).

The complexity of the task of reforming the housing and utilities sector is evident from the content of the draft government program 'Provision of Quality Housing and Utilities to the Population of Russia' for 2013–2020¹. In that program, the decision to deviate from the level of 7% recommended by international organizations for the share of housing and utilities costs in household incomes is explained by the poor condition of Russia's housing and utilities sector (the government program acknowledges that its fixed assets are deteriorating, breakage incidence is on the rise, a considerable percentage of resources is wasted, the volume of water loss is estimated to be 21%, heat loss – 11% of supplies, and the expenditures of the enterprises and networks in the housing and utilities sector are by 25–30%, and sometimes even by 50% higher than the European level). The Program states that the RF Government shifts the burden of investments in the housing and utilities sector directly onto the population and other consumers of these services through raising the relevant tariffs². As a result, the practice of targeted consolidation of relevant mandatory payments to a specific program or fund is *de facto* reestablished, while mandatory payments are placed outside of the system of control over the levy ceiling for commodity producers and taxpayers, established by the RF Tax Code, while the resources thus generated are placed outside of the general sphere of budget-based distribution of resources. The cost-effectiveness and manageability of the economy become lower, and the government policy's potential for maneuver is reduced.

In our previous overview we already noted that the price of services rendered by natural monopolies must be determined on a commercial basis – say, by means of loans that must be repaid over a certain period of time at a certain interest. A bank is a subject in market relations, and so it is interested in timely repayment of its money; in other words, a loan is issued against services that will be consumed and paid for. If the price of the service against which a loan is taken is excessively high, the borrower (an organization rendering a monopoly service) will, most likely, be unable to repay the loan with an interest in due time, and then it will be the bank that will find itself on the verge of financial troubles; thus, banks can really influence the pricing process already in the phase of loan issuance. Any attempts to "rid" the federal budget of the cost of the upkeep of natural monopolies, to shift the burden of investment onto the population and commodity producers by means of simply raising the tariffs over the level recommended by international organizations will be equal to the introduction of additional mandatory payments for the population, which is not envisaged in the RF Tax Code.

This can be illustrated by the following example. The RF Government issued Decree No 1075 of 22 October 2012 "On Pricing in the Field of Heating Supply". The fundamental pricing principles

1 E. Karpenko. Tarif "Putinskii" ugrozhaet realizatsii pravitel'stvennoi programmy razvitiia ZhKKh. [Putin's Tariff threatens the implementation of the government program for the housing and utilities sector's development]. See gazeta.ru of 22 November 2012

2 It is becoming a widespread practice to include an "investment" component in the tariffs for services rendered by natural monopolies. Thus, for example, Vice Prime Minister Arkady Dvorkovich in his interview given to the Kommersant newspaper, when commenting on the decision to apply, in 2013, an upward index of 7% to the railway cargo shipment tariffs, confirmed this principle as follows: "The government approved the principle of the possibility of adding an investment component in railway tariffs, the corresponding report was submitted both to the Prime Minister and the President, and there are no objections" (See Kommersant.ru of 22 November 2012, Kommersant Online, Liubye pravila igry mogut izmenit'sia. [Any rules of the game may be altered.]

for the heating supply sector approved by that decree establish the scheme for determining the necessary amount of gross proceeds to be covered by tariff.

An analysis of the content of Items 33, 46 and 48 of that document has revealed that, in addition to ordinary costs (which include the cost of raw materials and supplies, fuel, personnel salaries, the amount of depreciation of fixed assets to be taken into account when calculating the profit tax, and other production costs), the expenditures to be covered by the tariff include overheads consisting of interest to be paid on borrowed funds, deductions to reserves against dubious debts, environment pollution fees (within established standards), taxes, etc. Besides, the tariff – funded by profit after taxes – covers the cost of capital investment in amounts no more than 7% of the expenditures included in the necessary amount of gross proceeds and associated with the production and sale of products (or services) and with the overheads. From this scheme it is by no means clear why the investment component of the tariff is charged not only to the costs of production and sale, but also to the overheads; in other words, the higher the amount of the overheads reported by an organization and unrelated to its core activity, the higher the amount of investment to be taken into account when setting the size of the tariff. The source of fines and sanctions to be paid for violations of contractual terms, as well as penalties and fines imposed for failures to effectuate mandatory payments is also unclear; probably these expenditures will be covered by profit after taxes, at the expense of the investment component.

We believe that this scheme for calculating the size of the tariff has no sound economic substantiation, and that it is detrimental to the interests of the consumers of services, because it only accumulates producer costs and envisages no mechanism for adjusting the tariff size (or the price of service) by the current price level on the market. Besides, the amount of net profit after taxes received by the federal state unitary enterprises, which are subordinated to the RF Ministry of Energy as the main executor of budget funds, is at present transferred to the budget. Thereby an additional mandatory payment to the state budget has been effectively levied on the consumers of utilities in the form of tariff's investment component. The base for calculating the size of that mandatory payment has no economic substantiation for its payer, because it is composed of the expenditures incurred by a third party, including that third party's overheads (the costs that are not directly associated with the rendering of services consumed by the payer of the tariff).

In our opinion, consumers must pay for the services rendered by natural monopolies with due regard for the market level of prices (in particular, the tariff for the services in the housing and utilities sector must be calculated on the basis of the norm of consumption per individual consumer (determined as a relative value)², the average number of such consumers, and the price of a service unit (P) determined by the following formula: $P = 7\%$ of aggregate household income divided by aggregate standard consumption, weighted by type of service). The producers of services can get bank loans against the market level of their tariffs. All the incomes received in excess of the market level can be covered by allocations from relevant budgets only after the producers' expenditures have been verified by the RF Audit Chamber and on the basis of its resolution concerning the size of the sums that can be included in each budget's expenditure for the next financial year.

The additional burden on the population resulting from rising tariffs is increasing at a very alarming rate; thus, over the past two years it increased by 36% (in the draft government program discussed earlier it is envisaged that the share of housing and utilities expenditures in the budgets of households will grow from 7% in 2011 to 9.5% in 2013. By 2015, their share will further increase by one-third – to 12%, and the RF Government is convinced that their accelerated growth rate against that of household incomes is inevitable³. All the issues relating to the introduction (or adoption), alteration or abolition of taxes (and consequently – the levy ceiling

1 Item 9 of the List of Federal Budget Revenue Sources administered by the RF Ministry of Energy in its capacity of administrator of federal budget revenue (Annex 2 to the RF Ministry of Energy's Order of 26 October 2012, No 513).

2 Article 28.2 of Federal Law 'On Social Protection of Disabled Persons in the RF', No 181-FZ of 24 November 1995 (wording as of 20 July 2012, No 124-FZ) the housing allotment standard per disabled person was established in the amount of 18 square meters; in accordance with this standard, the relevant consumption norms for natural gas, electric energy, water, and heating can be established.

3 E. Karpenko. *Tarif "Putinskii" ugrozhaet realizatsii pravitel'stvennoi programmy razvitiia ZhKKh*. [Putin's Tariff threatens the implementation of the government program for the housing and utilities sector's development]. See gazeta.ru of 22 November 2012.

for commodity producers and taxpayers established within the framework of the RF Tax Code) are directly delegated to the Federal Assembly; and the regulation of legislation relating to the setting of natural monopolies' tariffs is the prerogative of the RF Government. We believe that the government's functions with regard to the tariffs set by natural monopolies must be determined more precisely.

Natural monopolies are an indispensable environmental component of contemporary civilized lifestyle. The goal of the State in this connection is to create for each member of society appropriate conditions for gaining free access to a guaranteed set of services provided by one or other natural monopoly. In other words, the granting of access to a service provided by a natural monopoly and maintaining the necessary volume and quality of such services may be qualified as a commercial service provided to an individual by the State. If any individuals cannot pay in full for the service provided by a natural monopoly, they must be granted a subsidy from welfare funds in an amount sufficient for covering the standard level of services rendered by natural monopolies.

Any other approach to determining the value of a 'utilities unit', as we have demonstrated, will transform it into a source of additional revenues derived by the providers of such services (or by the State – if the payments are transferred into the budget) through making the consumers pay for them in an enforced procedure.

The issue of government policy with regard to the tariffs for services rendered by natural monopolies has recently become very acute. The ongoing large-scale transformation of budget-funded institutions into non-profit organizations, and federal state unitary enterprises – into joint-stock companies, will inevitably result for some of their former employees in a forced "transfer" to other sectors of the national economy – or in being dumped on the labor market. Under these conditions, social tension may increase manifold. The accelerated growth in the "housing and utilities" tariffs against the background of a slower growth rate of the population's incomes may exacerbate the situation even further.

Among the technical issues of running the RF taxation system that emerged over the period under consideration, the following ones may be pointed out as the most noteworthy.

1. The RF Federal Tax Service's Letter of 17 October 2012, No ED-4-3/17589, concerning VAT. Essentially, the Letter explains that the work (or services) that can be regarded as subject to the exceptions to the general VAT rules stipulated in Article 148, Items 1, Paragraphs 1–4 with regard to the place of performance of work (or services), including the work (or services) that apply directly to movable property (in particular, installation, assembling, processing, treatment, repair and technical servicing), are to be considered to be realized at the place where that movable property is situated (including beyond the borders of the Russian Federation), even when both parties in a given transaction are Russian organizations.

In contrast to the taxation of income, Russia has no agreements concerning the elimination of double taxation with regard to indirect taxes. Under Russian legislation, a payer of VAT is designated not as a stationary representative office, but as a person (an organization or individual entrepreneur). In other words, tax agencies must on their own identify those non-residents that render to other non-residents services related to movable property in RF territory, while the services relocated by Russian residents beyond the borders of the Russian Federation are not levied with that tax, although under the general rule the place of rendering a service is determined as the place where its recipient is engaged in economic activities. To identify that place, it is sufficient to know a person's place of registration or the place where a given organization is situated in accordance with a relevant entry in its charter or founding documents, or the place where an organization is administered, or the place where its stationary executive body is situated, or the place where its stationary representative office is situated (if the work (or services) are realized through that stationary representative office), or the place of residence of a physical person.

The primary purpose of introducing that norm into the RF Tax Code was to make exempt from VAT the services relating to repairs of special and military equipment rendered by Russian organization to other Russian organizations outside of the borders of the Russian Federation. However, after the creation of the Customs Union, the loss of VAT resulting from the exemptions granted

to that type of transactions may become substantial. So we believe that, within the RF Tax Code's framework, the list of movable properties to which exemptions VAT are applied must be reduced.

2. Another noteworthy document is the explanation, by First Deputy Chairman of the RF Government Igor Shuvalov, of the procedure for Russia's accession to the OECD¹. It is planned that the relevant negotiations (the accession request was submitted 12 years ago) should be completed in 2013, and that Russia will become a full-fledged member of that organization from 2014 onwards. To avoid being treated as an offshore zone by the other OECD members, Russia must assume the obligation to comply with the OECD criteria. One of the most important criteria is the one concerning mandatory disclosure of foreign companies' beneficiaries. The RF Ministry of Finance has confirmed its intention to prevent the withdrawal of profit into offshore zones by introducing a tax on the undistributed profit of those foreign companies that are directly or indirectly controlled by Russian organizations; the tax will be paid by their parent companies situated in Russia. It should be reminded that this proposal is stipulated in the *Main Directions of Tax Policy for 2013–2015*. In our opinion, the introduction of tax on undistributed profit of those foreign businesses controlled by Russian organizations whose beneficiaries have not been disclosed to Russian tax agencies must be fully supported – regardless of Russia's accession to the OECD.

3. By Decree of the RF Government of 25 October 2012, No 1097, some alterations to the *Model Agreement on Eliminating Double Taxation and Preventing Evasion of Income and Property Taxes* are introduced, which were approved by the RF Government's Decree of 24 February 2010, No 84 “*On the Conclusion of Intergovernmental Agreements Concerning the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Regard to Income and Property Taxes*”.

The newly introduced alterations define more precisely a Russian party's approach to determining the tax base of a Russian taxpayer in those transactions with non-residents where transfer prices are applied. The suggested scheme can be concisely described as follows: the profit derived by a Russian organization and the profit derived by its foreign contracting party as a result of one and the same transaction is to be consolidated,² and profit tax is levied on the sum of consolidated profit (profit received from a transaction with an independent contracting party). It is suggested that the financial structures of a foreign state are to determine on their own whether the amount of tax paid by the Russian contracting party to the Russian budget on a given transaction should be taken into account in their tax records, or not.

It is not quite clear how Russian tax agencies can actually know the actual amount of profit tax paid by a Russian organization's contracting party to the budget of a foreign state. Our general impression of the suggested scheme is that it is correct in theory, but can hardly be implemented in actual practice.

Besides, the *Model Agreement* contains a stipulation that an equal approach must be applied to Russian and foreign organizations when determining the size of debt of one contracting party to the other in order to identify “taxable capital”. The term “taxable capital” is questionable, because the subject of the *Model Agreement* is the prevention of double taxation and the fiscal evasion with regard to the income and property taxes. In accordance with Item 1 of Article 128 of the RF Civil Code, the notion of property includes, among other things, also a legal entity's property rights. In other words, “property” is comparable to assets on a balance sheet. Capital is part of liabilities, it can belong to an entity (including its net profit) or be borrowed. If tax is levied on assets (or property), there can be no “taxable capital”. As far as profit is concerned, tax is levied not on balance-sheet profit (assets in excess of liabilities), but on the operating profit constituted by the income from entrepreneurial activity in excess of the expenditures incurred over a reporting period. Therefore it is evident that the wording of Item 24 of the *Model Agreement* will, most likely, be further elaborated. ●

1 M. Liutova. *Rossii pridetsia zastavliat' inostrannye kompanii raskryvat' benefitsiarov*. [Russia will have to force foreign companies to disclose their beneficiaries]. *Vedomosti.ru* of 1 November 2012.

2 Profit on one and the same deal cannot be received simultaneously by both contracting parties (always one of them receives money, and the other pays money).

REVIEW OF THE ECONOMIC LEGISLATION¹

I.Tolmacheva

In November, the following changes were introduced in the legislation: the list of grounds for approval by the Ministry of Justice of a decision on permission to include in the name of a non-profit organization of the official names – “the Russian Federation” or “Russia” – was supplemented; the rules of calculation of the insurance compensation in case of damage caused to the health of a person who was injured in a road accident were approved; the Government of the Russian Federation plans to develop and put into service the federal public information system which ensures the process of extrajudicial appeal of decisions and actions made by officials in provision of public and municipal services; Rosfinmonitoring reports that the procedure for mandatory control over some types of operations related to securing by non-profit organizations of cash funds or other property has become effective¹.

I. Resolutions of the Government of the Russian Federation

1. Resolution No. 1165 of November 15, 2012 ON AMENDMENT OF ITEM 5 OF THE RULES OF ISSUING OF PERMISSION TO INCLUDE IN THE NAME OF A NON-PROFIT ORGANIZATION OF THE OFFICIAL NAME – “THE RUSSIAN FEDERATION” OR “RUSSIA” – AS WELL AS DERIVATIVES FROM THAT NAME.

The list of grounds for approval by the Ministry of Justice of the Russian Federation of decisions on permission to include in the name of a non-profit organization of the official names “the Russian Federation” or “Russia” has been supplemented.

Earlier, to secure a permit the non-profit organization had to comply with a number of criteria: the entity has to carry out for at least three years activities aimed at realization of foundations of the constitutional system of the Russian Federation and development of its national, historical and cultural traditions or render unique services valuable to the community (realize the relevant produce) and comply with a number of requirements which reflect the extent of the activities (the non-profit organization needs to have structural units or members (permanent residents) in the territory of more than one-third of constituent entities of the Russian Federation or its representative offices in each federal district and be a part or member of international organizations).

By amendments it has been established that such a decision is also taken in case the founder of the non-profit organization is a public company, a state corporation and an entity in whose charter (reserve) capital the share of participation of the Russian Federation amounts to over 50% or an entity which uses the official name – “the Russian Federation” or “Russia” – as well as derivatives from that name by operation of law or on the basis of permission secured in accordance with the procedure established by the Government of the Russian Federation and the activities of the non-profit organization are aimed at realization of the foundations of the constitutional system of the Russian Federation and development of its national, historical and cultural traditions. Also, it is envisaged in which cases a decision on issuing of permits to a non-profit organization is taken by the Ministry of Justice of the Russian Federation on the basis of instructions of the Chairman of the Government of the Russian Federation. In particular, if a non-profit organization has carried out activities for less than three years.

2. Resolution No. 1164 of November 15, 2012 ON APPROVAL OF THE RULES OF CALCULATION OF THE AMOUNT OF THE INSURANCE COMPENSATION IN CASE OF DAMAGE CAUSED TO THE HEALTH OF THE INJURED PERSON.

The value of the insurance compensation paid to the person injured in a road accident will depend on the nature and the extent of damage caused to that person’s health.

According to the approved Rules, the amount of the insurance compensation is to be calculated by the insurer by way of multiplying the insurance sum specified in relation to that risk in the in-

¹ The review was prepared with assistance of the KonsultantPlus legal system.

insurance agreement by percentage norms. The norms depend on the nature and extent of damage caused to the health. So, with a complete lung loss the insurance payment norm will amount to 60%, while in case of a loss of a lower limb, to 50% and so on. In case of several injuries, the norms are totaled. The amount of payment of the insurance compensation due to physical disability is determined depending on the extent of imbalance of functions of the injured person's system and the disability group (the 1st disability group, as well as disabled children are paid Rb 2m while the 2nd disability group and the 3rd disability group, Rb 1.4m and Rb 1m, respectively).

It has been envisaged that payment of an insurance compensation due to determination of disability is carried out in the amount of the difference between the sum of the insurance compensation due to disability and the earlier made payment depending on the nature and the extent of damage caused to the injured person.

The above rules will become effective from January 1, 2013.

3. Resolution No. 1198 of November 20, 2012 ON THE FEDERAL PUBLIC INFORMATION SYSTEM ENSURING THE PROCESS OF PRE-TRIAL (EXTRAJUDICIAL) APPEAL OF DECISIONS AND ACTIONS MADE IN RENDERING OF PUBLIC AND MUNICIPAL SERVICES .

From January 1, 2014, it is expected to develop and put into service the federal public information system which ensures the process of extrajudicial appeal of decisions and actions made by officials in provision of public and municipal services. Such complaints can be submitted to the system via the specialized Internet-site, by mail through the multifunctional center for provision of public and municipal services, via the official site of the authority providing public and municipal services and via the Single Web-Site of Public and Municipal Services, as well as by applicant personally. The Ministry of Economic Development of the Russian Federation has been authorized to maintain the information resources of the system; the Minkomsvyaz of Russia was authorized as the operator of the system.

II. Instructions, Letters and Orders

1. Information Message of Rosfinmonitoring on AMENDMENTS TO FEDERAL LAW NO.115-FZ OF AUGUST 7, 2001 ON PREVENTION OF LEGALIZATION (LAUNDERING) OF INCOMES RECEIVED BY CRIMINAL MEANS AND FINANCING OF TERRORISM COMING INTO EFFECT .

Rosfinmonitoring informs that from November 21, 2012 some types of operations related to receipt by non-profit organizations of cash funds or other property are subject to mandatory control. Namely, amendments to the Federal Law on Prevention of Legalization (Laundering) of Income Received by Criminal Means and Financing of Terrorism will come into force; under the above amendments operations related to receipt by any non-profit organization of cash funds and other property from foreign states and international and foreign organizations (foreign nationals and stateless persons) if the sum of the operation is equal to or exceeds Rb 200,000 (or the equivalent of that sum in foreign currency) are subject to mandatory control.

Rosfinmonitoring draws attention of the entities which are obligated to report the data on such operations to the fact that they have to introduce changes into their in-house control rules in submitting of the information on operations which are subject to control and notifies of the type code – 9001 – assigned to such operations (at present relevant additions are being prepared to the directory of codes of operation types provided for by Instructions No. 245 of October 5, 2009). ●

CHANGES IN THE REGULATORY BASE OF THE BUDGETARY PROCESS

M.Goldin

In November 2012, by amendments to the Budget Code of the Russian Federation, a five-year legal limitation as regards money liabilities to the Russian Federation was established; The Constitutional Court of the Russian Federation specified the rights of servicemen who became disabled persons as a result of the Chernobyl Accident to a monetary compensation for harm.

By Federal Law No. 189-FZ of November 12, 2012 on Amendment of the Budget Code of the Russian Federation and Recognition as Null and Void of Individual Provisions of Statutory Acts of the Russian Federation a five-year legal limitation as regards money liabilities to the Russian Federation was established. According to the wording of Cl. 93.4 (4) of the Budget Code of the Russian Federation – which was in effect before – general rules in respect of legal limitation did not apply to claims of the Russian Federation which arose due to the following instances:

- in connection with provision on a return and (or) refundable basis of budget funds, including budget loans at the expense of funds of purpose foreign loans (borrowings) and other budget loans (borrowings), including interest claims and (or) other payments provided for by the law and (or) contract (agreement), including unjust enrichment claims and claims of indemnity;
- in connection with provision and (or) execution by the Russian Federation of state guarantees of the Russian Federation;
- in connection with a legal entity's obligations as regards purpose financing which is provided on condition of assignment of that legal entity's equities in ownership of the Russian Federation;
- in connection with agreements and other transactions related to enforcement of liabilities specified in that Clause.

In its Resolution No. 20-P of July 20, 2011 on the Case of Checking of Constitutionality of provisions of Cl. 93.4 (4) of the Budget Code of the Russian Federation, Article 5 (6) of the Federal Law on “Amendment of the Budgetary Code of the Russian Federation as Regard Regulation of the Budgetary Process and Bringing into Compliance of Individual Statutory Acts of the Russian Federation with the Budget Legislation of the Russian Federation” and Article 116 of the Federal Law on the 2007 Federal Budget, the Constitutional Court considered the issue of constitutionality of the above provision of the Budget Code of the Russian Federation and ordered the federal legislator to establish the specific time-limit for the increased legal limitation in respect of claims of the Russian Federation.

Proceeding from the above, by amendments to the Budget Code of the Russian Federation a five-year legal limitation in respect of claims specified in Cl. 93.4 (4) of the Budget Code of the Russian Federation was established.

In its Resolution No. 24-P of November 7, 2012, the Constitutional Court of the Russian Federation recognized that Article 2 (1) of the Federal Law No.5-FZ of February 12, 2001 on Amendment of the Law of the Russian Federation on “Social Security of Persons Subjected to Radiation Exposure as a Result of the Accident at the Chernobyl Nuclear Power Plant” did not comply with the Constitution of the Russian Federation. The above case was considered due to a complaint filed by Citizen R. Inamov. The reason for consideration of the above case was ambiguity about the issue whether provisions – disputed in the complaint – of Federal Law No.5-FZ of February 12, 2001 as interpreted in enforcement practice which was formed after Resolution No. 21-P of December 20, 2010 came into force complied with the Constitution of the Russian Federation.

In accordance with the decision of the Constitutional Court of the Russian Federation, former servicemen who became disabled persons as a result of the Chernobyl accident are entitled to a

monetary compensation for harm after February 15, 2001 which compensation is calculated on the basis of the lost income (more specifically, on the basis of the pay with the extent of loss of professional ability to work taken into account). Earlier, courts of general jurisdiction passed judgments on the basis of the fact that the size of the compensation for harm payable after February 15, 2001 to former servicemen who became disabled persons as a result of the Chernobyl accident was to be set as a fixed cash amount depending on the disability group and not on the basis of the lost income. ●