



RUSSIAN ECONOMY: TRENDS AND PROSPECTS 10'2012

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

The Political Background: the Kremlin Will Control Elections and Oil

In October, for the first time after an eight-year “break”, gubernatorial elections were held in Russia. The revival of gubernatorial elections by no means implies a revival of competition at the regional level – existing legislation ensures that this should not be allowed. At the same time, the new electoral pattern, while still granting to the Kremlin broad opportunities for interfering with the process of elections, also provides the regional elites with some significant means for their consolidation. At the first election that took place of 15 October, all the incumbent governors running for reelection (of Belgorod, Bryansk, Ryazan, Amur and Novgorod oblasts) were soundly reelected, and this process was under the Kremlin’s control. However, later on this pattern will bring about a significant change in the balance of forces between the federal center and the regions, especially if the current downward trend in the level of the population’s support for the federal authority continues.

The major specific feature of the single day of voting on 15 October was the low voter turnout at the election of deputies to local bodies of authority. On the one hand, this made easier the demonstration of victory by United Russia. On the other, it exposed both the opposition’s organizational weakness and the weakened support of the current political regime – and of United Russia as the institution created for the purpose of mobilizing such support.

October’s most important development was the announcement of the buyout, by the government represented by the state-owned corporation Rosneft, of shares in TNK-BP from its private owners. This transaction was the largest de-privatization deal in Russia’s contemporary history, which demonstrated that, in spite of regularly voiced declarations to the effect that the State’s presence in the national economy is going to diminish, the real course of the Putin Government towards nationalization of the oil and gas industry has remained unchanged since the early 2000s. As a result of that transaction, the State will be in control of more than one half of Russia’s oil production (vs. 36% as of today).

Although this deal will make Rosneft one of biggest oil companies, its financial situation will be very unstable. Thus, Rosneft’s net debt will increase from approximately \$ 20bn to \$ 70bn. Meanwhile, its debt to proceeds ratio was as high as 25% even prior to the deal (the norm for big oil companies being 10%), and its transaction costs amounted to more than \$ 40 per barrel, which is approximately 1.5 times above the market’s average. So, by buying out TNK-BP from its private owners at a huge premium to its market price, the State is going to acquire a company that will be weak in its market qualities. The deal looks even more doubtful in view of the increasingly frequent speculations of analysts as to the probability of structural changes on the oil market. It is interesting that it was in the same October that Vladimir Putin was forced to acknowledge the structural changes that had occurred on the gas market – after both the government and Gazprom, for several recent years, had been adamant in ignoring the issue and denying any prospects of such changes.

October also saw some conflicts unfolding inside the new government. Thus, in particular, Minister of Regional development Oleg Govorun was dismissed from his post; he has actually given in his notice a month earlier, after having received an unjustified public reprimand from Vladimir Putin. His notice was not accepted, but the Minister, nevertheless, from then on did not attend his office. Besides, the RF Investigative Committee initiated a criminal case over the misappropriation of funds at Oboronservice, a state-controlled company subordinated to the RF Ministry of Defense; the police and investigators searched the apartment of Yevgenia Vasilieva, a close associate of Defense Minister Anatoly Serdiukov. The majority of experts view this development as a renewal of the apparatus-instigated struggle around the Minister of Defense and a manifestation of his seriously weakened position.

The Macroeconomic Background: Capital Is Flowing Out, Rates Are Climbing

The external macroeconomic background in October turned out to be sufficiently calm. Although oil prices displayed multi-vectored and rather sharp fluctuations, on the whole the per-barrel price of Brent as of the month's end was only 3.6% below its index as of 1 October. The ratio within the euro-USD pair over the month also remained nearly the same (\$ 1.29 and 1.30 per euro as of the month's beginning and end respectively). As demonstrated by October's results, the Russian ruble became somewhat weaker by comparison with the major currencies (by 1.4% relative to the USD, and by 0.9% relative to the euro); so, the bi-currency basket's value increased from Rb 35.25 as of 2 October to Rb 35.66 as of 31 October. The movement of stock market indices traditionally followed that of oil prices, and so the MICEX index fell by 4.3% (to 1426 points), and the RTS index – by 5.3% (to 1435 points).

As seen by October's results (1–29 October), monthly inflation growth amounted to 100.5%, and its full-year since January – to 105.7% (in 2011: growth over October – 100.5%, full-year index – 105.1%). As in September, the full-year inflation rate amounted to 6.6%. Over autumn, the prices of wheat flour, millet, sunflower oil, and gasoline were on the rise (+2%), having overcome the effect of the recent seasonal decline in the prices of fruits and vegetables. The accumulated inflation rate since 1 January was as high as 5.7% (5.1% in 2011).

In September, broad money base continued to display its downward trend, having shrunk over the month by 0.3% to Rb 8,082.8bn. This happened as a result of the nearly twofold drop in the volume of commercial banks' deposits with the RF Central Bank: as of 1 October, it amounted to Rb 90.8bn. Excess reserves of commercial bank were also on the decline in September, having dropped as of the month's end by 5.4% to Rb 844.5bn. At the same time, the monthly weighted average Moscow interbank interest rate (MIACR) on overnight credit rose in September to 5.5% against 5.3% in August. Banks' aggregate debt to the RF Central Bank as of the end of September remained at a high level, amounting to approximately Rb 2.2 trillion. Nevertheless, the Bank of Russia has no intention to bring down the scale of refinancing granted to banks: according to First Deputy Chairman of the RF Central Bank Aleksey Uliukaev, the amount of gross debt of Russian banks to the regulator is going to more than double over the next 3 years, increasing to Rb 6–7 trillion.

September once again witnessed net capital outflow from Russia. According to the RF Central Bank's preliminary estimates, in Q3 2012 net capital outflow amounted to \$ 13.6bn, thus exceeding the index recorded in Q2 by \$ 4.2bn. Still, this figure is lower than the one recorded in the same period of last year, when capital outflow became as high as \$ 18.4bn. By the results of the period of January–September 2012, capital outflow amounted to \$ 57.9bn, which is by \$ 12.4bn higher than in 2011.

The Real Sector: Rising Incomes and Hopes in Face of Stagnation

In Q3 2012, the growth rate of GDP dropped to 2.8% against 3.9% in Q2 2012 and 4.9% in Q1 2012. Thus, GDP growth over the period of January–September 2012 on the same period of last year amounted to 3.8%.

The upsurge in investor activity in the first half-year gave way to a dramatic slowdown in the rate of investment over the period of July–September. In Q3 2012, investment in fixed assets exceeded only by 1.4% their index for the same period of last year, whereas in Q1 their increase amounted to 16.6%. In September 2012 the movement of investment shifted to the negative zone (–2,3%). In September 2012, the volume of work in the construction industry dropped on September 2011 (–5.6%), as did the index of the volume of new housing put in operation (–7.2%).

The industrial production index over January–September 2012 amounted to 102.9% (against 105.2% a year earlier), including for mineral resources extraction – 101.0% (against 102.4% in 2011), and for the processing industries – 104.5% (against 107.2% in 2011). The declining growth rate in September gave rise to negative indices: the production volumes in mineral resources extraction and the dropped on August 2012 by 1.5% and 1.2% respectively.

The change in the general trend manifested itself most graphically in machine-building: in the post-crisis period, it was growth machine-building that acted as a significant positive factor that influenced the general indices. However, in September 2012 the production index for the manufacturing of machines and equipment amounted to 89.5% on the same period of 2011 (over January–

September – 100.4%). A positive dynamics in the production means of transportation and transport equipment (117.2% over January–September on January–September of 2011) was preserved due to a high output of passenger cars; but even in that sector, zero growth on September 2011 was observed in September 2012.

In the majority of sectors manufacturing intermediate products, a significant drop on the previous month was noted in September 2012: in the chemical industry – by 5.7 – 8.0%, depending on a given subsector; in forestry – by 3.4 – 7.3%. In September 2012, agricultural production amounted to 92.3% of the index for the same period of 2011 (over January–September – 97.7%), and output of foodstuffs – to 103.6% (105.6%).

Consumer demand growth over the period of January–September 2012 remained one of the major factors that sustained the economic indices. The retail turnover growth rate in January–September amounted to 106.3% (as it also did last year). This year's specific feature, however, is the trend towards intensive growth displayed by the population's real income and real wages against the backdrop of a stable slowdown in the rate of economic growth. On the whole, over January–September 2012, real income increased by 3.6%, and real wages – by 9.4% on the same period of 2011. In September 2012, growth of real disposable income was 103.8% on September 2011, and that of real wages – 106.6%. The accelerated growth rate of wages against that of labor productivity increases costs and brings down the financial and economic indices of companies. The share of gross profit in GDP in the first half-year of 2012 amounted to 26.2%, thus being 1.7 pp. below the same index for 2011.

On the whole, the trends that became visible in the national economy throughout Q3 make it doubtful that the full-year forecasted production growth index of 3.6% can indeed be achieved. At the same time, an acceleration of the growth rate in Q4 is very likely. According to the results of the business surveys conducted by the Gaidar Institute, in spite of lack of any fundamental changes in the actual movement of demand, output, prices and employment, the forecasts are becoming more optimistic. The combination of all the components of the Industrial Forecast Index produced an eight-month record high of the aggregate index value. Although, as demonstrated the estimates of enterprises, the rate of production growth in September once again amounted to zero (and so, according to industrialists, stagnation has persisted for four months in a row), the output plans demonstrate their growing desire to break through stagnation.

At the same time, enterprises have seemingly come to terms with the situation when it has become impossible to increase prices any further: the share of reports registering unchanged producer prices reached the level of 84%, which represents an absolute record high of the entire post-default period (since 1998). This, however, may become a problem in its own right: the share of reports where product cost is increasing at a higher rate than the level of prices has reached 25%. This is also a record high of the past ten quarters in a row, and is indicative of a decline of profitability in industry, which may restrict the potential of enterprises to increase their output. ●

THE POLITICAL AND ECONOMIC RESULTS OF OCTOBER 2012

S.Zhavoronkov

The October 2012 single day of voting produced approximately the same results for United Russia as were achieved by it in the 2011 parliamentary elections. The CPRF also had a good showing at the polls. The two other parliamentary parties – Fair Russia and the LDPR – did not manage to overcome the electoral threshold in most of the regions. The new parties created after the recent liberalization of the electoral law did not manage to achieve much success either. October saw the conclusion of the biggest transaction for years involving the Russian State. Rosneft bought out 100% of shares in TNK-BP from both the Russian shareholders and the British Petroleum. This transaction has indicated that, despite numerous official assurances to the contrary, the real course of the Russian government is not towards privatization of big-ticket properties but towards their nationalization.

In October 2012, Russia saw her single day of voting, in the course of which gubernatorial elections were held in five oblasts; deputies to regional legislative assemblies were elected in six subjects of the Federation; and a number of cities and towns held mayoral and municipal elections. All the incumbent governors running for reelection (of Belgorod, Bryansk, Ryazan, Amur and Novgorod oblasts) were soundly reelected, by winning more than 60% of the votes cast even in Bryansk and Ryazan oblasts, where electoral competition was exceptionally severe – Governor Nikolai Denin and Governor Oleg Kovalev gathered 65.2% and 64.4% of the votes cast there, respectively. However, it should be noted that gubernatorial elections were set to take place in those regions where positions of the existing governors were especially strong, while in the regions where their positions had been weak, governors had been replaced in the period from December to May 2012. Moreover, in Ryazan Oblast, a strong gubernatorial candidate, former State Duma member Igor Morozov, had quit the governor race in exchange for a seat on the Federation Council of the RF Federal Assembly, promised to him by the incumbent governor. As far as the gubernatorial candidates from the opposition parties are concerned, relatively high scores were earned only by the CPRF – in Ryazan Oblast (Vladimir Fedotkin with 21% of the votes cast) and Bryansk Oblast (Vadim Potomsky with 30% of the votes cast).

Regional legislative elections were different in some ways from the gubernatorial ones. Their results were in many respects comparable with those gained by *United Russia* in December 2011, but this time the ‘party of power’ owed a large part of its success to the low voter turnout typical of regional elections. In Saratov Oblast, *United Russia* gathered 77.9% of the vote – its best result in the October legislative elections. In the rest of the regions, *United Russia*’s success was more modest: 70.6% in Penza Oblast; 60.4% in Krasnodar Krai; 53.1% in Udmurtia; 50.1% in Sakhalin Oblast; and 46.2% in North Ossetia. The CPRF performed sufficiently strongly, gaining 18.9% of the vote in Krasnodar Krai; 18.3% in Sakhalin Oblast; 17.2% in Udmurtia; and more than 10% in each of the other contested regions (except for Saratov Oblast, a region plagued by vote fraud, where it gathered 8.2% of the vote). *Fair Russia* failed to overcome the 5-percent electoral threshold in Krasnodar Krai and Penza Oblast, while the LDPR failed to do so in Krasnodar Krai, Penza Oblast, Saratov Oblast, and North Ossetia. These two parties’ electoral efforts were hampered both by the insufficiency of funds for their election campaigns and by the new parties, whose participation in the elections made voting for ‘a lesser evil’ (and not for *United Russia* or the Communists) simply illogical. By the time of the October elections, Vladimir Zhirinovskiy’s LDPR had been positioning itself as a radical supporter of Vladimir Putin and *United Russia*, whilst at the same time vehemently attacking the opposition for six months in a row, and therefore had lost its image of “independence”. As a result, Putin’s supporters quite reasonably preferred to cast their votes for *United Russia* and not for these brand-new fellow travelers.

However, the failure of *Fair Russia* and the LDPR did not mean a big success for non-parliamentary or new parties. They managed to enter legislatures practically nowhere. The only exception was North Ossetia, where the *Patriots of Russia* list headed by politician-cum-businessman Arsen Fadzeyev had gathered 26.5% of the vote. Nevertheless, it is crystal clear that, even in this case, the role of the *Patriots of Russia's* brand is close to zero – if Fadzeyev had headed the list of the LDPR or that of *The Party of Social Networks*, the result would have been the same. Two to three percent each of the vote was collected by the projects that used the words “communist party” in their names, while the rest of the newcomers got nothing. In the elections to the Barnaul City Council, the 5% electoral threshold was overcome by the *Republican Party of Russia* headed by Vladimir Ryzhkov, who is well known in Altai Krai. However, this achievement can hardly be called “victory”, because Ryzhkov had previously collected 25 to 35% of the vote in federal elections, when running for parliament in a single-member district. Moreover, according to his own estimates, the Republicans’ list gathered up to 12% of the vote, including the votes “stolen” through fraud – not a very impressive showing for a party. Elena Chirikova, a prominent representative of the radical opposition, ran for the office of Mayor of Khimki (a town in the vicinity of Moscow). She managed to come second, with a modest result of 17% of the vote, while the official candidate Oleg Shakhov gathered 47.6% – and won. No violations were recorded at the majority of polling stations, and the voter turnout was 16% (during federal elections, the voter turnout usually stands at no less than 60%).

Thus, it can be said that the autumn-2012 single day of voting witnessed the preservation of the status quo: in conditions of a low voter turnout, *United Russia* achieved better – but not much better – results than it did in parliamentary elections. In a number of places, including North Ossetia, where the authorities had not managed to prevent splitting of the elites, this party’s results even deteriorated (to 46% from 67% in December 2011). At the same time, the opposition, and especially the non-parliamentary opposition, was taught a good lesson: the electorate’s tiredness of *United Russia* does not necessarily herald victory for the opposition and especially for the new opposition groups. Despite being adequately financed and sufficiently recognizable, and also having led an active election campaign, Elena Chirikova gathered less than 20% of the vote – a good result for a party list but a rather weak one for a personified campaign aimed at capturing the office of mayor, especially bearing in mind that Chirikova’s competitor, who had been appointed acting mayor on the eve of the election, was by no means a formidable opponent. As any election campaign is a costly undertaking, in many regions the opposition did not have enough money to keep any poll observers at the polling stations at all. Unfortunately, some representatives of the radical opposition, including Aleksey Navalny, do not simply ignore all these problems, but openly object to participation in election procedures on the pretext of their “inherent dishonesty”. Maybe the actual reason for their intransigence in this matter is fear of real elections with unpredictable results.

In October 2012, Minister of Regional Development Oleg Govorun, former head of the Domestic Policy Department of the Presidential Administration under Vladislav Surkov, became the first cabinet member to quit the new Russian government of Dmitry Medvedev. A month earlier, he had been officially and quite surprisingly reprimanded by Vladimir Putin for having failed to properly elaborate Russia’s draft budget. In the wake of the reprimand, he stopped attending office amidst rumors of his imminent retirement, which were later corroborated. Govorun was replaced by former Kostroma governor Igor Sliuniaev. Govorun’s retirement is an ominous sign for his patron Vladislav Surkov, who currently holds the posts of Deputy Prime Minister and Head of the Government Apparatus.

October also saw some unexpected developments at the RF Ministry of Defense. The sequence of events was as follows: the RF Investigative Committee (Russia’s top investigative agency) initiated a criminal case over the misappropriation of funds at *Oboronservice*, a state-controlled company subordinated to the RF Ministry of Defense; the police and investigators searched the apartment of Yevgenia Vasilieva, a close associate of Defense Minister Anatoly Serdiukov, and carried out the seizure of evidence; Vladimir Putin personally instructed the minister to “fully cooperate with the investigation”. The civilian minister of defense, who had long been a cause of irritation for the army top brass, and whose sacking had been predicted since the formation of the new government and even earlier, once again felt ill at ease.

October saw the end of the controversy over the future of TNK-BP, which had begun this summer. President of Rosneft Igor Sechin managed at last to gain Vladimir Putin's support for his idea of purchasing 100% of shares in TNK-BP. This transaction was the largest buyout in Russia's contemporary history, far surpassing the previous records – *Gazprom's* purchase of *Sibneft* and *Rosneft's* purchase of *Uganskneftegaz*, the key asset of *Ukos*. As a result of this two-stage transaction BP, will get \$ 17.1bn in cash and 12.84% of shares in the new, enlarged *Rosneft*, and then will purchase from *Rosneftegaz*, the nominal owner of *Rosneft*, another 5.66% of shares in *Rosneft*, at the same price of \$ 8 per share. The private owners of TNK-BP will get approximately \$ 28bn. It should be added, however, that many details of the concluded transaction are not completely clear as yet. As a result, the State will spend on this transaction part of the dividends accumulated in *Rosneftegaz's* accounts, while the net debt of *Rosneft* will increase from about \$ 20bn to \$ 70bn. This transaction does not violate anybody's property rights – the shares belonging to BP and those owned by Alfa Group's shareholders will be bought at a premium to their market price. However, once the transaction is executed, the State will be in control of more than one half of Russia's oil production (vs. 36% as of today), and a lot of serious doubts have already been raised about whether this situation is going to be really beneficial or not. For example, *Rosneft's* dividend for 2011 amounted to less than \$ 1 per barrel (while TNK-BP, soon to be absorbed by *Rosneft*, paid 10 times more); its debt to income ratio was 25% even before the transaction increased its debt twofold (while the debt to income ratio norm for big oil companies is set at 10%), and its operating expenses amounted to more than \$ 40 per barrel, which was 1.5 times higher than the market norm. Absolutely no success has been achieved in developing the continental shelf – the field that has been monopolized by *Rosneft* and *Gazprom* for five years already. Thus, as far as Russia is concerned, the economic effect of the transaction is extremely doubtful. Indirectly, this was acknowledged even by Vladimir Putin, who justified the transaction not by the State's interests but by BP's inability to come to terms with Russian shareholders.

It should be noted that the traditional speakers, who have been talking about privatization and the State's withdrawal from the economy for no less than five years in a row (e.g. Arcady Dvorkovich and Igor Shuvalov), have so far abstained from any comments on the transaction. However, it should be admitted that, in spite of Igor Sechin's yet another administrative victory, his capacity to influence the course of events has also been diminishing: Vladimir Putin cannot afford taking his side in all current commercial conflicts involving *Rosneft*. Although one of such conflicts has been resolved, many more remain smoldering – from conflicts related to the future of the continental shelf to those over the trading operations of *Rosneft*. Igor Sechin is fast approaching the stage of being actively opposed by the whole of the ruling elite. ●

INFLATION AND MONETARY POLICY

N.Luksha

In September the growth rate of food prices, higher cost of fuel, as well as a new stage of regulated tariffs indexing have provoked acceleration of consumer price inflation: as per the month results, CPI amounted to 0.6% (vs. 0% in September 2011). Within three weeks of October, there was no reduction in the growth rate of consumer prices, and on October 22 it was recorded at the level of 0.3% (against 0.2% in the same period of 2011). As a result, the cumulative inflation since the beginning of the year made 5.7% (vs. 4.9% in the same period of the last year). According to tentative estimates of the Central Bank, the net capital outflow from the country in Q3 reached \$13.6bn, exceeding the outflow in Q2 of this year. Thus, over the first nine months of 2012 capital outflow amounted to \$57.9bn (vs. \$45.5bn in the relevant period of 2011).

As of September results, the growth rate of consumer prices increased from 0.1% in August to 0.6% (in September 2011 prices were not growing). This acceleration in inflation is urged by another upsurge in regulated prices of natural monopolies, as well as growing prices for foodstuffs (in September 2011 food prices decreased by 0.6%).

The utmost contribution to the increase in consumer prices was made by commercial services, which rose in September by 1% (for comparison, in September 2011 those services decreased by 0.1%). The leaders in the growth of prices at the beginning of the new school year were educational services, which rose by 5.1%. Among other services under review the greatest price growth was noted in housing and public utilities (+2.4%), as well as fitness services (2.3%). With the completion of the peak of vacations season, healthcare and recreation services got cheaper (-2.6%), passenger transport (-2.8%) and international tourism (-1.4%). Prices for insurance services have also declined (-0.1%).

In September the growth rate of non-food goods has nearly doubled (+0.7%), having matched the indicator of September in the last year. Significant growth was observed in petrol (+2%). This is due to both, the seasonal demand for fuel, and the increase in the excise tax on petroleum products. The price of tobacco products continued to increase (+2.4%). At the same time, video and audio appliances were still getting cheaper (-0.2%).

Despite the seasonal price reduction in fruit and vegetable products, the growth rate for foodstuffs accounted to 0.1%, which is higher than the indicator of the same period in the last year, when in September food prices fell down by 0.6%. The greatest decrease in prices of the foodstuffs under review was noted in fruit and vegetables (-5.6%) and sugar (-5.4%). However, there was a significant price growth for eggs (+8.1%), as well as bread and bakery products (+2.1%) and pasta (+1.5%).

In September, the annual inflation (September 2012 against September 2011) has accelerated to 6.6% (*Fig. 1*), having exceeded the bottom threshold of the official estimates and coming close to the indicator of the last year (+7.2%).

In September the core consumer price index¹ has grown from 0.6% to 0.7%, went up again, having made 0.6% (vs. 0.4% in 2011), and the core inflation indicator in annual terms made 5.7%, having also exceeded the target indicator 5.5%.

In the first half of October, inflation has not slowed down and within a little more than three weeks of the month, on October 22 reached 0.5% (vs. 0.2% in 2011). The main factors of inflation were wheat flour (+4.1%), millet (+2.2%) and gasoline (+1.8%). Despite the record production of sunflower oil in September of this year (about a quarter more than in 2011), its prices were also

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).

increasing rapidly: in 22 days of October, oil prices rose by 3.5%. At the same time, there was a seasonal reduction in the prices of vegetables: potatoes (-3.7%) and cabbage (-9.2%).

Inflation accumulated from the beginning of the year, on October 22 reached 5.7% (against 4.9% in 2011). According to Ye.T. Gaidar IEP assessment, by the end of the year inflation will exceed the estimated by the Ministry of Economic Development value of 7%.

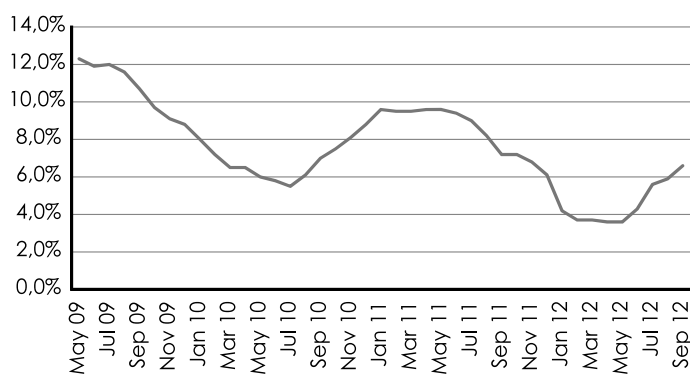
In September the monetary base in broad definition has continued to decline: over the month it decreased by 0.3% to Rb 8,082.8bn. This happened due to almost two-fold reduction of commercial banks' deposits with the RF Central Bank; on October 1, they made Rb 90.8bn. After the reduction of correspondent accounts of credit organizations by 17% in August, in September they increased by 4% to Rb 753.7bn. Other components of monetary base in broad definition were also growing. The volume of monetary base in broad terms has decreased in January–September of this year by 6.5% (against 9.6% over nine months of 2011).

In September, the excessive reserves¹ of commercial banks were still decreasing. At the end of the month they decreased by 5.4% to Rb 844.5bn. Herewith, the average rate on overnight MIACR bank loans in September rose to 5.5% against 5.3% in August. The total debt of banks to the RF Central Bank at the end of September remained at a high level, amounting to about \$2.2 trillion (Fig. 2). Note that the Bank of Russia has no intention to reduce the refinancing rate to the banks: according to the First Deputy of the Central Bank A.Ulyukaev, gross liability of Russian banks to the Regulator will grow more than two-fold in the next 3 years and reach Rb 7.6 trillion.

In September the monetary base in narrow definition (cash plus mandatory reserves) remained virtually unchanged, having slightly increased by 0.3% to Rb 7238.3bn (Fig. 3).

In mid-October, the volume of international reserves amounted to \$526bn (as of October 12), having increased by 0.6% over the month.

Whereas in the first half of October, the Bank of Russia did not participate in currency trading, in September, on the contrary, the Regulator made foreign exchange interventions: there were sold \$453.81m, which is by 18% more than in previous month and Euro 43.99m, which is, in contrast,



Source: RF Statistical Service.

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

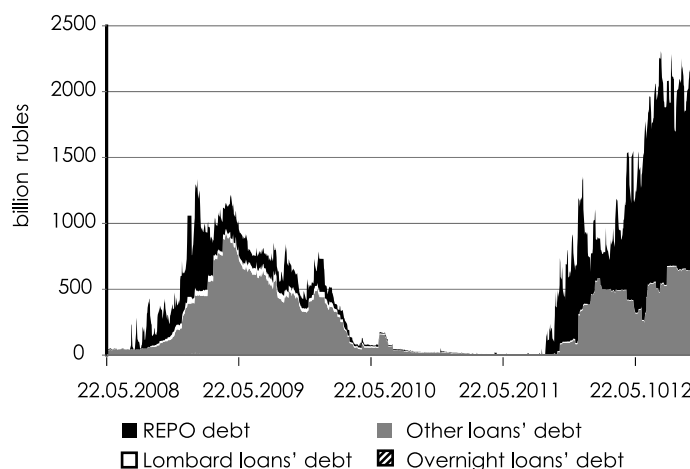


Fig.2. Arrears of commercial banks with the Bank of Russia in 2008–2012.

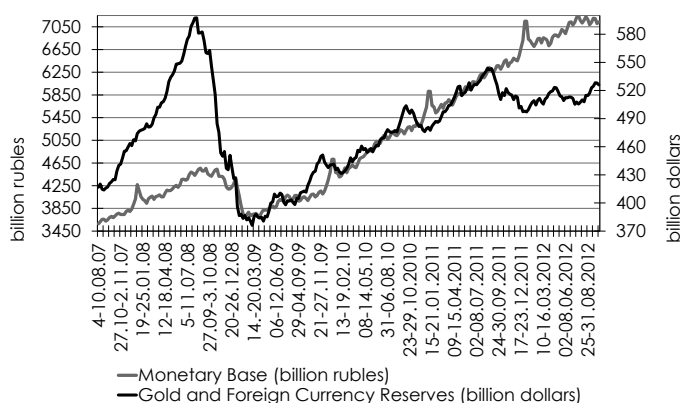
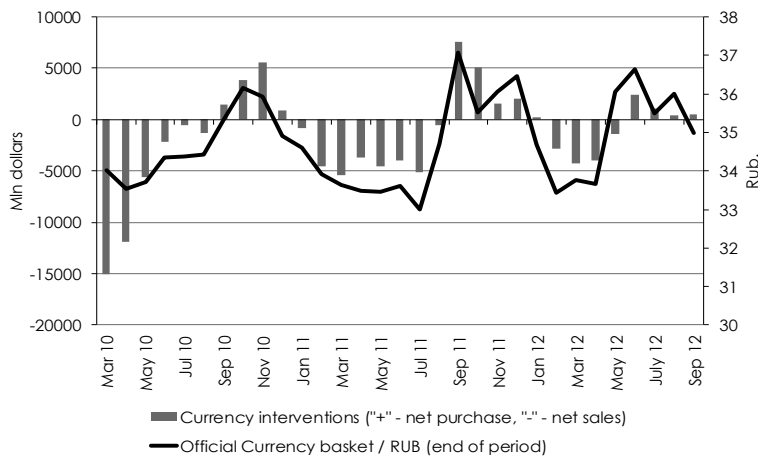
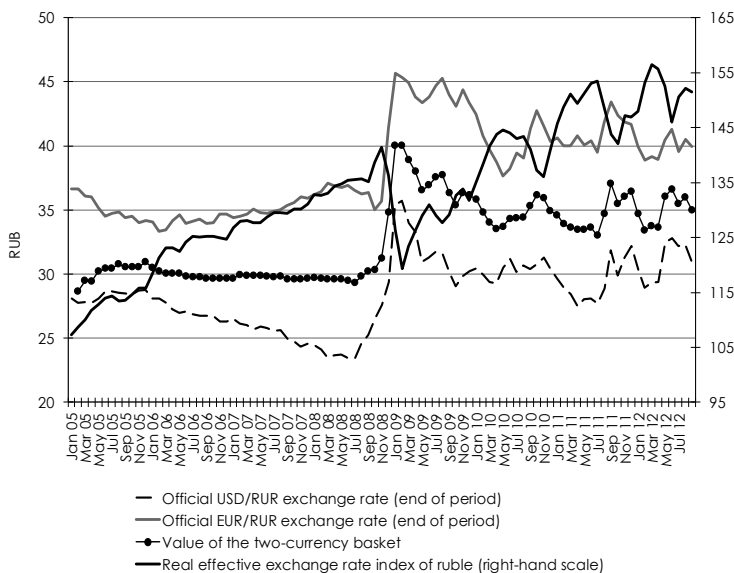


Fig.3. Changes in the Monetary Base and in the Gold and Foreign Currency Reserves in 2007–2012

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.



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



Source: RF Central Bank, author's estimates.
 Fig. 5. Indicators of ruble exchange rate dynamics in January 2005 – September 2012

by 7% lower than in August (Fig. 4). Therefore, foreign exchange interventions of the RF Central Bank remain insignificant.

In August an outflow of capital was observed again. According to tentative assessments of the RF Central Bank, in Q3 the net outflow has exceeded the outflow of Q2 by \$4.2bn and made \$13.6bn. However, it is lower than in the same period of the last year, when the outflow reached \$18.4bn. As per result of three quarters of the current year, capital outflow from the country amounted to \$57.9bn, which is by \$12.4bn more than in 2011. It should be noted that the official forecast of the Bank of Russia remains unchanged: the net capital outflow by the year result is expected in the amount of \$65bn. After growth in July-August, the real effective exchange rate of ruble in September started to decline again (-0.4%). As a result, index of the real effective exchange rate fell down to 151.52¹ (Fig. 5).

Since the beginning of October to the end of the second decade of the month the dollar/ruble rate was reducing: within 19 days of the month the dollar has declined by 1.7%. In this period, the ruble was supported by increasing global oil prices. Then, from October 19 to 24, due to decline in oil prices, the U.S. currency has grown by 1.3%. In addition to oil price, the dollar growth was urged by the investors' disappointment with the effect of the open EU summit, which led to a reduction in long-term risky assets, which include Russian currency.

During three weeks of October Euro against ruble was relatively stable, varying around the rate of Rb40.2/ Euro. After successful placement of bonds of Spain and Italy and the elections in Spain, Euro started to grow. As a result, in 24 days of October the European currency strengthened by 1%, reaching the level of Rb40.58/ Euro. During the same period, the two-currency basket has grown by 1.1% to Rb35.38.

On October 4 the Bank of Russia has published on its website the draft Guidelines for the Consistent State Monetary Policy for 2013 and the period of 2014 and 2015. By 2015, Russia plans to complete the transition to inflation targeting. In the framework strategy of progressively reducing growth rates the objective is set forth to reduce annual inflation to 4–5% by 2014. Herewith, for 2013 inflation target range is 5–6%. The Bank of Russia sees the reduction of direct involvement in the exchange rate and creating the conditions for the transition to a floating exchange rate (2015) as the main purpose of the exchange rate policy. With reduction of the RF Central Bank involvement in foreign currency market the interest rate management policy through liquidity provision

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

and withdrawal will be used as a key tool in the process of monetary regulation. The interest rates will be revised, as a rule, monthly, based on the analysis of inflation and economic activity.

Other important medium-term objectives set up by the Bank of Russia are as follows:

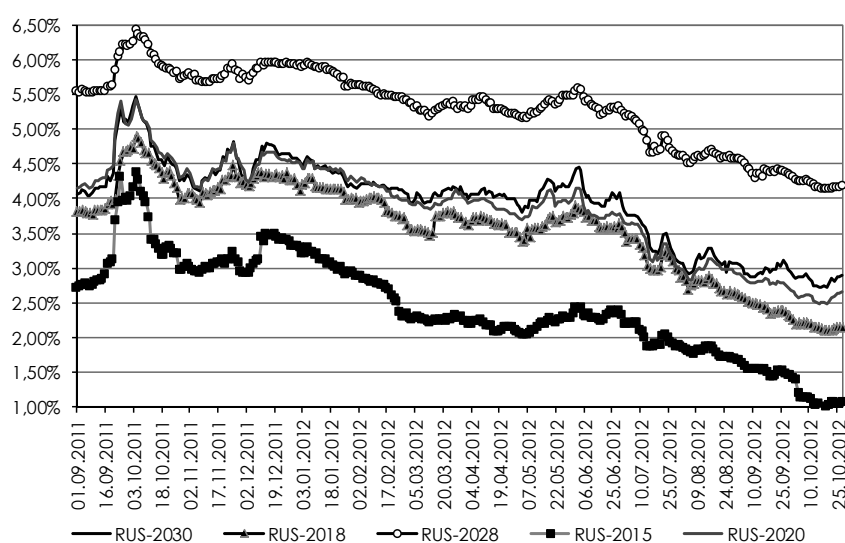
- maintaining financial stability (for the realization of this objective, the Bank of Russia will use international best practices in risks supervision, transparency of credit institutions, differentiated monitoring of financial institutions in view of their systemic importance). We believe that in pursuit of this objective great attention should be paid to the analysis of the banking system resistance to stresses given its high dependence on the refinancing from the government authorities;
- infrastructure of financial markets development and enhancement their capacity. In the transition to inflation targeting, particular importance will acquire the market of financial derivative instruments of risk hedging, including currency risks, which will be increasing with the volatility of ruble exchange rate;
- coordination of monetary and fiscal policy of the Russian government. The importance of such coordination in the situation of regulated tariffs contribution to inflation, as well as the impact of fiscal policy on the monetary supply in the RF is hard to be overestimated. Of course, balanced budget policy aimed at reducing the budget deficit and the national macroeconomic risks will help the RF Central Bank to achieve the objective in terms of inflation, but the influence of the Central Bank on fiscal policy is minimal;
- increasing transparency of the Bank of Russia in terms of monetary policy. In recent years, the Central Bank has made progress in improving the transparency of its policy and is now close to the best world practices, while at the same time, there are resources to improve the quality of analytical work, the analysis of macroeconomic situation and a more detailed presentation of grounds and effects of its decisions to the economic agents. ●

FINANCIAL MARKETS

N.Burkova, E.Khudko

In October 2012, continuing instability of the global economy has resulted in the sustained high volatility of the Russian financial market. The average daily turnover of the government securities market has increased by 51% over the month, while the turnover in the RF securities market has decreased by 23%, and by 3.8% in futures market. In the domestic corporate bond market the key monetary indicators: market volume and index, the activity of issuers and investors in the primary and secondary market were growing. At the same time, a decline was observed in the average daily market yield.

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 October, a decrease in the yield to maturity of all government securities was observed (Fig. 1). Within the period from September 25 to October 29, 2012, the total turnover in the secondary market of government bonds amounted to Rb 127bn with an average daily turnover at the level of Rb 5.1bn, which means the increase of the average monthly turnover by 51% as compared with the preceding period.

From September 25 to October 29 of the current year, like a month earlier, there were held five auctions in federal loan bonds (OFZ) placement in the primary market (Table 1). The total actual amount of place-

ment made 92% of the planned volume (against 55% 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
29.08.2012	ОФЗ-25080-ПД	20 000.00	19 160.00	7,53
05.09.2012	ОФЗ-26209-ПД	25 000.00	18 563.79	8,22
12.09.2012	ОФЗ-26207-ПД	35 000.00	34 230.00	7,79
12.09.2012	ОФЗ-26208-ПД	20 000.00	19 635.00	7,90
19.09.2012	ОФЗ-26209-ПД	20 000.00	19 099.50	6,98
Total:		120 000.00	110 688.29	

Source: Russian Ministry of Finance.

Stock market

Factors of the Russian stock market dynamics

Russian stock market volatility remained high in October. On the one hand, a negative impact on the stock market was made by the IMF reduced forecast of global growth in 2012–2013, and by the

World Bank estimates for economic growth in the East Asian region, as well as downgraded growth of German economy. On the other hand, the sustained key interest rates of the U.S. Federal Reserve, the European Central Bank and the Bank of England and positive statistics in the decline of the unemployment rate in the U.S. in September of this year supported the Russian financial markets.

In general, over the month, the markets of developed countries have downgraded by 1–5%, while since the beginning of the year they have grown by 5–25% on average. Emerging markets over the last month have shown volatile trends: from the growth of 1-5% to a similar reduction. The basic Russian indices decreased by 5% (*Table 2 and Fig. 2*).

Table 2

DYNAMICS OF THE GLOBAL STOCK INDICES

Index	Value (as of 24.10.2012)	Dynamics within the month (%)*	Dynamics from the year beginning (%)
MICEX (Russia)	1 431.90	-3.89	6.25
RTS (Russia)	1 435.05	-4.94	9.24
Dow Jones Industrial Average (USA)	13 107.21	-3.33	10.98
NASDAQ Composite (USA)	2 987.95	-5.47	21.33
S&P 500 (USA)	1 411.94	-3.09	15.85
FTSE 100 (UK)	5 795.10	-0.75	4.78
DAX-30 (Germany)	7 203.16	-2.83	25.68
CAC-40 (France)	3 408.89	-2.53	10.68
Swiss Market (Switzerland)	6 601.42	0.06	11.13
Nikkei-225 (Japan)	8 929.34	-1.54	7.26
Bovespa (Brazil)	57 176.58	-7.65	9.08
IPC (Mexico)	41 817.11	3.10	9.40
IPSA (Chile)	4 257.51	1.10	0.80
Straits Times (Singapore)	3 029.61	-1.25	15.93
Seoul Composite (South Korea)	1 891.52	-5.59	9.73
ISE National-100 (Turkey)	70 708.41	5.21	31.09
BSE 30 (India)	18 635.82	-0.20	20.82
Shanghai Composite (China)	2 058.94	1.27	-7.56
Morgan Stanley Emerging&Frontier Markets Index	782.16	-1.37	9.37

* versus index values as of September 24, 2012.

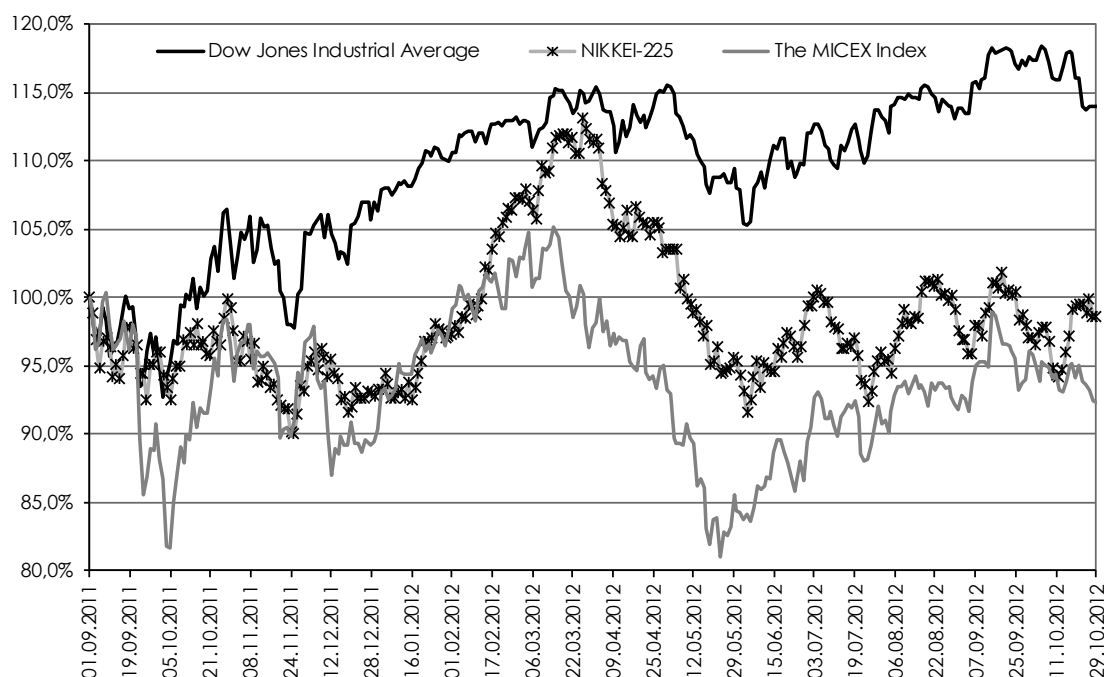
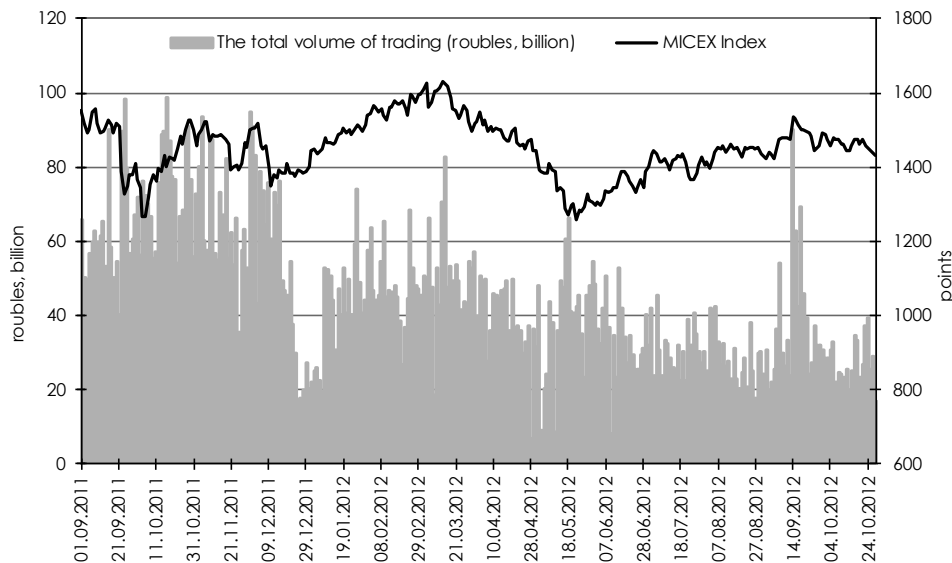


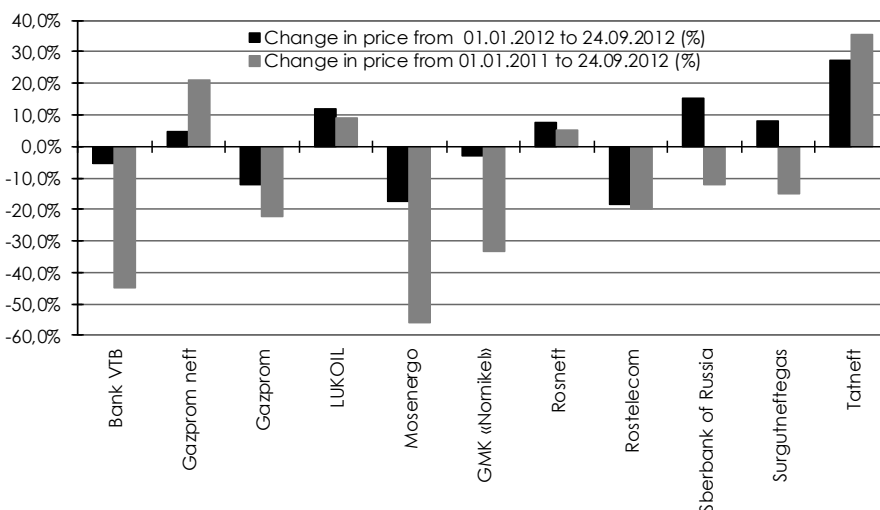
Fig. 2. Dynamics of the main USA, Japanese and Russian stock indexes (in % to the date 01.09.2011)

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

ingly, while the leaders of decline were Rostelecom and Mosenergo securities, downgraded by 18.2% and 17.4%, accordingly (Fig. 4). According to the OAO MICEX, on October 29 of this year, five leaders of the domestic market in terms of capitalization were as follows: Gazprom – Rb 3,569bn (against Rb 3,828bn on September 24, 2012), Rosneft – Rb 2,439bn (against Rb 2,203bn), Sberbank of Russia – Rb 1,976bn (against Rb 2,025bn), LUKOIL – Rb 1,604bn (against Rb 1,644bn) and Sugrutneftegas – Rb 978bn (against Rb 1,018bn).

Futures and Options Market

From October 1, 2012, in view of the completion of the FORTS and MICEX futures market sectors integration, which took place on September 17, admission to trading in futures contracts to the MICEX futures market sector was stopped. The contracts turnover has been fully transferred to FORTS futures market.

In FORTS market, the average daily activity of investors from September 25 to October 29, 2012 has decreased by 3.8% as compared with the previous month. Herewith, the leaders in terms of

Within the month, the maximum value of the MICEX index was demonstrated on October 1, having reached 1,490.2 p. (versus 1,535.4 p. in the preceding month). The minimum value of the MICEX index at 1,431.9 p. has been reached on October 29 (against 1,4217.6 p. in the preceding month) (Fig. 3).

Overall, in the period from September 25 to October 29, 2012, the MICEX index has declined by 3.9% (from October 30, 2011 to October 29, 2012, the MICEX index fell down by 6.2%), and the turnover of auctions included in the MICEX index reached Rb 736.8bn. Average daily activity of investors in the stock market in October has decreased by 23.1% as compared with the previous month.

Since the beginning of the year through October 29, 2012 the leaders in the value growth among the “blue chips”, like a month earlier were securities of Tatneft and Sberbank, which value has increased by 27.3 and 15.5%, accord-

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 Gazprom.

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/\$ 31.1–31.7, i.e., ruble strengthening (by 0–1.2%) is expected by some market participants; whereas others, on the contrary, expect ruble depreciation (by 0–0.7%) as compared with the indicator of September 29, 2012 (to Rb/\$ 31.48), and with the date of execution on March 15, 2013 - within the range of Rb/\$ 31.5–32.2. 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 40.5–41.2, i.e., a depreciation of the ruble by 0–1.2% is expected as compared with the indicator of October 29, 2012 –Rb/ Euro 40.7, and with the date of execution on March 15, 2013 – within Rb/ Euro 41.2–41.8.

The value of the futures contract for RTS index (based on prices of recent transactions) with the execution date on December 15 was within 1420–1510 points, i.e., market participants expect a 0–5.2% growth against the indicator of October 29, 2012. By March 15, 2012 market participants expect the RTS index value to be in the range of 1,430–1,500 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 1,440–1,500 points, i.e., market participants in general expect an increase of MICEX index in the range of 0.6–4.8%, as compared with October 29, 2012. By March 15, 2013 market participants expect the RTS index value to be in the range of 1,480–1,510 points. Options enjoyed a far less demand, from September 25 to October 29, 2012 their trading turnover made about Rb 345.9bn (versus Rb 4,999.7bn in futures). The leaders in terms of trading turnover were the marginal options for futures contracts on the RTS index.

Corporate bonds market

In October the volume of domestic corporate bonds market in Russia (at par value of circulating securities denominated in local currency) has significantly grown and at the end of the month made Rb 3,924.3bn, which is by 3.9% more than its value at the end of September¹. Therefore, the indicator has overcome its historical maximum peak once again. The significant growth of the market capacity is associated primarily with an increased number of bond issues (850 issues of corporate bonds were offered in the national currency against 828 emissions at the end of the previous month), though the number of emitters recorded in the debt sector has also increased (342 against 336 companies in September). In circulation there remains 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 October has also significantly increased, having reached its historical maximum over the last few months. Thus, from September 25 to October 29, the total volume of transactions in the MICEX amounted to Rb 144.0bn (for comparison, from August 27 to September 24, the trading turnover was equal to Rb 110.3bn), and the number of transactions within the period under review made 29.3 thousand (against 23.4 thousand in the previous period)².

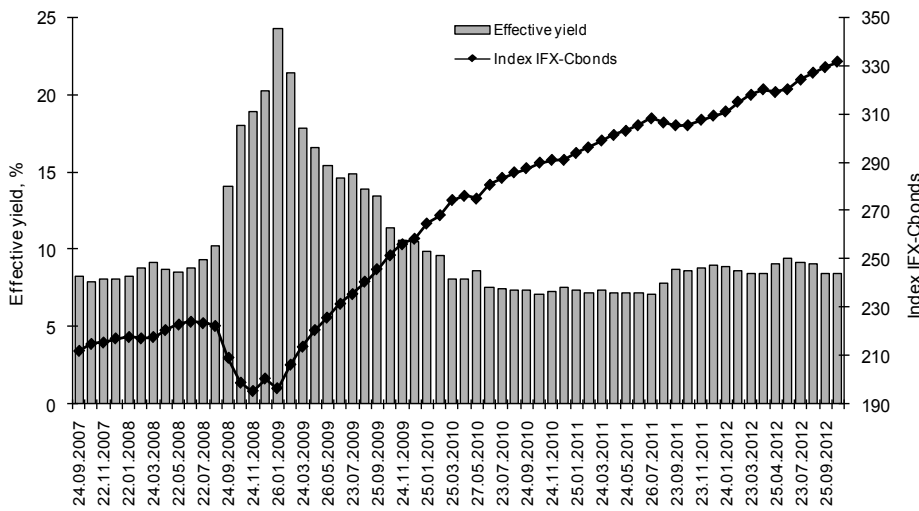
Index of the Russian corporate bond market IFX-Cbonds continued its growth trend. By the end of October its value increased by 2.1 points (or 0.6%) as compared with the value of late September. The average weighted yield, after its intense decline in the last month, in October remained unchanged at the level of 8.47% (*Fig. 5*). Further development of positive trend was hindered by adverse events in the Russian financial market, which include the lowering of ratings and forecasts by international rating agencies in regard to fairly large Russian emitters of the bond market³. In addition, an unfavorable situation was sustained at the global financial markets during the month, which is associated with the pessimistic macroeconomic statistics in the Eurozone, as well as with growing yields on sovereign bonds of Spain and Italy.

The portfolio duration indicator of corporate bonds continued to decrease, though not so expressed as in September, and in late October made 575 days, which is by 25 days less than at the end of previous month. In this case, the downgrading trend in portfolio duration reflects the reduc-

1 Rusbonds Information Agency data.

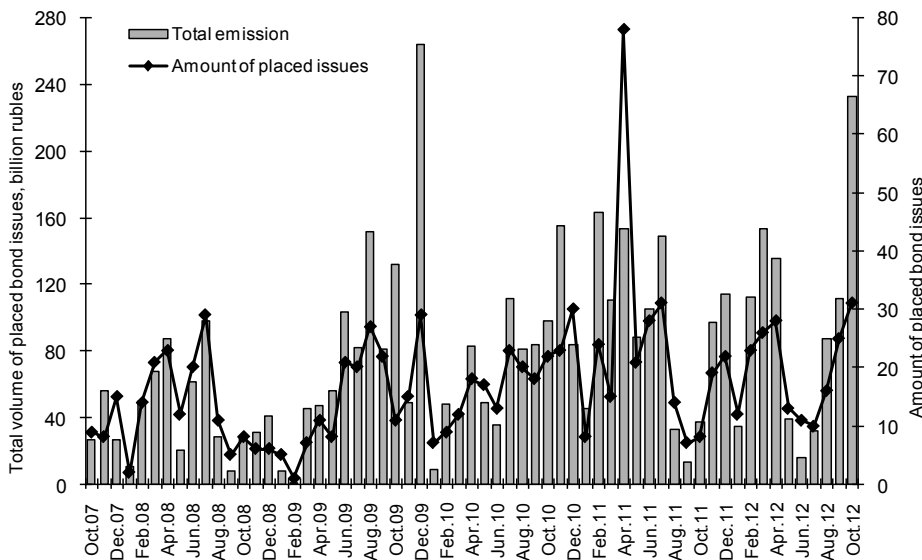
2 Finmarket Information Agency data.

3 Cbonds Information Agency data.



Source: Cbonds data.

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



Source: Rusbonds data.

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

September 25 there were registered 37 bond issues at the nominal value of Rb 172.0bn). It is possible that the activity of issuers will remain high in the coming months, as Q4 is usually characterized by high market indicators. Exchange bonds again made more than a half of registered issues.

Investor activity in the primary market has grown, though in view of the market situation volatility, investors showed interest mainly in the large emitters.

From September 26 to October 24 of the current year, twenty two emitters have placed 31 bonds with a total face value of Rb 233bn, which is the maximum indicator since late 2009 (from August 28 to September 25, there were placed 25 bonds with a total face value of Rb 111.4bn (Fig. 6). In October, several long-term loans were placed: three issuers have raised funds for 10 years, two of issuers – for 15 years, and the SC Vnesheconombank has placed bonds with maturity term up to 20 years.

In October this year, FFMS of Russia has recognized as invalid eight bond issues due to the non-placement of any securities security (in the previous two months the Regulator did cancel any state registration of issues due to non-placement of securities)¹. However, this indicates not the lack of

tion in the term of maturity of bonds in the corporate sector.

Though the average weighted yield in the bonds market in the expired period has not changed, the most liquid bond issues has grown. Maximum increase in the rates (more than 1 p.p.) was recorded in respect of securities of OAO “AFK System” (issue 03 series) and OAO “Mechel” (series 02, 14 and BO-02). The utmost volatility in the yield on various bond issues in both, downward and upward trends, like in September, was demonstrated by the issuers of the financial sector: “Bank Zenit”, “MDM Bank”, “Credit Bank of Moscow”.

In October, despite the market rates stabilization, rather high investors’ activity remained in the debt market sector. Thus, from September 26 to October 24 of the current year, fourteen emitters have placed 48 stock bonds series with the total nominal value of Rb 192.0bn (for comparison, from August 28 to

1 FFMS of Russia data.

investment demand at the bond market, but rather the changes of borrowing programs of issuers themselves, given that in October there were cancelled securities of such companies as “RUSAL Bratsk aluminum plant”, “VEB-Leasing”, etc.

From September 26 to October 24 of the current year, seven emitters have paid off their issues for the total amount of Rb 10.6bn in due time. Herewith, it should be noted, that one emitter failed to fulfill its liabilities to the bondholders in due time, and earlier two emitters have announced a technical default. In November 2012, twelve corporate bond issues totaling to Rb 71.7bn are expected to be paid off¹.

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 not been significantly changed against the previous month. Thus, in the period from September 26 to October 24, all issuers have fulfilled their current liabilities on time, or at least within the framework of a technical default (from August 28 to September 25, two issuers have announced a real default on coupon yield). However, one issuer announced a real default on redemption of the par value of the bond issue (there were no defaults in the previous period under review). Early redemption of the securities on offer, as well as in the previous period, were accomplished by all issuers in due time². ●

1 Rusbonds data.

2 Cbonds data.

REAL ECONOMY: TRENDS AND FACTORS

O.Izryadnova

In Q3 2012 the GDP growth rates slowed down to 2.8% versus 3.9% in Q2 and 4.9% in Q1 2012. In September 2012 as compared with September 2011 investments in fixed assets contracted by 1.3% and workload in construction – by 5.6%. In September 2012 for the first time in the post-crisis period growth rates in machine-building were observed to be below the average for manufacturing production and for the industry as a whole. Economic growth rates slowing down, acceleration of growth rates of the real incomes of the population by 3.8% and of the real wages – by 6.6% versus September 2011 contributes to the trend of the production costs increase due to the growth of labor remuneration costs and leads to the worsening of enterprises' operation results. The decrease of the general unemployment to the level that is the minimum for ten-year period can be characterized as a plus.

According to the estimations of the RF Ministry of Economic Development, in January–September 2012 as compared with the corresponding period of the previous year the GDP growth rates made 103.8%. In Q3 2012 the GDP growth rates slowed down to 2.8% versus 3.9% in Q2 and 4.9% in Q1 2012. The slowdown of the GDP growth rates in Q3 2012 is connected with the structural characteristics of the economic growth.

This year the investment and consumer demand are characterized by the decaying wave dynamics (Table 1). The upsurge of the investment activity in H1 2012 was interrupted in July–September 2012. In Q3 2012 investment in fixed assets exceeded the figure off the corresponding period of the previous year by only 1.4% (16.6% in Q1 and 8.5% in Q2 2012) and were insufficient to maintain the positive dynamics of workload in construction and regularity of residential floor area implementation. Although on the whole in January–September 2012 the indices of investment activity went up, when estimating the situation one should take into account that in September 2012 the investments in fixed assets decreased by 2.3%, workload in construction – by 5.6% and implementation of the residential floor area – by 7.2% versus September 2011. The RF Ministry of Economic Development estimated the growth rates of the investments in fixed assets to be at the level of 102.6% in H2 2012 versus the corresponding period of the previous year. As a result the increase in the investments in fixed assets in 2012 will make 5.5% versus 8.3% a year ago.

The growth of the consumer demand in January–September 2012 remained one of the main factors supporting the economic dynamics. However, quarter-by-quarter dynamics of the retail trade turnover in the current year reveals gradual diminishing of the demand growth rates for both the foodstuffs and the non-food goods. In January–September 2012 the growth rates of the retail trade turnover made 106.3% and were equal to the figure of the corresponding period of the previous year. The incomes of the population increasing, such dynamics can be accounted for by the change in the consumer behavior: in Q3 2012 the trend towards the proportion of expenses for foreign currency purchase was observed to expand while the proportion of savings and expenses for goods and services purchase was contracting.

Consumer prices index made 105.2% from the beginning of the year to September 2012 as compared with 104.7% in the corresponding period of 2011, the prices for the foodstuffs at the same time went up by 4.8% (0.8% in 2011), for non-food goods – by 3.7% (5.0%) and for paid services – by 6.7% (8.1%).

The dynamics of the industrial production was considerably influenced by the changes in the price situation at the domestic market. In September 2012 the index of producer prices for industrial goods made 104.8% (109.4% for the period from the beginning of the year), being 115.9% (131.7%) in mineral extraction, 101.3% (104.2%) in manufacturing industry, 101.6% (107.2%) in electricity, gas and water production and distribution. In September 2012 the growth of prices in fossil fuels extraction was mainly caused by the increase of prices for crude oil by 25.7%, and in manufacturing industries – by the increase in prices for coke and oil products production by 5.5%.

In spite of the fuel and electricity becoming more expensive manufacturing industries still stick to the policy of the reserved growth of prices. It is the foodstuffs production that is the exception due to the growth of prices for the raw materials as a result of the recession in agricultural production.

Table 1

MAIN MACROECONOMIC INDICES IN 2011–2012, AS PERCENTAGE TO THE CORRESPONDING PERIOD OF THE PRECEDING YEAR

	2011				2012			
	January–September	Quarters			January–September	Quarters		
		1	2	3		1	2	3
Gross domestic product	104.2	104.0	103.4	105.0	103.8*	104.9	103.9	102.8*
Investment demand								
Investments in fixed assets	105.0	99.2	105.1	107.7	107.2	116.3	106.5	101.4
Construction	107.9	101.6	101.0	107.6	101.9	105.2	105.4	97.3
Implementation of the residential floor area	102.8	97.6	95.2	114.3	102.7	105.7	98.7	104.2
Consumer demand								
Retail trade turnover	106.3	105.0	105.7	107.9	106.3	107.6	107.0	104.6
foodstuffs	101.9	101.3	100.8	103.4	103.5	105.2	104.6	100.9
non-food goods	110.7	108.7	110.7	112.3	108.9	109.7	109.1	108.1
Paid services rendered to the population	103.0	102.9	103.8	102.4	103.7	104.9	103.5	102.7
Goods production								
Industrial production volume	105.2	105.9	104.8	105.1	102.9	104.0	102.3	102.5
minerals extraction	102.4	103.3	101.7	102.2	101.0	101.9	100.4	101.2
manufacturing industry	107.2	110.6	105.8	105.7	104.5	104.4	104.7	104.5
electricity, gas and water production and distribution	100.6	99.0	101.9	101.4	101.3	102.6	100.8	100.0
Agriculture produce	118.6	100.7	100.6	129.7	97.7	104.0	104.3	94.6
Infrastructure services								
Freight turnover	103.8	103.9	105.2	102.4	102.0	103.8	99.8	102.5
Communication services	102.3				106.0			
Social parameters								
Real disposable monetary incomes	100.1	100.2	98.7	101.4	103.6	102.4	104.0	104.3
Real wages	102.6	101.6	102.7	103.8	109.4	110.3	111.3	106.9
Real volume of accrued pensions	100.9	102.7	99.4	100.6		104.4	106.8	
Labor market								
Total number of the unemployed	88.3	85.7	88.1	91.8	85.3	86.7	84.8	84.4
Number of officially registered unemployed	75.3	73.1	75.4	78.0	79.5	80.1	78.5	79.9
External factors								
Foreign trade turnover	133.0	129.3	139.4	130.0	103.4*	114.9	98.1	99.4*
export	131.4	122.8	137.3	133.7	103.7*	116.5	98.3	97.9*
import	135.6	142.5	142.6	124.7	103.2*	112.1	97.8	101.4*

Source: RF Ministry of Economic Development, Federal State Statistics Service

* preliminary data

In January–September 2012 the index of the industrial production was equal to 102.9% (105.2% a year ago), being 101.0% (102.4%) in minerals extraction, 104.5% (107.2%) in manufacturing industry. At the same time in September 2012 the volumes of the mineral extraction and manu-

facturing production were observed to decrease as compared with August 2012 by 1.5% and 1.2%, correspondingly.

In January–September 2012 the index of fossil fuels extraction made 101.4% versus the corresponding period of 2011, oil extraction volume being 385.6m tons exceeding by 1.0% the corresponding figure of 2011, natural gas extraction volume being 476.4bn cu m (97.0% of the figure of 2011). In January–September 2012 the Russian oil refineries received 200.6m tons of crude oil for processing (104.2% versus the corresponding period of 2011) and 178.5m tons (99.3%) was directed to export. The proportion of the oil processing in the total volume of oil extraction went up to 52.0% in January–September 2012 as compared with 50.4% in the corresponding period of 2011. Oil products production index in January–September 2012 as compared with the corresponding period of 2011 made 102.4%, in September 2012 the growth rates of the volume of the primary oil processing making 105.1% versus September 2011.

According to the live data of the RF Ministry of Energy, in January–September 2012 as compared with January–September 2011 the consumption of the natural gas in the domestic market went down by 1.7% and its export – by 6.0%.

In August and September of the current year the manufacturing industry was characterized by the decrease in the output versus the preceding month, which determined monthly negative dynamics of the industrial production on the whole over Q3 2012.

Since in the post-crisis period dynamic recovery of the machine-building industry had a considerable effect on the aggregated figure of the manufacturing industries development, it should be noted that this year a sharp slowdown of the growth rates in all types of machine-building industries was observed. In September the registered growth rates for machine-building industries have been the lowest for the elapsed period of 2012. This month as compared with the corresponding period of 2011 the index of the machinery and equipment production made 89.5% (100.4% in January–September), of the electric, electronic and optical equipment production – 100.3% (105.2%), of the transport vehicles and equipment production – 100.0% (117.2%). The positive dynamics in transport vehicles and equipment production is still maintained due to passenger cars production which compensates for the decrease in trucks and some types of railway equipment production.

The investment activity and demand for the capital goods growth rates slowing down, the production of the construction materials, construction and metallurgy products is still characterized by anticipating growth rates, the machinery and equipment stocks growing simultaneously. The comparison of the dynamics of the main indices of the investment market reflects the delay in the producers' reaction to the changes in the situation with the internal demand and can later result in considerable changes in the output plans for the production adjacent with the construction complex.

In September 2012 the majority of the intermediate goods productions were observed to decrease the output considerably as compared with the previous month: chemistry industry – by 5.7–8.0% depending on the type of activity, in timber industry – by 3.4–7.3%. The slowdown of the growth rates versus September 2011 and decrease in the production as compared with the previous month reflects both the internal limitations in the development of particular enterprises (production facilities, staff reserves) and the change in the demand for the production at the internal and external markets.

Out of the industries producing consumer demand goods it is only the foodstuffs production that is characterized by the steady positive dynamics at the moment. Textile and sewing industry, as well as production of leather, leather goods and footwear are contracting as compared with the previous year. However analyzing the dynamics of the foodstuffs production, one should take into account the impact of the agriculture production. The decrease in the agriculture produce output has resulted in the systematic slowdown of the foodstuffs production throughout 2012. In September 2012 the agriculture production volume made 92.3% versus the corresponding figure of 2011 (97.7% over January–September), and foodstuffs output – 103.6% (105.6%).

Taking into account the existing trends of Q2 and Q3 2012, it seems difficult to reach the growth of industry of 103.6% this year declared in the RF Ministry of Economic Development forecast.

The current year is specifically characterized by the intensive growth of the real income of the population and real wages against the background of the steady slowdown of the economic growth

rates. On the whole in January–September of the current year the real incomes went up by 3.6%, real wages – by 9.4% as compared with the corresponding period of the previous year. In September 2012 the growth of the real disposable incomes made 103.8% versus the figure of the previous year and the growth of real wages – 106.6%. The anticipating growth of real wages versus labor efficiency results in the increase of the production costs and worsening of the financial and economic result of enterprises' operation. The proportion of the gross profit in the GDP in H1 2012 made 26.2% and was 1.7% below the corresponding figure of 2011.

It should also be noted that the situation at the labor market is exceptional for the past ten years – the level of the unemployment (as calculated by ILO methodology) is at the lowest and made 5.2% of the total number of the economically active population in September 2012. For a year the demand for the workforce from the employers as declared to the state employment agencies has been observed to grow as compared with the previous year. As at the end of September 2012 the job bank contained information about 1.57m of vacant positions while only 1.02m of the unemployed was registered in the unemployment agencies. The tension coefficient decreased due to the contraction of the number of the registered unemployed and made 74% 100 declared vacant positions as at the end of September 2012 as compared with 98.8 a year ago. ●

RUSSIAN INDUSTRY IN SEPTEMBER 2012

S.Tsukhlo

According to the outputs of the Gaidar Institute's surveys¹, in September a lack of principal (the more so, crisis) changes in the actual dynamics of the demand, output, prices and employment takes place in industry together with growth in optimism of forecasts. In the 4th quarter, enterprises are prepared to pull Russian industry out of stagnation.

Industrial Optimism Index

In September, the main drivers of growth in optimism in industry (Fig. 1) were evaluations of stocks of finished products and output plans.

All the components of the Industry Forecasts Index (dynamics of the demand, output, prices and employment) (Fig. 2) ensured growth in the composite index to the eight-month maximum.

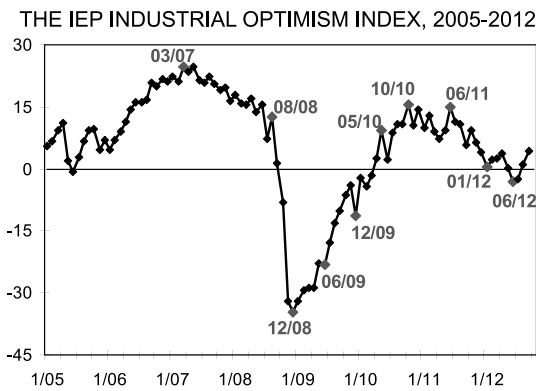


Fig. 1

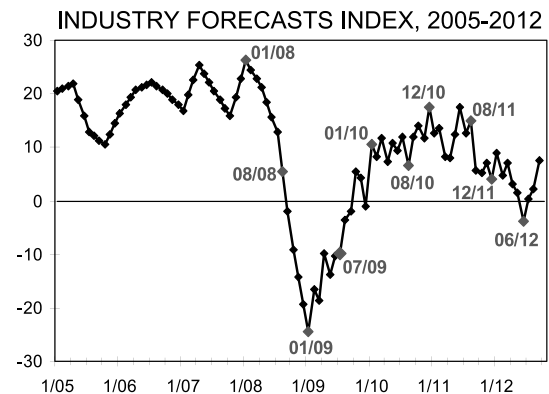


Fig. 2

Demand on industrial products

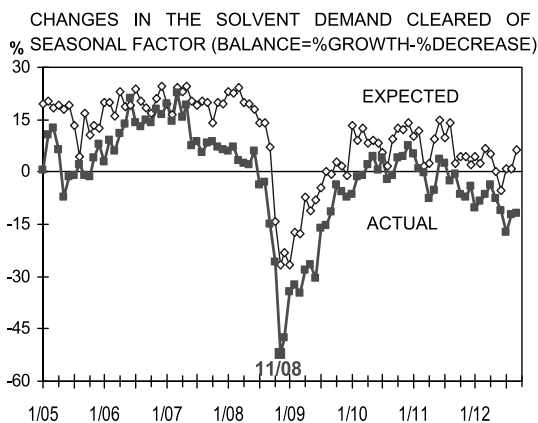


Fig. 3

In September, the actual dynamics of the demand did not undergo any changes either in the input data or the data cleared of the seasonal factor. According to the estimates of enterprises, sales keep decreasing, but not at such a high rate as in the beginning of the quarter. Due to a lack of positive changes in the dynamics of the demand, satisfaction with its volumes fell by 4 points; as a result only 50% of industrial enterprises think that their sales volumes are "normal". The best result of 2012 was registered in April and it amounted to 57%.

The input data on the forecasts of the demand (Fig. 3) has shown for four months running a surprising stability of the balance at the zero level: growth expectations are counterbalanced by recession forecasts. So, from the beginning of summer the industry cannot make up its mind about the direction of the change in the main economic indicator and remains in the wait and see state.

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%.

Stocks of Finished Products

In September, the balance of stocks of finished products (*Fig. 4*) kept declining and fell to the zero level; it is to be noted that the above trend emerged in June. As a result, in the past four months the above index lost 13 points and is about to fall into the negative area where “below the norm” estimates dominate over “above the norm” ones. Such a situation took place late in 2010 when enterprises minimized their inventory stocks due to a loss of confidence in early revival of industrial growth. However, the same factor creates an additional impetus to the industry in case hopes for revival of growth arise.

The Output

According to the estimates of enterprises and after clearing of the data of the seasonal factor (*Fig. 5*), in September growth rates of production were at the zero level again. As a result, for four months running surveys have shown both stagnation in the Russian industry and the worst period in its history from the mid-2009 if the industrial production index – which is the only index of Rosstat available to most consumers – is used. Surveys permit to evaluate the state and sentiments in the Russian industry with utilization of a larger number of indices which are partially unavailable to the Rosstat. As regards industrial production, it concerns plans to change output volumes in the forthcoming months (that is, in September 2012 in respect of plans for the 4th quarter of 2012). Throughout the past quarter, the above index showed industrial enterprises’ growing intention to break away from stagnation and switch over to consistent output growth. As a result, in June–September the balance of expectations rose by 17 points and amounted to the 12-month maximum level. In the 4th quarter, industry is ready to switch over from zero growth rates to positive dynamics of the output.

Prices of enterprises

Moderate growth in producer prices may become a factor behind revival of the demand and output (*Fig. 6*). After a surge in July, it returned to the minimum rates which were registered in March–June, while a share of reports about selling prices remaining unchanged amounted to 84% which is the absolute record in the entire post-default period from 1998. In addition to the above, in the 3rd quarter of 2012 enterprises demonstrated slower growth rates of their prices as compared to growth in expenditures: a share of reports about growth rates of production costs being faster than those of prices amounted to 25%. The above value has become the maximum one in the past ten quarters, that is, from the 1st quarter of 2010 the industry’ cost-effectiveness has never dropped to such a low level as in the past quarter. The absolute maximum loss of cost-effectiveness in industry was registered on

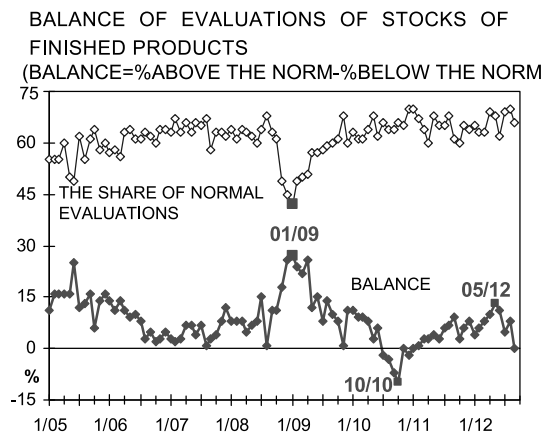


Fig. 4

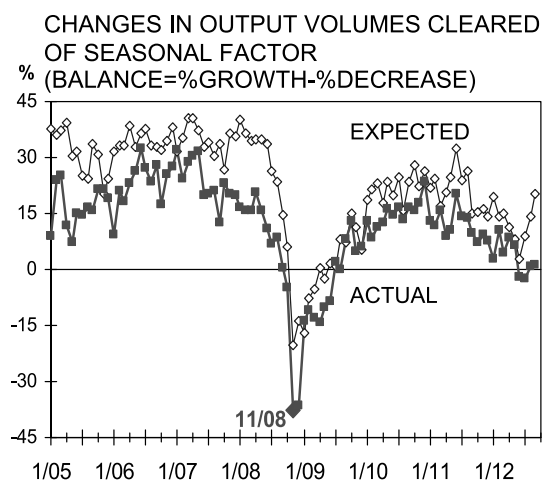


Fig. 5

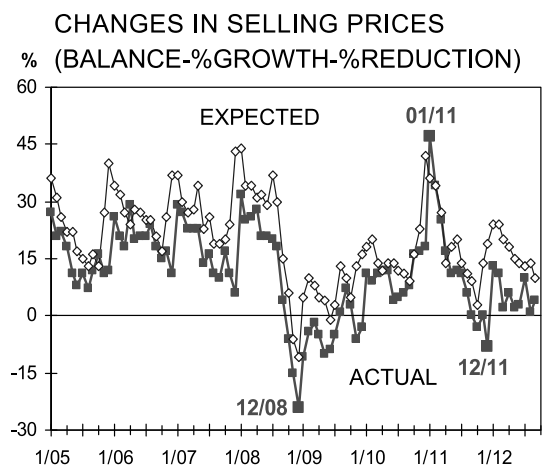


Fig. 6

the basis of surveys in the 1st quarter of 2009 when growth in prices lagged behind growth in expenditures with 49% of enterprises.

Pricing plans show that the industry intends to use that factor for revival of sales in future, as well. In September, the balance of pricing plans decreased by another 4 points. It is to be noted that at the end of the first half-year the industry intended to preserve growth rates of prices at the same level, rather than increase them.

Actual dynamics and lay-off plans

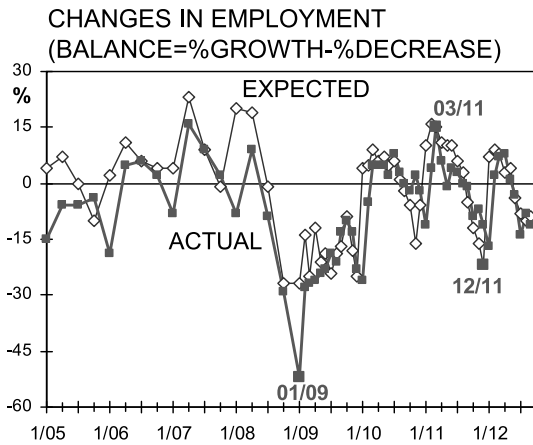


Fig. 7

In September, the number of the employed in industry kept decreasing (*Fig. 7*). According to surveys, growth rates of reduction of the number of the employed rose by 3 points as compared to August and, thus, point to the fact that large-scale lay-offs in industry continued throughout the 3rd quarter of 2012. However, such a situation was forecasted by enterprises. Plans to change the number of workers in the past quarter were the worst ones in 2012. The initial balance was within the range of -10...-8 points. However, formal methods of clearing of the seasonal factor changed the dynamics of employment forecasts: in September they showed an improvement of 5 points with the negative value of the balance preserved. The latter means that the number of workers keep decreasing, but at a slower rate than in June–August when the 3-year maximum was registered (that is, the highest rate of lay-offs). ●

STATE BUDGET

T.Tishchenko

According to the Federal Treasury, the federal budget for the first nine months of 2012 was executed with a surplus of Rb 637.8bn, or 1.5% of GDP. The sustained for several months federal budget surplus and the growth rate of non-oil and gas revenues provide grounds to suggest that as of the year outcome, there will be a surplus in the federal budget¹. In early October, the decision of the Russian Ministry of Finance was disclosed on preparing one more package of amendments to the expenditure part of the federal budget of the current year with about Rb 300bn, which is expected to approve the zero deficit of the federal budget, the redistribution of budget expenditures within budget sections (about Rb 100bn) due to savings in some budget lines and the use of additional revenue from Savings Bank privatization² (about Rb 148bn) and “Rosneftegaz” dividends (about Rb 50bn).

Analysis of key indicators of the federal budget execution over 9 months of 2012

Federal budget revenues in January–September 2012 amounted to Rb 9384.5bn (*Table 1*), i.e., decreased by 0,2 p.p. of GDP against the relevant period of 2011, while the increase in oil and gas revenues for the nine months made 0.3 p.p. of GDP, as compared to the relevant period of the last year. Within January–September 2012, budget expenditures increased to Rb 8746.7bn (19.9% of GDP), which is by 1.2 p.p. of GDP more than in nine months of 2011. As a result, the federal budget was executed with a surplus of 1.5% of GDP, which is by 1.4 p.p. of GDP lower than in the relevant period of 2011. Non-oil deficit of the federal budget increased by 1.6 p.p. of GDP and reached the level of 9.3% of GDP.

Table 1

KEY INDICATORS OF THE RF FEDERAL BUDGET OVER 9 MONTHS OF 2011–2012

	January–September 2012		January–September 2011		Change, p.p. of GDP
	Rb bn	GDP%	Rb bn	GDP%	
Expenditures, including:	9384.5	21.3	8211.1	21.5	-0.2
Percentage expenditures	4739.6	10.8	4007.9	10.5	0.3
Non-percentage expenditures	8746.7	19.9	7121.7	18.7	1.2
Federal budget surplus (deficit)	274.2	0.7	215.2	0.6	0.1
Non-oil and gas deficit	8472.5	19.2	6906.5	18.1	1.1
GDP estimates	637.8	1.5	1089.4	2.9	-1.4
	-4101.8	-9.3	-2918.5	-7.7	-1.6
	44077		38209		

Source: Ministry of Finance of Russia, RF Federal Treasury, Gaidar Institute assessments/

Dynamics of the federal budget revenues within nine months of the current year (*Table 2*) shows the increase in revenues as compared to the same period of the last year in terms of MET by 0.3 p.p. of GDP, in internal excise duties – by 0.1 p.p. of GDP against nine months of 2011. There is noted a reduction in the federal budget revenues in January–September of this year in terms of VAT by 0.3 p.p. of GDP and income from foreign trade by 0.2 p.p. of GDP as compared to the relevant period of 2011. Reduction of the federal budget revenue from foreign economic activity in terms of GDP share was due to the decreased revenue from export duties on crude oil by 0.1 p.p. of GDP for the first

1 Source: RIA Novosti, 15.10.2012, the “Ministry of Finance will review the parameters of the RF budget deficit for 2012 from 0.2% of GDP to 0%, the Minister Anton Siluanov said to the journalists.

2 Earlier, the government decided to credit to the federal budget revenue of the Central Bank from Sberbank package privatization in full.

nine months of the year against nine months of 2011. Revenue for the nine months of 2012 from income tax and excise duties on imported goods in terms of GDP share remained at the same level of the relevant period of the last year.

Table 2

DYNAMICS OF FEDERAL BUDGET REVENUES FROM BASIC TAXES IN JANUARY–SEPTEMBER
2011–2012

	January–September 2012		January–September 2011		Change, p.p. of GDP
	Rb bn	GDP%	Rb bn	GDP%	
1. Revenue, including:					
corporate profit tax	286.7	0.7	260.8	0.7	0.0
VAT on goods sold in the RF territory	1438.1	3.3	1340.8	3.5	-0.2
VAT on goods imported to the RF territory	1206.1	2.8	1087.9	2.9	-0.1
Excise duties on goods manufactured in the RF territory	246.2	0.6	170.7	0.5	0.1
Excise duties on goods imported to the RF territory	37.6	0.1	31.2	0.1	0.0
MET	1810.6	4.1	1454.6	3.8	0.3
2. Revenue from external economic activities	3625.7	8.3	3224.5	8.5	-0.2

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

In the first nine months of 2012, the estimated revenue of the federal budget was executed in terms of: corporate income tax – by 77.1%, domestic VAT – by 76.9% on domestic excise duty – by 70.7%, VAT and excise duties on goods imported into the territory of the Russian Federation – by 66.4% and 67.3%, respectively, MET – by 86.8%, export customs duties – by 83.5%. Given the expected in the second half of the year decline in economic growth and, consequently, reduction in corporate income tax and VAT, growth of the revenue part of the federal budget in excess of the projected amounts will be achieved through revenue from MET. Despite the decline in revenues from export duties on crude oil in the first nine months of 2012 in terms of GDP share as compared to the relevant period of the last year, revenues of the federal budget from the export duty for the year may also be higher than estimated level in case of ruble weakening.

The federal budget surplus allowed to adjust plans for privatization. Back in mid-September, the Minister of Finance Anton Siluanov said at the meeting of the Government that the proceeds from privatization of state companies in 2012 may amount to Rb 200bn, rather than the earlier planned Rb 300bn, and the Head of the Ministry of Economic Development of Russia Andrey Belousov noted that the privatization of companies, planned for 2012 can be carried forward to the beginning of 2013. Currently, the proceeds from the sale of shares and land owned by the state for the first nine months of 2012 accounted for only 2.2% of the approved amount. Part of the additional revenue from the sale of 7.6% of Sberbank shares owned by Central Bank in the amount of Rb 62,6 bn upon approval of amendments to the 2012 budget will be addressed for the capitalization of the Russian Direct Investment Fund (RFDI)¹.

The dynamics of the federal budget for the first nine months of this year as broken down by sections of functional classification (*Table 3*) shows the growth of funding under the budget lines “National Defense” by 0,4 p.p. of GDP, “National security and law enforcement” by 0.5 p.p. of GDP, “Education” by 0.2 p.p. of GDP, “Healthcare” by 0,1 p.p. of GDP, “Social Policy” by 0.6 p.p. of GDP as compared to January–September 2011.

¹ Apparently, there is an agreed position of the Ministry of Finance and the Central Bank on this issue, as the Ministry of Finance of Russia supported the proposal of A. Ulyukayev, the Head of the Supervisory Board of the Fund, the First Deputy Chairman of the Central Bank of Russia, on allocating Rb 62.6bn annually to the RFDI; otherwise, if the fund donations are not be included in the budget for 2012–2015, the Fund, according to the Central Bank, will be virtually suspended. When creating RFDI in 2011, the decision was made initially on the capital of the Fund in the amount of \$10bn with its further extension by \$2bn per year. Source: Russian Ministry of Finance website.

For some sections expenditures of the federal budget over January–September 2012 in terms of GDP share versus the same period of the last year have declined, including such budget lines as “Housing and public utilities” and “Intergovernmental transfers” by 0,3 p.p. of GDP each, “Physical Training and sports”, Federal issues”, “Mass media” by 0.1 p.p. of GDP each. In the other sections federal budget expenditures in terms of GDP share for the first nine months of the year remained at the level of the relevant period of the last year.

Table 3

FEDERAL BUDGET EXPENDITURES IN JANUARY–SEPTEMBER 2011–2012

	January–September 2012			January–September 2011			Change, p.p. of GDP
	Rb bn	GDP%	Cash execution, %	Rb bn	GDP%	Cash execution, %	
Expenditures, total:	8746.7	19.9	68.3	7121.7	18.7	64.3	1.2
Including							
Federal issues	521.9	1.2	61.0	489.4	1.3	57.9	-0.1
National defense	1256.5	2.9	67.5	942.4	2.5	59.1	0.4
National defense and law enforcement	1131.2	2.6	61.2	790.8	2.1	63.4	0.5
National Economy	1126.1	2.6	63.0	968.6	2.6	54.4	0.0
Housing and public utilities	68.7	0.2	48.5	158.0	0.5	67.1	-0.3
Environmental protection	15.9	0.1	71.0	10.3	0.1	58.9	0.0
Education	475.9	1.1	77.0	346.5	0.9	61.8	0.2
Culture and cinematography	54.4	0.2	59.9	47.9	0.2	54.6	0.0
Healthcare	378.6	0.9	61.6	298.9	0.8	59.2	0.1
Social policy	2923.0	6.7	74.9	2298.7	6.1	73.4	0.6
Physical training and sports	30.6	0.1	69.9	51.5	0.2	70.5	-0.1
Mass media	57.7	0.2	76.4	40.3	0.1	65.6	-0.1
Public and municipal debt servicing	274.2	0.7	71.6	215.2	0.6	61.5	0.1
Interbudgetary transfers	432.0	1.0	76.0	481.6	1.3	77.2	-0.3

Source: Federal Treasury, Gaidar Institute assessments.

One reason for the changes of certain budget lines is the difference in cash execution of the federal budget for the first nine months of the current against previous year. For example, if the section “National Defense” cash execution of the budget for January–September accounted to 67.5%, in the first nine months of the last year it made only 59.1% of the approved amount of federal expenditures. The worst situation with cash execution of the federal budget for the first nine months is observed in the section “Housing and public utilities” – only 48.5% of the approved expenditures. Herewith, if the federal budget spending under “Housing” line for the first nine months of the current year at 45.0% of the approved amount can be explained by the transfer of works completion to the end of the year, the reduced disbursement of funds under “Public utilities” budget line at 17.0% of the approved amount, to a greater extent is the result of inefficient administration.

Analyzing the dynamics of cash execution of the federal budget expenditures over the first nine months of this year, we should admit that the Ministry of Finance decision to reallocate budget resources between its sections due to savings was insufficiently substantiated. Refusal to finance certain budget lines gives grounds to assume that not all budget expenditures approved in the federal budget law in 2012, were distributed with due regard to their feasibility, effectiveness and principles of performance-based budgeting. The unutilized budget resources raises a question

about the quality of public finance management¹ and the level of responsibility of the heads of ministries and other government agencies for the budget execution.

It is also worth noting that the inflation growth above the level envisaged in the budget 2012² may result in the need to extend budget allocations (for housing and public utilities, telecom services, and the acquisition of current assets) in the last quarter of this year.

According to the Russian Ministry of Finance, the balances of the Reserve Fund and the National Welfare Fund have slightly declined in September of this year as compared to late August and totaled to Rb1,900.1bn (- Rb 53bn) and Rb 2,708.6bn (- Rb 64bn), respectively.

Management of the Reserve Fund and National Welfare Fund is executed by the Ministry of Finance of the Russian Federation, and some powers of the sovereign Funds administration can be performed by the Central Bank. Since 2013, it is proposed to transfer these powers to a new body – Rosfinagency³. Under the relevant draft law, prepared by the Russian Ministry of Finance, Rosfinagency will not only perform functions of the allocation and accounting of the Reserve Fund and the National Welfare Fund, but those of placement, redemption, exchange, service, accounting and repayment of government debt liabilities on government securities, but will have the right to invest some assets of the sovereign Funds of Russia in shares. Thus, Rosfinagency is provided sufficiently broad authority to manage public funds, while some budget restrictions will not apply to the activities of the new Agency, being founded by the Russian government in the form of an open joint stock company.

RF Subjects consolidated budget execution in January–August 2012

According to the Federal Treasury, the *revenues of the consolidated budget of the Subjects of the Russian Federation* for the first eight months of 2012 amounted to 13.8% of GDP, which is by 1.6 p.p. of GDP lower than in the relevant period of 2011 (*Table 4*). Expenditures of the consolidated budget of the Russian Federation Subjects within January–August of this year have grown as compared with the same period of the last year by 0.1 p.p. of GDP to 12.7% of GDP. As per the first eight months of 2012 performance, the consolidated budget was executed with a surplus of 1.1% of GDP (Rb 395.3bn), which is by 1.7 p.p. of GDP lower than in January–August 2011.

Table 4

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

	January–August 2012		January–August 2011		Change, p.p. of GDP
	Rb bn	GDP%	Rb bn	GDP%	
Revenues, including:	5213.1	13.8	5079.4	15.4	-1.6
– Corporate profit tax	1384.8	3.7	1379.7	4.2	-0.5
– Individual income tax	1405.5	3.7	1227.5	3.8	-0.1
– Excise duties in the RF territory	292.5	0.8	243.9	0.8	0.0
– Aggregate income tax	201.1	0.6	154.2	0.5	0.1
– Property tax	535.0	1.4	489.3	1.5	-0.1
– Non-repayable proceeds from other budgets of the RF fiscal system	989.1	2.6	1076.6	3.3	-0.7
Expenditures,	4817.8	12.7	4156.7	12.6	0.1
Surplus/Deficit of the RF Subjects consolidated budget	395.3	1.1	922.7	2.8	-1.7
GDP estimates	38057		33055		

Source: Federal Treasury, Gaidar Institute assessments.

Reduction of proceeds to the revenue part of the consolidated budget of the RF Subjects over January–August of this year against eight months of the last year is observed in the majority of

1 In October 2012 the Ministry of Finance of Russia has estimated that outstanding balances of the federal budget as per the year performance could reach Rb 809bn. Source: Ministry of Finance of Russia.

2 In the Federal Law on Budget 2012 inflation is set up at 5.5%, while the year-end inflation forecast accounts to 7%.

3 Ministry of Finance of Russia web-site.

taxes: corporate income tax – by 0.5 p.p. of GDP, personal income tax – by 0.1 p.p. of GDP, property tax – by 0.1 p.p. of GDP. Significant reduction is noted in the amount of intergovernmental transfers received by the regional budgets over eight months of 2012 – by 0.4 p.p. of GDP as compared to the same period of the last year.

Within January–August 2012 proceeds to the revenue part of the consolidated budget have somewhat increased from the tax on total income by 0.1 p.p. of GDP against the same period of the last year. Excise duties revenues to the budgets of the Subjects of the Russian Federation for eight months of the year in terms of GDP share remained at the level as in the relevant period of 2011.

In regard to the expenditure part of the consolidated budget of the Russian Federation Subjects, an increase in expenses can be noted over the first eight months of this year (*Table 5*) as compared to January–August 2011 under the budget lines “Education” – by 0.3 p.p. of GDP, “National Economy” and “Healthcare” – by 0.2 p.p. of GDP each. Reduced expenditures of consolidated budget of the Russian Federation Subjects over 8 months of the year against the same period of the last year were noted in the sections “National Security and Law Enforcement”, “Education” – by 0.3 p.p. of GDP each, in “Federal Issues”, “Housing and public utilities” and “Social Policy” – by 0.1 p.p. of GDP each. In the other sections of consolidated budget of the Russian Federation Subjects over the January–August of this year, expenditures in terms of GDP share remained at the same level as in the last year.

Table 5

RF SUBJECTS CONSOLIDATED BUDGET EXECUTION IN TERMS OF EXPENDITURES
IN JANUARY–AUGUST 2011–2012

	January–August 2012		January–August 2011		Change, p.p. of GDP
	Rb bn	GDP%	Rb bn	GDP%	
Federal issues					
National defense	4817.8	12.7	4156.7	12.6	0.1
National defense and law enforcement	307.0	0.8	278.4	0.9	-0.1
National Economy	2.2	0.0	1.9	0.0	0.0
Housing and public utilities	50.1	0.2	155.0	0.5	-0.3
Environmental protection	825.8	2.2	653.2	2.0	0.2
Expenditures, total:	462.8	1.3	442.7	1.4	-0.1
Including	10.6	0.1	8.1	0.1	0.0
Healthcare	1258.4	3.3	982.4	3.0	0.3
Social policy	155.1	0.4	129.1	0.4	0.0
Physical training and sports	796.6	2.1	645.8	2.0	0.1
Mass media	796.4	2.1	720.6	2.2	-0.1
Public and municipal debt servicing	80.0	0.3	74.1	0.3	0.0
Interbudgetary transfers	22.0	0.1	18.6	0.1	0.0
	39.4	0.1	36.4	0.1	0.0
	11.1	0.1	10.3	0.1	0.0

Source: Federal Treasury, Gaidar Institute assessments.

Public debt of the RF Subjects from the beginning of the year has reduced by nearly Rb 40bn and amounted to Rb1,125.3bn in August of the current year. ●

RUSSIAN BANKING SECTOR

M.Khromov

In September, the growth rate of the banking sector assets remained low. At the same time, the trend of slowing lending to the economy was observed not only in the corporate segment, but in the retail segment of the credit market as well.

Growth rate of total banking sector assets in Q3 2012 was 5.0%¹, including 1.9% in September, and the annual growth rates remain in the range of 20–22%.

Capital net worth of the banking sector² in September remained virtually unchanged. Herewith, there was a noticeable decrease in capital net worth of Sberbank, the largest Russian bank, whose capital fell over the month by 5%. The reason was the purchase of a subsidiary in Turkey that led to the deduction of the corresponding value from regulatory capital. Due to the lack of capital net worth growth, capital adequacy of own funds standard reduction was continued. H1 standard for the banking sector in general has declined over the last month from 13.3% to 13.0%. The capital adequacy ratio of Sberbank has decreased much more: from 12.8% to 12.0%, whereas this indicator of other banks remained at around 13.5%.

The aggregate profit of the banking sector in September was minimal over 2012 and amounted to Rb 72.3bn. As a result, the return on assets in the banking sector in September has reduced to 1.9% in annual terms, while for the total period since the year beginning its values remains at the level of 2.3%.

Raised funds

Funds in accounts and deposits of individuals

The main source of funds of banks – *funds in the accounts and deposits of individuals* – in recent months continues to grow more slowly than the total assets of the banking sector. For Q3 2012, the volume of funds in the accounts and deposits of individuals increased by 2.5%, including 1.0% in September. The annual growth rate of the individual assets, however, has returned to the level of Q1 2012 (19.1%), i.e., total growth of deposits in Q2 and Q3 was comparable to the relevant period of the last year, while in Q3 it was even somewhat higher.

The rate of household savings in bank deposits for the period of January–September 2012 amounted to 4.3%, that is, found to be higher than in the corresponding period in 2011. However, with the cash (domestic and foreign currency) in 2012 the individuals allocate a smaller part of their income for savings (4.8% against 5.0% a year earlier). Accordingly, the relative increase in deposit growth in 2012 is due to the redistribution of household assets from cash income. A significant contribution to the increase of individuals' funds in the banking sector is the accrual of interest on deposits. The average yield of deposits (regardless current accounts) in Q3 reached 6.2%, having increased against Q1 by 0.3 p.p. The total amount of income from bank accounts and deposits in Q3 was about Rb 170bn, which is equivalent to more than 50% increase in the funds of individuals with the banks.

The currency structure of deposits continues to shift in favor of foreign currencies. In Q3 ruble accounts and deposits grew by 1.3%, and remained virtually unchanged in September. At the same time, the deposits denominated in \$ increased by 7.7% over the quarter including 3.7% in September.

Funds in accounts and deposits of legal entities increased over Q3 by 1.7%, including 2.3% in September. Herewith, the annual growth rate has decreased to 14.9% from 19.1% a month earlier. The reason for such dynamics was the so-called “base effect”: in September 2011, the Bank of Moscow has attracted a long-term loan from the Deposit Insurance Agency (DIA) worth Rb 295bn

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

² Estimated under Form No.0409134.

in the framework of government program of financial recovery. According to the Russian accounting standards, these funds are accounted for as a nonbank institution deposit. Less the amount of DIA assets with the Bank of Moscow, the annual growth rate of corporate funds with the banks in September of this year would be reduced from 15.7% to 15.4%.

Currency structure of corporate clients is similar to that of individual accounts, with the difference that foreign currency predominance in the assets of enterprises and organizations was even stronger. Thus, in Q3 ruble funds of legal entities with the banks increased only by 0.4%, while foreign currency ones – by 13.8% in dollar terms. In September the ratio remained similar: 1.1% – in ruble accounts versus 7.9% in foreign currency.

The ratio of current accounts versus term deposits is sustained at less than one. That is, for current activities businesses and organizations need only a half of their funds allocated with the Russian banks, and major share part of their funds is kept on term deposits. In September, this ratio has shifted a little in favor of current accounts, the share of which has increased from 45% to 47%.

The balance sheet value of the Russian banks' *foreign liabilities*¹ has increased during Q3 2012 to Rb 10.9bn, including \$3.8bn in September. Along with the growth of foreign liabilities, banks were increasing investments in foreign assets (by \$15.7bn for the quarter and \$10.2bn in September). As a result, in recent months, the external market served not as a source of fund raising for the Russian banks, but vice versa, the way of assets outflow.

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	05.12	06.12	07.12	08.12	09.12
Liabilities, Rb bn	20125	28022	29430	33805	35237	41628	41533	43225	44266	45090	45523	45861
Own assets	15.3	14.1	19.3	18.7	18.5	16.9	17.5	17.0	16.8	16.8	16.9	16.9
Loans of the Bank of Russia	0.2	12.0	4.8	1.0	0.9	2.9	3.5	3.9	5.1	5.7	5.3	5.1
Interbank operations	4.1	4.4	4.8	5.5	5.2	5.7	5.1	4.7	4.8	4.8	5.0	5.1
Foreign liabilities	18.1	16.4	12.1	11.8	10.9	11.1	10.2	11.0	11.3	11.4	11.4	11.0
Private deposits	26.2	21.5	25.9	29.6	30.4	29.1	29.4	29.4	29.4	28.8	28.9	28.7
Corporate deposits	25.8	23.6	25.9	25.7	24.3	26.0	25.7	24.9	24.0	23.5	23.1	23.3
Accounts and deposits of state agencies and local authorities	1.5	1.0	1.0	1.5	3.5	2.3	1.4	1.7	1.5	1.7	2.3	2.5
Securities issued	5.8	4.1	4.1	4.0	4.0	3.7	4.8	4.6	4.5	4.5	4.6	4.8

Source: Central Bank of Russia, IEP estimates.

Investments

Retail lending in Q3 started to slow down. Growth rate for the quarter was by 1.5 p.p. lower than in Q2 (9.3% vs. 10.8%), the growth of individuals' indebtedness was the lowest since March of the current year (2.7%), and the annual values decreased to 41% after 42-43% in the summer months. The share of new loans in the final consumption of households has also slightly decreased from the maximum 28% in May to 26% in September. Since the beginning of the year (over January–September 2012), the volume of new bank loans to individuals amounted to more than a quarter of the final consumption of households.

The quality of the retail loan portfolio of the banking sector continued to improve gradually due to faster growth of the indebtedness. Overdue loans to individuals in September did not change, and the value of provisions for losses on loans to individuals grew over the month by 1.4%. As a result, both, the share of overdue debt, and the ratio of provisions to outstanding loans decreased during the month by 0.1 p.p. to 4.5% and 6.3%, respectively.

¹ Dynamics of the balance sheet indicators of foreign assets and liabilities of the banking sector may be different from the balance of payments due to differences in the methods for calculating these indicators.

One of the factors slowing lending could be a gradual rise in the cost of loans to retail borrowers. Thus, if in Q1 2012 the average cost of loans to individuals (calculated as the ratio of interest income received by banks to the average debt for the period) was 16.5% per annum, in the third quarter it increased by almost 1 p.p., to 17.4% per annum. The achieved level of bank credit cost for individuals is the highest since 2006, when the year-end yield on lending made 17.6%. In subsequent years (2007–2011), its value was varying in the range of 15.5 to 16.6% per annum.

The growth of the credit cost for the population leads to an increase in the debt burden on disposable household income. In Q3 2012, according to Ye.T. Gaidar, households spent on service of their accounts payable to banks (the amount of interest and repayment of basic debt in accordance with payment schedule), 10.4% of disposable income. For comparison, the previous maximum recorded in Q1 2009, amounted to 9.7%.

Corporate borrowers' debt to banks increased in Q3 2012 by 5.3%, including 1.7% in September. The annual growth rate declined to 18.6%, which is the lowest indicator since August 2011. This suggests an established trend to the slowing growth of bank crediting to the economy – from the peak of 22.8% at the beginning of 2012 the annual growth rate of corporate loan portfolio has decreased already by more than 4 p.p.

Indicators of credit portfolio quality of corporate borrowers has not changed in September 2012. The share of overdue debt was 4.9% and the ratio of provisions for loan loss versus credit debt reached 7.8%.

Liquidity and government support

Liquidity of the banking sector (the ratio of liquid assets with the Bank of Russia and cash on hand versus total assets) in September remained unchanged at about 4.6%. The sustained overall level of liquidity was accompanied with a volatile dynamics of this index in Sberbank and other groups of banks¹. Liquidity of the largest bank has decreased in this month by nearly 1 p.p. from 5.0% to 4.1%, and for all other groups of banks an increase in this index was noted. Herewith, in the Sberbank, due to its size, a much lower level of liquidity is admitted than in other banks. Thus, over 2007–2008, this indicator value of the largest Russian bank was sinking even below 2%.

Currently, Sberbank liquidity roughly corresponds to the overall level of the banking sector. However, the national largest bank is the leader in terms of another indicator, i.e., the volume of the funds raised from the monetary authorities both, in absolute and in relative terms. The total overdue liabilities of Sberbank to the Bank of Russia and the Ministry of Finance deposits amounts to Rb 1.2 trillion or 9.1% of total assets, whereas to other banks – 5.2%. Herewith, in addition to Sberbank, the average level of state support is exceeded (6.3% of assets) is exceeded only by a group of other state-owned banks (6.8%). Thus, there remains a situation where government support of the banking sector is aimed mainly at the state-owned banks.

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	05.12	06.12	07.12	08.12	09.12
Assets, Rb bn	20125	28022	29430	33805	35237	41628	41533	43225	44266	45090	45523	45861
Cash and precious metals	2.5	3.0	2.7	2.7	2.2	2.9	2.4	2.4	2.5	2.5	2.5	2.6
Deposits with the Bank of Russia	6.9	7.5	6.9	7.1	4.5	4.2	3.2	2.6	3.0	3.2	2.9	2.8
Interbank operations	5.4	5.2	5.4	6.5	6.4	6.4	6.2	5.7	5.8	5.7	5.9	5.8
Foreign assets	9.8	13.8	14.1	13.4	13.8	14.3	14.2	14.6	14.2	14.5	14.0	13.9
Individuals	16.1	15.5	13.1	13.0	14.0	14.4	15.3	15.8	16.0	16.1	16.5	16.8
Corporate sector	47.2	44.5	44.5	43.6	45.3	44.0	44.4	44.1	43.6	42.7	43.7	43.4
Government	4.1	2.0	4.2	5.1	5.8	5.0	4.9	4.5	3.8	3.4	3.4	3.3
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.

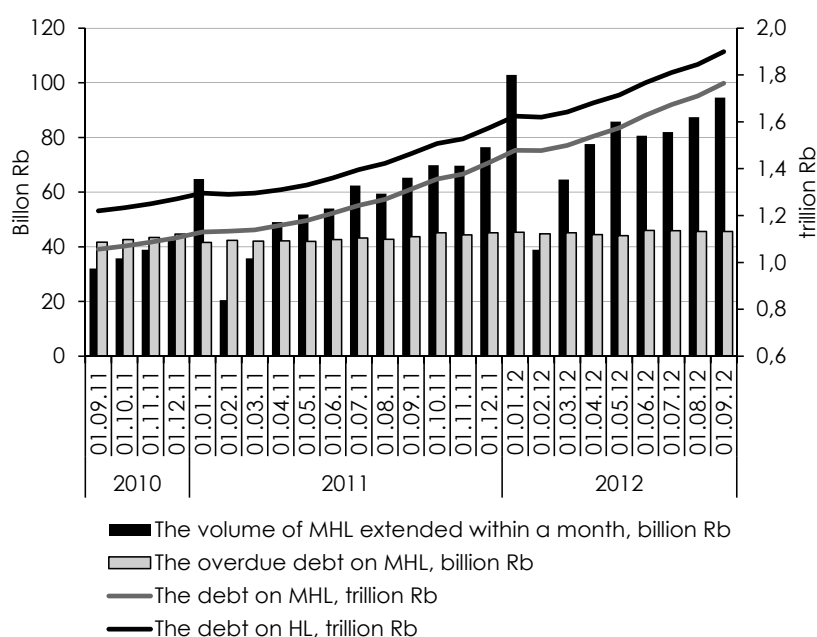
1 Other state-owned banks, foreign banks, large private banks and small and medium-sized banks.

The total amount of monetary authorities' assets in the banking sector has increased over the month from Rb 115bn to Rb 2.7 trillion, which makes 6.2% of total banking sector assets and 4.8% of GDP. In September an increased government support to the banks was carried out mainly by the Ministry of Finance deposits, which total volume increased by Rb 167bn. Overdue liabilities of the banks to the Bank of Russia on the contrary has decreased due to reduced loans, secured by assets and guarantees. ●

MORTGAGE IN THE RUSSIAN FEDERATION

G.Zadonsky

In January–August 2012, mortgage housing loans for Rb 611,561bn were extended which figure is 54% higher than the volume of lending in the respective period of 2011. As of September 1, 2012, the outstanding debt on MHL in the amount of Rb 1,765 trillion exceeded by 34.52% that as of September 1, 2011. The positive trend – a decrease both in the share of the overdue debt on MHL in rubles in the outstanding debt and the share of the volume of defaulted MHL in the total debt – continued. In August 2012, the weighted average rate on MHL in rubles rose by 0.1 p.p. and amounted to 12.3% against 11.4% as of December 1, 2011.



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

Fig. 1. Dynamics of Housing Lending

According to the data of the Central Bank of the Russian Federation, as of September 1, 2012, 452,184 housing loans (HL) for the amount of Rb 638,597bn were extended, including 417,492 mortgage housing loans (MHL) for the amount of Rb 611,561bn which figure exceeds by 54% in value terms the volume of loans extended as of September 1, 2011. In August 2012, the outstanding debt on HL rose by 2.94% to Rb 1.9 trillion, while that on MHL, by 3.17% to Rb 1,765 trillion. The latter exceeds by 34.52% the debt on MHL as of September 1, 2011. As of September 1, 2012, the overdue debt on HL amounted to Rb 52,088bn, while that on MHL, to Rb 45,628bn. (Fig. 1).

According to the data of the Central Bank of the Russian Federation, as of September 1, 2012

the debt on MHL with payments overdue for over 180 days (defaulted loans) (Table 1) amounted to Rb 49,591bn or 2.81% of the total amount of the debt, which figure is 0.14 p.p. lower as compared to August 1, 2012. In August 2012, the debt without overdue payments increased in value terms to Rb 1.67 trillion or by 0.29 p.p. of the total amount of the debt and amounted to 94.56% (Table 1). In the same period, as of September 1, 2012 the overdue debt on MHL increased by 0.06% (Fig. 1) in value terms, while as a percentage of the outstanding debt fell from 2.67% to 2.59%.

As regards the number of MHL extended from the beginning of the year with cumulative result per thousand persons, both as of September 1, 2012 and as of September 1, 2011 the leaders were the Khanty Mansiisk Autonomous Region, Yamalo-Nenetsk Autonomous Region, the Tyumen Region, the Nenetsk Autonomous Region and Tatarstan (Table 2). The overdue debt of the above regions is much lower than the nation-wide average value, that is, 2.59% of the outstanding debt. As regards the number of loans per thousand persons, the Urals Federal District is still the leader among federal districts.

Table 1

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

	Total amount of the debt	Including that without overdue payments		With payments overdue					
				from 1 to 90 days		from 91 to 180 days		over 180 days	
		Million Rb	%*	Million Rb	%*	Million Rb	%*	Million Rb	%*
Jan 01	1 478 982	1 391 130	94.06	27 805.00	1.88	5 916	0.4	54 131	3.66
Feb 01	1 477 318	1 377 599	93.25	40 331.00	2.73	6 648	0.45	52 740	3.57
Mar 01	1 499 730	1 398 649	93.26	42 142.00	2.81	5 699	0.38	53 240	3.55
Apr 01	1 538 333	1 449 417	94.22	32 151.00	2.09	5 846	0.38	50 919	3.31
May 01	1 574 311	1 489 140	94.59	28 338.00	1.80	5 668	0.36	51 165	3.25
Jun 01	1 627 360	1 527 115	93.84	39 382.00	2.42	5 533	0.34	55 330	3.40
Jul 01	1 673 047	1 581 364	94.52	35 469.00	2.12	5 019	0.3	51 195	3.06
Aug 01	1 710 519	1 612 506	94.27	42 250.00	2.47	5 303	0.31	50 460	2.95
Sep 01	1 764 809	1 668 804	94.56	41 120.00	2.33	5 294	0.3	49 591	2.81

* % of the total amount of the debt.

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

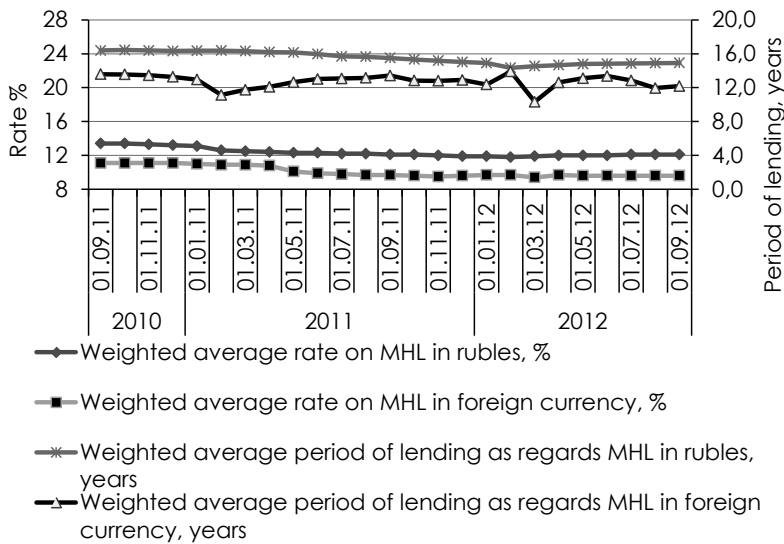
Table 2

BREAKDOWN OF REGIONS BY THE NUMBER OF MHL EXTENDED FROM THE BEGINNING OF THE YEAR WITH CUMULATIVE RESULT PER THOUSAND PERSONS

Region	Number of MHL per thousand persons	Overdue debt as % of the outstanding debt
	01.09.2012	01.09.2012
The Russian Federation	2,918	2.59
Constituent Entities of the Russian Federation		
Khanty-Mansiisk Autonomous District	6,681	0.30
Yamalo-Nenetsk Autonomous District	6,525	0.22
Tyumen Region	5,961	0.53
Nenetsk Autonomous District	5,797	0.05
Republic of Tatarstan	5,249	0.76
Republic of Udmurtia	4,991	1.69
Tomsk Region	4,372	1.32
Chelyabinsk Region	4,345	3.26
Vologda Region	4,292	1.29
St. Petersburg	2,717	2.65
Moscow Region	2,472	5.42
Moscow	1,715	5.95
Federal Districts		
Urals Federal District	4,341	1.32
Privolzhsky Federal District	3,741	1.78
Siberian Federal District	3,518	2.05
Far Eastern Federal District	3,071	0.72
North-Western Federal District	2,925	2.05
Central Federal District	2,330	4.43
Southern Federal District	1,935	2.28
North-Caucasian Federal District	1,018	3.27

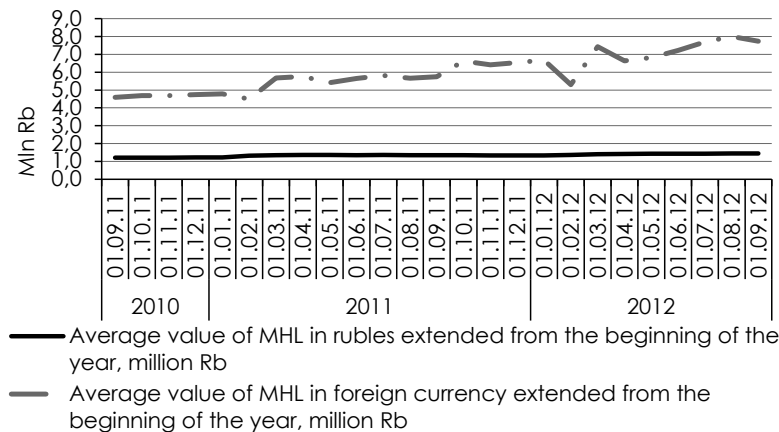
Source: on the basis of the data of the Central Bank of the Russian Federation.

According to the data of the Central Bank of the Russian Federation, during summer months of 2012 the weighted average rates on MHL extended both in rubles and foreign currency (Fig. 2) remained



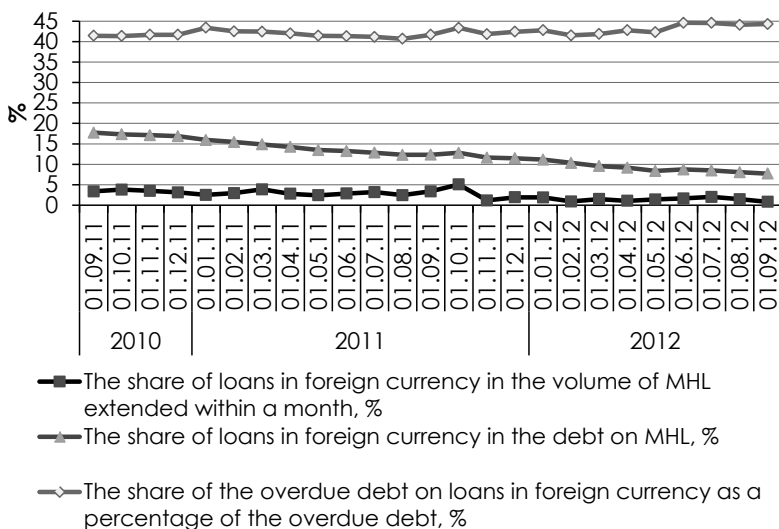
Source: on the basis of the data of the Central Bank of the Russian Federation.

Fig. 2. Dynamics of weighted average rate on and period of lending as regards MHL extended from the beginning of the year



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

Fig. 3. Dynamics of the average value of mortgage housing loans



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

Fig. 4. Dynamics of the ratio between MHL in rubles and MHL in foreign currency

unchanged at the level of 12.1% and 9.6% on loans in rubles and loans in foreign currency, respectively. At the same time, in August the weighted average rate on MHL in rubles increased by 0.1 p.p. and amounted to 12.3%. In 2012, the weighted average period of lending as regards MHL in rubles extended from the beginning of the year increased and amounted to 14.9 years as of September 1, 2012. In August, as regards loans in foreign currency the weighted average period of lending rose by 1.95% and amounted to 12.2 years (Fig. 2).

In 2012, the average value of MHL in rubles extended from the beginning of the year keeps growing and as of September 1, 2012 amounted to Rb 1,449m (Fig. 3) (growth of 8.14% as compared to January 1, 2012). In the same period, the relevant value in foreign currency varied and as of September 1 amounted to Rb 7,732m.

As of September 1, 2012, the share of loans in foreign currency in the volume of MHL granted within a month fell to the minimum and amounted to 0.82% (Fig. 4). Such a low volume of lending in foreign currency results in a stable decrease in the share of foreign currency in the MHL debt; as of September 1, 2012 the above share amounted to 7.72%. At the same time, the share of the overdue debt on MHL in foreign currency in the total overdue debt increased somewhat in 2012 and as of September 1 amounted to 44.28%, which figure is 1.52 p.p. higher than that as of January 1, 2012 (Fig. 4). The latter points to the fact that debts on the earlier extended loans account for the main volume of the overdue debt on MHL in foreign currency.

In January–August 2012, the share of five largest banks (the first group of credit institutions ranged by the value of their assets in descending order) in the total number of MHL extended to individuals fell to 58.95% (Fig. 5) against 68.83% in the same period of 2011. As compared to the respective period of 2011, in

January–August 2012 the overdue debt as a percentage of the outstanding debt of the first group fell from 3.21% to 2.28%, which figure is below the average value of 2.59% by all the groups. The overdue debt (3.95%) on less quality MHL of the second group exceeds the average value by all the groups (Fig. 5).

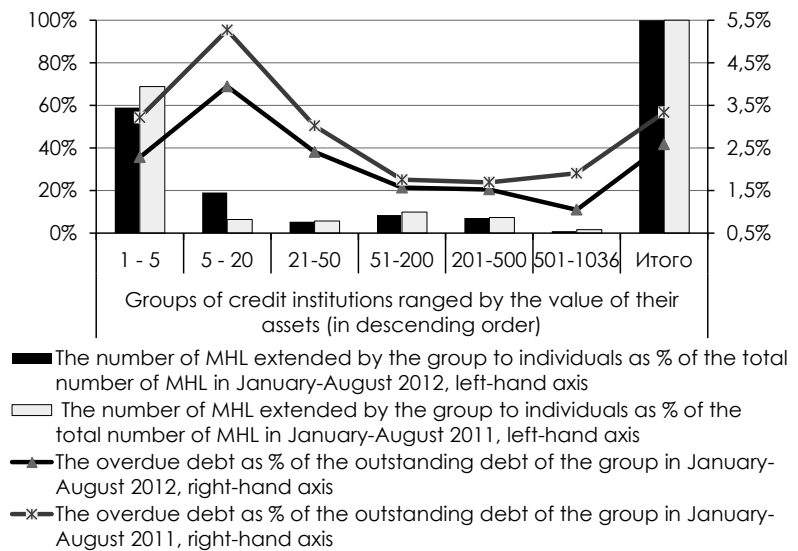
In January–August 2012, OAO AHML refinanced 32,387 MHL for the amount of Rb 43.25bn (Fig. 6), which figure exceeds by 26.2% the volume of refinanced loans in the same period of 2011. As of October 1, 2012, the share of the standard product in the total volume of repurchased mortgages amounted to 53.42%, having exceeded by 6.93 p.p. the minimum value of 2011 (Fig. 6).

In September 2012, the share of mortgage loans refinanced by AHML in the total number of mortgage loans granted amounted to 6.12%, which figure is 0.74 p.p. lower than that in August 2012 (Fig. 7).

The Supervisory Board of AHML approved placing of Rb 15bn worth of AHML unconvertible documentary coupon bonds payable on demand (A28–A30 series) with maturities ranging from January 15, 2029 till March 1, 2033. According to the Federal Law on the Federal Budget in 2012 and the 2013–2014 Planned Period and Resolution No. 1710-r of September 17, 2012 of the Government of the Russian Federation, Rb 15bn worth of state guarantees are provided for in respect of bonds of A28–A30 series.

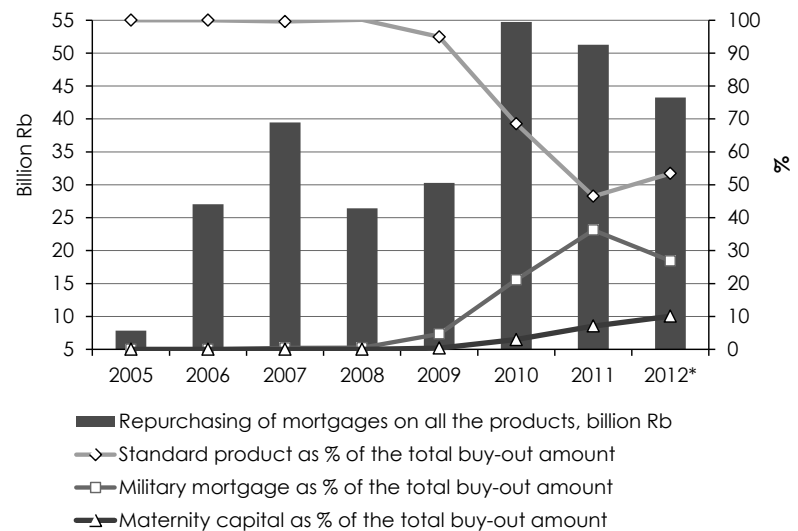
The Standard & Poor's, an international rating agency revised upward the short-term credit rating of OAO AHML from «A-3» to «A-2». Simultaneously, the AHML's «BBB» long-term credit rating and «ruAAA» national scale rating were confirmed. The ratings' forecast is «stable».

Gostroi and OAO AHML presented to the Government of the Russian Federation a new federal program of provision of affordable housing. According to the above program, within



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

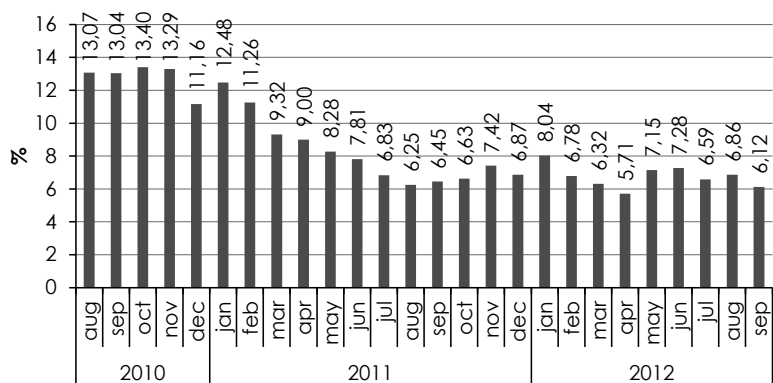
Fig. 5. Dynamics of MHL and the overdue debt by the group of credit institutions ranged by the value of assets



* January–September 2012 .

Source: on the basis of the data of OAO AHML.

Fig. 6. Dynamics of buy-out of mortgages of OAO AHML



Source: the data of OAO AHML.

Fig. 7. The share of mortgage loans refinanced by AHML in the total number of the mortgage loans granted

the frameworks of the public-private partnership certain categories of people will be able to buy housing at a price which is below the market one thanks to a feasibility provided for by the legislation to assign land plots to developers free of charge; in addition to the above the state has to assist in ensuring such land plots with the required infrastructure and provide long-term project financing through AHML and Vnesheconombank.

The State Duma is expected to consider in the second reading amendments to the Civil Code of the Russian Federation; the above amendments provide for mandatory notary certification of deals with property and, as a result, for individuals the cost of such deals, including mortgages will be 1% to 2% higher. The above amendments return the legislation to the issue solved by the Civil Code of the Russian Federation in 1994, that is, guarantees of the title to real property. According to regulations of the Civil Code of the Russian Federation, in Russia the system of state registration of titles to real property has been in operation since 2000 and that system was legislatively established. Thanks to the above system, the norms of mandatory notary certification of deals were abolished. ●

FOREIGN TRADE

N.Volovik

The rate of growth in both, exports and imports in recent months are ranging around zero. In October, Russia for the first time took part in the General Council of the World Trade Organization (WTO) as a full member.

Russian foreign trade turnover calculated under the balance of payments method, in August 2012 amounted to \$70.2 bn. As compared to July 2012, it rose by 3.5%, and against August 2011 it decreased by 6%.

Exports in August 2011 amounted to \$42.1bn, which is by 5.6% lower than in the last year. Imports also declined: in August of this year, imported goods amounted to \$29.4bn, which is by 2.5% less than in August last year. Due to the decline in exports the trade surplus has reduced. In August it was \$12.6bn, which is by 12% lower than in August 2011 and by 14.4% more than in July 2012.

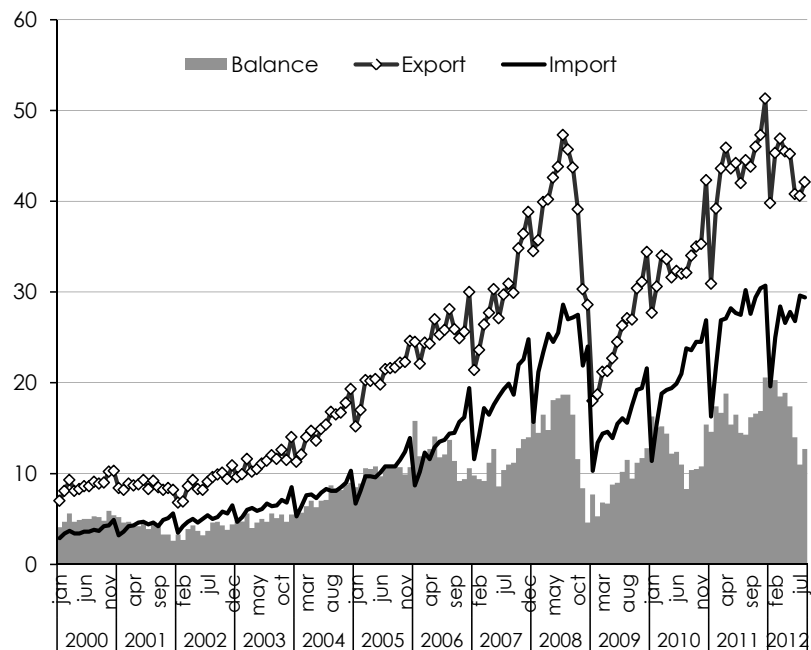
The decrease of the value of Russian exports in August 2011 compared to August 2011 was due to a decrease in volume by 6.9%, as well as to the decline in average prices of exports by 1.5%. Reduction of imports was provoked by lower import prices by 5.5% at the background of the volume extension by 2.6%.

Though the terms of trade in August 2012 remained favorable (“terms of trade” index between Russia and other countries in August 2012 totaled to 104.2 points), but significantly deteriorated as compared to August 2011, when the index value was 123.5 points.

The global oil market is still influenced by two major factors: sustained concern about the growth of the world economy (European debt problems and slowing economic growth in China), and geopolitical risks (instability in the Middle East). In August 2012 the price of Brent crude oil ranged from \$105.7/Bbl (on August 1) to \$116.2/Bbl (on August 15).

The average price for Urals in August 2012 amounted to \$113.1/Bbl, which is by 10.3% higher than in July 2012; as compared to August last year, the price rose by 3.3%. In January–August 2012 the price of Urals made \$111.0/Bbl; as compared with the corresponding period of the previous year, it increased by 1.6%.

According to the monitoring of the Russian Ministry of Finance, from September 15 to October 14, 2012 the average price of Urals oil was \$110.7/Bbl. According to the Government Decree of October 24, 2012 No. 1090, the export duty on crude oil from November 1, 2012 will be decreased by 3.4% – to \$404.5/t from \$418.9/t in October 2012. The unified export duty on light and dark oil products, except gasoline, from November 1, 2012



Source: RF Central Bank.

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

will be \$267/t vs. \$276.4/t in October. Herewith, the duty on petrol, sustained at 90% of the oil duty, in November will be reduced to \$364.1/t (vs. \$377/t in October 2012).

The global market situation in non-ferrous metals continues to deteriorate. As compared with August 2011, aluminum prices have fallen by 22.4%, reaching the lowest level since September 2009. For the majority of global aluminum producers the price level is now below the point of profitability. Nickel prices have dropped down against August of the last year by 28% and also reached the lowest level since September 2009. Copper market key indicators deteriorated since the beginning of the year under the pressure of declined demand in the manufacturing sector in Europe, and more significant than expected slowdown in economic growth in China. As a result, copper price has fallen down by 16.5% over the year.

Table 1

AVERAGE MONTHLY PRICES IN AUGUST OF RELEVANT YEAR

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Oil (Brent), \$/bbl	25.7	27.2	29.9	42.8	61.9	71.7	72.1	118.3	73.06	77.18	109.9	113.3
Natural gas*, \$/1m BTU	3.79	3.01	3.98	4.34	6.56	8.71	8.34	14.64	6.92	8.45	10.81	11.18
Gasoline, \$/gallon	0.776	0.834	0.935	1.152	1.811	2.073	1.968	2.93	1.971	1.94	2.77	2.829
Copper, \$/t	1499.4	1480.0	1731.0	2835.8	3800.0	7689	7510.5	7645.6	6165.3	7284	9001.0	7515.5
Aluminum, \$/t	1374.9	1292.0	1457.0	1694.3	1868.0	2460	2515.2	2780	1933.8	2118.4	2379.0	1845.4
Nickel, \$/t	5554	6720.0	9365.0	13723	14894	30872	27600	18581	19642	21413	21845	15735

* European market average contract price, franco border.

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

The FAO of Food Price Index average value in August totaled to 213 points in 2012, i.e., remained close to the level of the previous month, but decreased by 17.8 points as compared to the same indicator of August 2011.

During January–August 2012 the foreign trade turnover of the Russian Federation amounted to \$559.8bn, which exceeds the relevant indicator of 2011 by 3.8%. Herewith, the exports of Russia increased by 3.9%, amounting to \$346.4bn; imports increased by 3.7% to \$213.5bn. The surplus of the Russian trade balance in January–August 2012 amounted to \$132.9bn, having increased by 4% against January–August 2011.

Fuel and power component in the structure of exports has decreased. The share of fuel and energy products in January–August 2012 accounted for 70.8% (vs. 71.5% in January–August 2011). The share of exports of food and agricultural raw materials rose to 3% as compared with 1.7% in January–August 2011. The remaining shares of consolidated positions remained the same as in the last year.

The share of machinery, equipment and vehicles in the structure of imports continued to increase. In January–August 2012 it rose to 50.4% from 48.4% over the same period in 2011. The share of imports of food and agricultural raw materials fell down to 12.5% from 14.3% a year earlier.

Immediately after Russia became a full member of the World Trade Organization, there occurred a conflict situation. In accordance with the ratified by the Russian Federation Protocol of Accession to the WTO, import duties on coated paper and paperboard since joining the organization were set at 5%. However, the decision of the Council of the Eurasian Economic Commission No.54 of July 16, 2012 “On approval of the single commodity nomenclature of foreign economic activity of the Customs Union and the Common Customs Tariff of the Customs Union”, a single customs tariff of import customs duty at the rate of 15% was set for 16 items of FEACN codes for this commodity group.

New unified customs tariff published at the web-site of the Eurasian Economic Commission have formally entered into force on August 23, 2012. Thus, from that date, the import duty at the rate of 15% came into effect, rather than the expected 5%.

Initially, Russian publishers have suggested that it is a technical error, and on July 30 officially reported the problem to the Ministry of Economy and the government. However, there was no feedback to these and follow-up letters.

Coated paper consumption by 100%, and coated board by 90% is provided by imports. The volume of imports of coated paper and paperboard in 2011 amounted to 623.7 thousand tons in the amount of over \$685m, and it is expected that in 2012 it will be 830 thousand tons.

Import duties on coated paper in the amount of 15% of the value were introduced in 1995 to encourage the production of Russian domestic equivalent products. However, the production of coated paper in the country has not been established. In 2010, to support publishers and simultaneously promote the transfer print media production to Russia, the government has temporarily reduced the import duties on paper to 5%. Reduction of duties was practically the only direct and effective anti-crisis measure of support to the industry, because, along with the reduction of production costs, it provided a direct impact on cost reduction. According to the Inter-Regional Association of Printers, over the period when the reduced rates were in effect, the size of print run in Russia grew by 17%. The workload of domestic printing facilities increased to 75–80%, whereas previously it was only at the level of 40–50%.

In June 2011, within the framework of the investment project “Big Koryazhma”, Ilim Group JSC signed a contract to upgrade and supply of key components for paper coating production facility. The main supplier of the equipment is the company Metso Paper OY (Finland). Since 2013, the plant will produce 70 thousand tons of coated paper for the Russian market, the volume of which is estimated at 200–250 thousand tons annually. The Project for coated paper production at Koryazhma is aimed at import substitution with domestic products. Apparently, Russia could commit an infraction of agreements with the WTO to support the Project.

However, the planned release of 70 thousand tons of coated paper in Russia will cover the domestic demand only for 30%, whereas the increase of import duties will trigger a massive outflow of printing orders abroad.

In early October, Russia for the first time took part in the General Council of the World Trade Organization as a full member. First discussions of the problems that have arisen over the month of Russia's membership in WTO were held. The organization members, in particular, are dissatisfied with the introduction and implementation of utilization fees on imported cars, with increased import duties on coated paper, as well as measures prohibiting import of live animals for phytosanitary reasons.

The Russian side, in turn, has brought up the problems faced by Russian companies in foreign markets. For example, the barriers in the delivery of Russian poultry into foreign markets, requirements for packaging of goods supplied from Russia to some countries, issues related to access to the market of Russian carriers to the market of automobile transport services.

According to the Russian Ministry of Economic Development, as of October 1, 2012, eighteen countries use protective measures against Russian goods. The maximum number of restrictive measures is in effect in the EU, Ukraine, USA and Belarus. More than half of all existing anti-dumping measures are imposed on imports of Russian ferrous metals and their products. Mineral fertilizers are in the second place.

The main reasons for the restriction in the Russian goods import are dumping and non-tariff regulation in trade. Ministry of Economic Development of Russia has split all problems in the field of foreign Russian trade into four groups: the restrictions that will be removed immediately after joining WTO, restrictions, most of which will require consultation; limitations, the removal of which may have to be resolved through the WTO dispute settlement mechanism, and limitations that are generally unlikely to be removed.

In the WTO, there is a fairly complicated, but effective procedure for dispute resolution. The basic method of this procedure is negotiation through diplomatic channels. If the parties fail to reach an agreement that satisfies both of them in the course of negotiations, complaining party may request involvement of an arbitration commission. After the proceedings, the Arbitration Board issues initially an interim and then a final report to the parties, which is communicated to all WTO members. Review of the report is included in the agenda for the next meeting of the WTO Council.

In its report, the Commission presents recommendations to the party against which the complaint is brought, on the measures to be taken to comply with the Agreement. Recommendations of

the Commission as they are have no legal force. The Party against which the complaint is brought is liable to execute them only after approval by the Authority resolving disputes. The total time-frame of the procedure, which is calculated from the date of the Arbitration Committee establishment till the date of the Commission report is issued, shall not exceed 9 months.

On October 26, 2012 the European Parliament has adopted a resolution on Russia's membership in WTO, which is marked with "warning signs" of insufficient compliance of the Russian Federation with WTO requirements. Among other things, the issues of a ban on livestock imports from the EU, imposed in Russia on March 20, 2012, as well as preferential treatment for domestic producers in government procurement, the scheme disposal of vehicles and seasonal import duties on certain types of sugar are considered. The European Parliament members also note the need for discontinuation of counterfeit production and sale in Russia.

The Russian side recognizes that a number of issues require further discussion, including the use of Russian sanitary and phytosanitary measures and utilization fee. However, a number of issues cannot be included in the agenda of Russian commitments as a WTO member, such as public procurement, because Russia did not undertake that liability so far. ●

BASIC VEGETABLES AND FRUITS: FORECAST FOR PRODUCTION AND PRICES IN RUSSIA IN 2012/2013

N.Karlova

In Russia where the major volumes of vegetables are traditionally produced by household farms, the fruit and vegetable business started developing quite recently. 2009–2010 were favourable for farm producers: market prices for vegetables were relatively high, investing in the construction of vegetable storages began. 2011 was a year of good vegetable crop in Russia. The preliminary data for 2012 indicate the lowering of gross output of vegetables but they are still above the average figures for the 5 recent years. After the accession to WTO imports of vegetables and fruit will be growing.

In 2011/2012 the areas sown in potatoes and almost all basic vegetables were growing as well as investments in the construction of vegetable and fruit storages. Large revenues received in the previous two better seasons were invested in the building of storage facilities and the expansion of acreage. In autumn 2011 the volumes of produce put in storage increased due to the good vegetable crop resulting in the rise of rates for storage space.

From September 2011 to April 2012 prices for vegetables and fruit were steadily falling. As a result in spring 2012 vegetable prices hit the bottom for the 5 recent years (comparable periods). In April – the traditional season of high prices on the vegetable market – prices for the so called “borsch set” [vegetables used for cooking traditional beet-root soup – *ed.*] were low: for cabbage, carrots, onions and potatoes they were even below the level registered at the time of harvesting (Fig. 1–5).

The main task of producers was to avoid at least disposal costs and correspondingly they offered the produce at minimal prices. As a result the price that formed on the market in 2011/2012 precluded market operators from making any profit.

The poor financial performance of the last year affected producers’ plans for the current season. Acreage under some vegetables shrank, low quality seeds were planted, the number of treatments reduced. Producers drastically cut the purchase of farm machinery and their investments in the construction of storages became much smaller (however, the trend towards the increase of corresponding capacities persisted).

In 2012 weather conditions were worse than in 2011, there were local crop losses due the drought. Still, the losses turned out to be less devastating than one had expected.

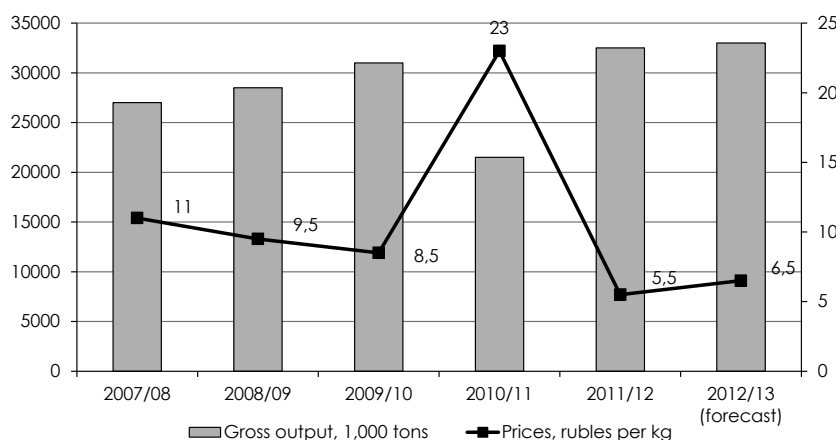
Let’s examine separately the markets of “borsch set” vegetables and apples.

Potatoes. The potato losses in 2011/2012 reached about 7.5 million tons (it’s approximately the volume produced by Holland annually). For reference, in previous years the losses were about 3.5 million tons of commodity potatoes. These potatoes were used in only one way – as a planting material. Due to that the areas under potatoes in 2012 grew again. The yields in basic producing regions were about the same as in 2011. According to preliminary data, the gross output of potatoes in 2012 will be around 33 million tons¹ which speaks of their possible over-production this year too and of higher prospective losses.

In 2012/2013 the opportunities for exporting domestic potatoes to the CIS countries are poor since in the neighbouring countries, e.g. Ukraine, the gross output of this crop will also be high. In the EU countries there is no demand for Russian potatoes as well as for potatoes from any other CIS country since they do not correspond to the quality requirements. So, the only sales outlet for this product is domestic market. But for the domestic market such volumes of production are surplus. Therefore, prices for potatoes in April 2013 are expected to be only 15–20% above the 2012 level at best and there are actually no chances to benefit from storing potatoes². Unfavourable weather conditions in many regions affected the quality of new crop potatoes. This will also put downward pressure on prices. According to forecasts of APK-Inform, in April 2013 the wholesale price won’t be higher than 6–6.5 rubles per kg.

1 Based on data of APK-Inform.

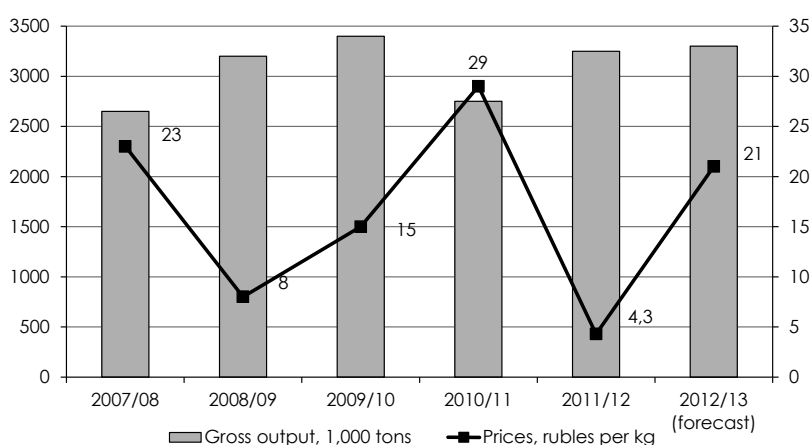
2 Based on data of APK-Inform.



*Prices registered in April.

Source: APK-Inform.

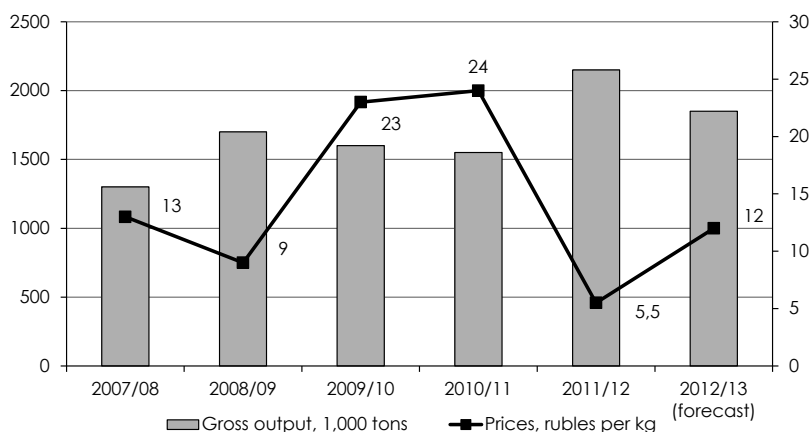
Fig. 1. Dynamics of potato output and prices in Russia *



*Prices registered in April.

Source: APK-Inform.

Fig. 2. Dynamics of cabbage output and prices in Russia *



*Prices registered in April.

Source: APK-Inform.

Fig. 3. Dynamics of onion output and prices in Russia *

Cabbage. In the previous season the output of cabbage was high. As a result in April 2012 large amounts of unsold cabbage stocks were offered at very low price. As these stocks were being sold till May, it seriously undermined prices for early-ripening cabbage – they were 7 fold below the level of spring 2011.

Due to the financial problems producers sharply reduced acreage sown in cabbage – in the Russian Federation at large it fell by about 10–15%. In 2011/2012 yields decreased by 6–8% due to the strong drought in the regions where cabbage production is concentrated – i.e. the center and south of Russia. All this resulted in lower gross output of cabbage – it was 20% below the 2011 level. Since the new crop was rather seriously damaged during the drought, it was not suitable for storage. Therefore, in the beginning of autumn producers and wholesalers strove to market early-ripening cabbage at low prices but by November when the harvesting of late-ripening cabbage begins, prices will start to grow smoothly and by April 2013 will be rather high – 20–22 rubles per kg. The market situation will provide good opportunities for cabbage import to the Russian market.

Onions. This year quite a noticeable shift in the period of marketing this product was observed – onions of 2011 crop were sold till August 2012. Therefore producers of early-ripening onions sustained losses. As a result in June 2012 prices were about 5–6 rubles per kg, i.e. 4 fold below the 2011 level. This led to the reduction of acreage under onions – by 5% as compared with 2011.

Despite the 2012 drought the output of onions will be pretty good – about 1.7 million tons. According to estimates of APK-Inform the decrease of gross output relative to 2011 will be only 10%. However, the latter is still 12% above the recent 5-year average. In September 2012 wholesale prices for onions were comparable to those of September 2011.

In the new season the yields in commercial farms of Central and Southern federal districts were about the same as in 2011. However, the average yield in the country at large fell by 5% due to the producers' saving on quality seeds, pesticides and fertilizers.

In the situation of shrinking production imports of onions can grow by 30% but they will be still 1.5 fold below the 5-year average. The decrease of onion output in Poland gives not a bad chance to the Ukrainian farmers to benefit from exports to Russia. In case the Ukraine starts to supply onions to Russian, their price by April 2013 can reach 12–15 rubles per kg.

Carrots. In 2011 the output of carrots was record for the 5 recent years. As a result from the moment of putting in storage till April 2012 the price for them fell by 15–20%. This affected the plans of farms for the following season of 2012/2013 – areas sown fell by 10%.

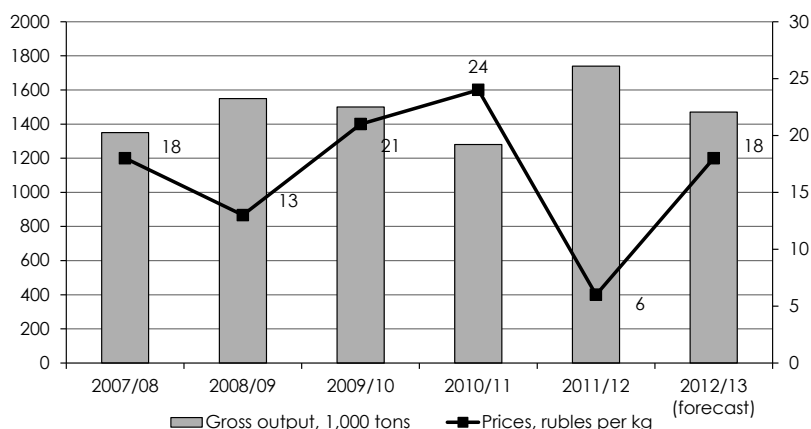
In 2012 the market situation changed – because of the drought yields in the major producing regions reduced by 10% and the quality of carrots was worse than in the previous season. According to forecasts of APK-Inform, in 2012 Russia will harvest 14% less carrots than in 2011 but this indicator will be around the recent 5-year average. By the beginning of new 2012/2013 season there was a lot of carrots in non-marketable condition on the market. As a result in September 2012 the wholesale price for this product was 10% above the level of September 2011. It is expected that from the moment of putting in storage till April 2013 prices for carrots can grow 2.5 fold – up to 18 rubles per kg. In the situation of shortage of quality carrots that will become perceptible already in the mid-winter, imports will grow by 20% as compared with the last season and by 10% as compared with the recent 5-year average.

Red beet. In 2012 acreage under red beet shrank by 5% and its yield fell by 2% which led to the decrease of output by 6% as compared with 2011. Due to the problems with quality the volumes of beet storage in the new season are expected to reduce.

The decrease of gross output and the inferior quality of new crop beet influenced the prices – in September 2012 it cost 30% more than in September 2011. By April prices can grow by another 60–70% – up to 15 rubles per kg.

Apples. At present the share of imported apples on the Russian market is rather high. The need to meet commitments taken upon the country's accession to WTO will result in the stage-by-stage lowering of import duties on apples – by 2017 they are to reduce actually 2 fold.

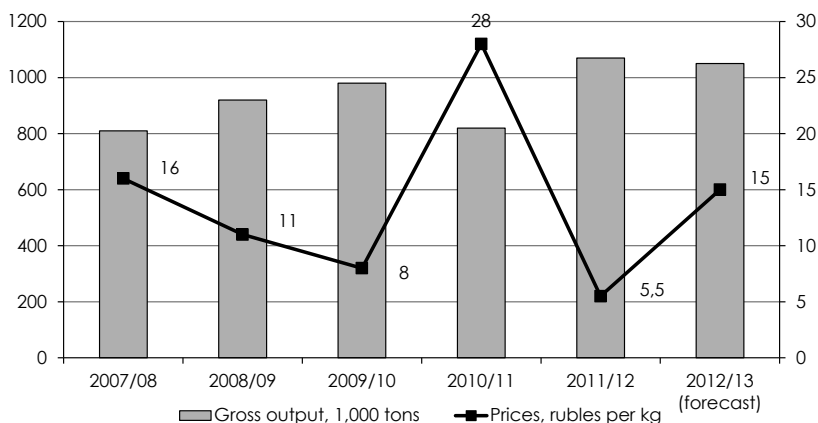
In 2012 a record crop of apples was harvested in Russia – 1.6 million tons. Apple production is also expected to grow in Poland – by more than 20% (up to 2.8 million tons). In the Ukraine the output will be large as well. All this will put downward pressure on prices that in Russia are expected to fall by 15% as compared with the previous year, in the Ukraine and Poland – by 20%.



*Prices registered in April.

Source: APK-Inform.

Fig. 4. Dynamics of carrot output and prices in Russia *



*Prices registered in April.

Source: APK-Inform.

Fig. 5. Dynamics of red beet output and prices in Russia *

According to data of APK-Inform, in 2012/2013 the share of imported apples on the Russian market will exceed 80% and in the nearest 5 years import supplies will be growing due to the lowering of import duties in compliance with WTO requirements. In this situation the CIS countries are losing their advantages provided by the free trade regime. The terms of apple export to Russia from these countries will deteriorate relative to those from other countries.

In the two recent years the capacities for fruit storage in Russia grew by 20%. The segment of storage in controlled atmosphere is rapidly expanding which allows to sell apples all year round. Accordingly, the opportunities for seasonal raising of prices and getting the margin will be diminishing.

Table 1

RUSSIA'S COMMITMENTS TO WTO CONCERNING THE LOWERING OF IMPORT DUTIES
ON APPLES, EUR/KG

Commodity classifier for foreign economic activities	2012 (WTO accession)	2013	2014	2015	2016	2017
From January 1 till March 31	0.06	0.054	0.048	0.042	0.036	0.03
From April 1 till June 30	0.06	0.054	0.048	0.042	0.031	0.015
From July 1 till July 31	0.06	0.054	0.048	0.042	0.036	0.03
From August 1 till November 30						
Golden Delicious and Granny Smith varieties	0.2	0.17	0.144	0.115	0.088	0.06
Other varieties	0.1	0.092	0.084	0.076	0.068	0.06
From December 1 till December 31						
Golden Delicious and Granny Smith varieties	0.2	0.16	0.13	0.09	0.055	0.03
Other varieties	0.1	0.092	0.084	0.076	0.054	0.03

Source: WTO. ●

IPO¹–SPO² PROBLEMS OF THE RUSSIAN COMPANIES

A.Abramov

In the second half of 2012, against the background of the next round of “quantitative mitigation” in the U.S. and Eurozone countries, an upsurge of Russian issuers interest to public offerings was noted. The history of the Russian companies involved in IPO and SPO in this short time is different.

In September 2012, in the framework of privatization process there was a relatively successful SPO of the Sberbank of Russia. The organizers managed to sell the government stock of the bank in the amount of 7.58% for Rb 160bn. The offering price was Rb 94.75 per share, the underpricing at the point of closing trading day was 1.88 p.p.

In October 2012 a successful IPO of private Cyprus company MD Medical Group Investment, the owner of “Mother and Child” Holding in Russia was arranged in the London stock exchange. The company has placed 35% of its shares and the amount of proceeds received by the founders of the holding amounted to \$31m. However, at the offering price of \$12.00 per depositary receipt, the closing price of the first trading day at the exchange made \$11.94 per depositary receipt. The overpricing made 0.51%, which is in fact not typical to the IPO. In general, on the first offering day the value of the IPO shares of the companies are traded at a higher price than the offering value, which reflects the underwriters’ fee for risky investments at this stage of offer.

Promsvyazbank shares IPO was a total failure. At the last moment it was postponed due to the lack of investors’ demand for the shares of the bank.

The success of the IPO-SPO shares emitters in any country depends on the further investors’ rate of return. There are two indicators used to measure the investment return on the shares of IPO companies: one of them is underpricing / overpricing margin between the first day closing market price at the stock market after the IPO-SPO placement and their offer price; the second indicator is the cumulative excess return, calculated on the basis of difference between the cumulative return on equity of IPO company and a similar indicator of the basic instrument (stock index, shares of comparable companies, etc.).

It is noteworthy, that during the IPO-SPO of the Russian companies, the underpricing level is very low as compared with other countries.

According to the data published by Jay Ritter³, the U.S. researcher, the underpricing of the IPO-SPO amounted to:

- *in emerging economies of Asia:* China in 1990–2010 – 137.4%, India in 1990–2011 – 88.5%, Malaysia in 1980–2009 – 62.6%, Korea in 1980–2010. – 61.6%, Singapore in 1973–2011 – 28.3%, in the Philippines, 1987–2006. – 21.2%, Indonesia in 1990–2011 – 25.7%, Hong Kong in 1980–2010 – 15.4%;
- *in emerging economies of Latin America:* Brazil in 1979–2011 – 33.1%, Mexico in 1987–1994 – 15.9% , Chile in 1982–2006. – 8.4%, Argentina in 1991–1994 – 4.4%;
- *in emerging economies of Europe:* Bulgaria in 2004–2007 – 36.5%, Poland in 1991–2006 – 22.9%, Turkey in 1990–2011 – 10.3%;
- *in mature economies of:* Greece in 1976–2011 – 50.8%, and Japan in 1970–2010 – 40.4%, Switzerland in 1983–2008 – 28.0%, Germany 1978–2011 – 24.2%, Ireland in 1999–2006 – 23.7%, Australia in 1976–2011 – 21.8%, the United States in 1960–2011 – 16.8%, UK in 1959–2011 – 16.1%, Spain in 1986–2006. – 10.9%, France in 1983–2010 – 10.5%, Denmark in 1984–2011 – 7.4%, Canada in 1971–2010 – 6.7%.

1 SPO – Secondary Public Offering of shares.

2 IPO – Initial Public Offering of shares in the market, during which the company’s shares become available to a wide range of investors and are freely traded at the stock exchange.

3 <http://bear.warrington.ufl.edu/ritter/>

The data on IPOs in Russia cover 40 companies involved in transactions in 1999-2006. The average premium (underpricing) of shares of Russian companies is 4.2% of the offering price, which is the lowest indicator among all 45 countries in the sample¹. The low level of underpricing was recorded in all “public IPOs” in Russia, including 0.25% of “Rosneft” shares in July 2006, 4.27% in Sberbank of Russia shares and 4.12% in VTB shares in February-May 2007. During the SPO sales of VTB shares (on 14.02.2011), the underpricing amount was 4.16%, and Sberbank of Russia shares (on 19.09.2012) – 1.88%. Why is the level of underpricing of the Russian IPO-companies shares so low? Is it good or bad in terms of their investors? In our opinion, these facts suggest that the Russian companies shares prices during public offerings, as a rule, are much too high as compared to foreign companies offers in the global market. For this reason, the first-day offer price of the Russian IPO issuers grows less than that of their foreign counterparts, and in the long run it falls well below the shares of foreign IPO issuers.

Various methods of regression analysis are used to substantiate this hypothesis. We will illustrate it on the example of two methods for analyzing the long-term cumulative excess return of 30 Russian issuers shares, participated in IPOs, carried out within 2002–2007.

In summary, the results of the Russian companies IPOs, including “public” ones, are shown in *Fig. 1*, where the long-term analysis of the cumulative excess return on shares of two Russian companies portfolios for the period of 1070 business days, or about 4.5 years after public offering of these companies’ shares. *Fig. 1* shows the cumulative excess return on Rosneft, Sberbank of Russia and VTB shares. Herewith, for comparison, the curve of the cumulative excess return on 27 IPOs of private Russian companies, which took place in 2002–2007 is demonstrated².

For a curve of cumulative excess return plotting on 27 issues of IPO private companies shares, the following calculations are to be made. A series of the curve points of cumulative returns on 27 IPO-companies shares is formed. Herewith, the value of the shares issues in each company portfolio is assumed equal to:

$$P_t = \frac{\sum_{i=1}^{27} \frac{P_t^i}{P_0^i}}{27}$$

where P_t^i – IPO-issuer share value i at the point of time t ; P_0^i – IPO-company share offer price i .

The curve of MICEX index cumulative return is formed in a similar way:

$$I_t = \frac{\sum_{i=1}^{27} \frac{I_t^i}{I_0^i}}{27}$$

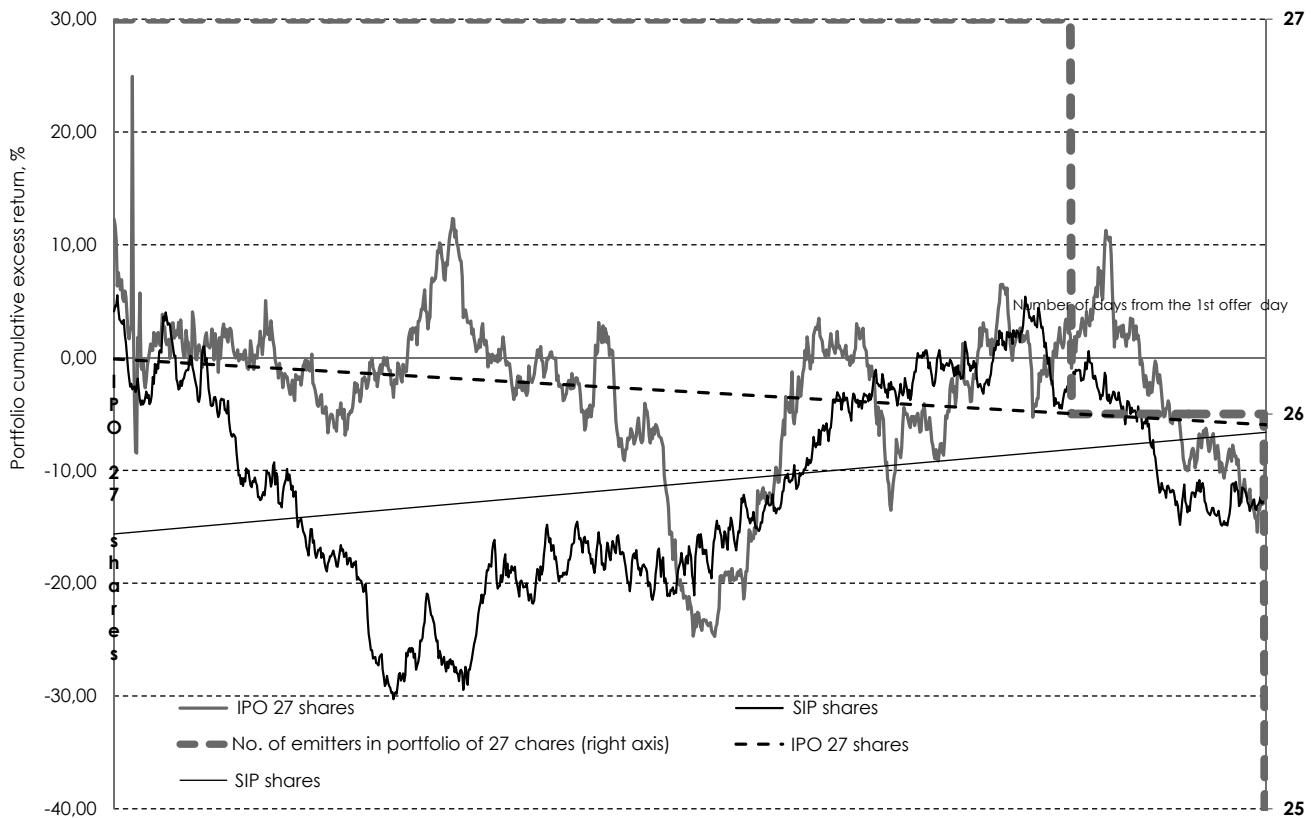
Where I_t^i – MICEX index value for the company i (the companies made placements in different time periods, and respectively, the index value will be specific for each company) at the point of time t ; I_0^i – MICEX index at the point of time when the company i made the offer.

Finally, a series of cumulative excess return of 27 IPO-companies portfolio of shares is formed as compared with the index portfolio:

$$Dif_t = I_t - P_t = \frac{\sum_{i=1}^{27} \frac{I_t^i}{I_0^i}}{27} - \frac{\sum_{i=1}^{27} \frac{P_t^i}{P_0^i}}{27}$$

1 We have obtained a similar underpricing value of Russian companies’ IPO-SPO in the amount of 4.4% in the course of the study conducted in 2011 on the data on 150 issues of Russian companies that have passed through the IPO-SPO in the period of 2000–2007.

2 Pharmacies 36.6 (APTK), Irkutsk (IRKT), RosBusinessConsulting (RBCI), Kalina Group (KLNA), The Seventh Continent (SCON), Lebedyansky (LBDO), Pava-Bread Altai (AKHA), Sollers (SVAV), Razgulay (GRAZ), Magnet (MGNT), OGC-5 (OGKE), Sistema-Hals (HALS), Rospadskaya (RASP), Polymetal CMI (MAGN), Nutriinvetholding, Pharmstandard (PHST), Renaissance (VZRZ), Dixie (DIXY), PIC (PIKK), Armada (ARMD), OGC-2 (OGKB), M-Video (MVID), St. Petersburg Bank (BSPB), NCSP (NMTP), LSR (LSRG), Synergy (SYNG).



Source: estimates based on Moscow Stock Exchange data.

Fig. 1. Cumulative excess return of two groups of shares of Russian issuers

The cumulative excess return on shares of three companies’ portfolios (Rosneft, Sberbank of Russia and VTB) involved in public IPOs is formed in a similar way:

$$Dif_t = I_t - P_t = \frac{\sum_{i=1}^3 \frac{I_t^i}{I_0^i}}{27} - \frac{\sum_{i=1}^3 \frac{P_t^i}{P_0^i}}{27}$$

As can be seen from the graph in Fig. 1, that over 4.5 years cumulative excess return of private IPO portfolio was usually higher than that of the stock portfolio of three government companies (SIP shares portfolio). However, after 4.5 years, the difference between the excess return of shares of private and government companies has practically disappeared. The trend lines in the chart of both indicators were aligned at one point. This roughly corresponds to the behavior of the cumulative excess return on shares of IPO-companies in the majority of emerging economies.

The more favorable results of excess returns on IPO of private Russian companies shares in comparison with “public” IPOs may be due to excessive excitement generated when placing the shares of government companies, when together with the investment banks – underwriters and issuers, government media and officials of the highest level get involved in marketing. Officials responsible for the IPO of government companies, as a rule, are motivated to maximize revenue from the sale of shares and may ignore other social and economic privatization objectives. As a result, individuals and domestic institutional investors are forced to buy overpriced shares of privatized companies¹. An example of an alternative approach to the privatization of shares of national companies

1 Commenting on the Sberbank of Russia shares SPO at its very beginning, the then Head of the bank A. Kazmin explained that the objective is “to sell more and at a higher price.” According to him, in order that the application is granted, “we should take the market price plus some premium”, “the will be no discount...”, “we are not abnormal.” Quoted from: Interview A. Kazmin. The task is: to sell more shares at a higher price. Kommersant, 31 January 2007.

is IPO-SPO of Brazilian state company Petrobras, when shares were sold to domestic investors at a discount of 2% of the oil company stock market value.

Eventually, both, individual market participants, as well as issuers of “public” IPOs are often dissatisfied with the results of sales. Herewith, individual market participants are disappointed with the fact that offering price of shares is deliberately overpriced, which does not bring them the expected high short-term and medium-term investment returns. Issuers are dissatisfied that the contribution of the population and other domestic investors in the total amount of IPO proceeds is minimized, while the prospective high dispersion of shareholders increases the risk of a conflict with the minority investors.

This experience raises questions about the additional risks of “public” IPO. As demonstrated by the experience of Rosneft, Sberbank of Russia and VTB, individuals and domestic institutional investors are participating in the acquisition of shares of governmental companies on equal terms without any benefits in privatization along with the largest foreign investors. For all categories of investors the same mechanism for determining the offering price with the order book is applied, which in itself adds to the offering price maximizing. In addition, the high cost of offers in progress of “public” IPO is the result of active participation of foreign investors in privatization.

However, the traditional method of calculating the cumulative excess return for IPO and SIP, used by D. Ritter, W. Magginson and others, not fully reflects the investors’ incentives in such investments. Method of cumulative excess return assessment is based on a retrospective analysis of the issuers portfolio proceeds as a result of IPO. Usually it is used in the following manner. Among all IPOs, there selected those issues that are in circulation at the time of the evaluation. Cumulative return of each issue is compared with the cumulative return of the basic financial instrument for the same period of time. Herewith, the stock index, shares of comparable companies or shares of the same company whose return is measured with CAPM model are selected as the basic instruments. Then the arithmetic average excess return is calculated on the pooled analysis of IPO-companies shares, whose issues of securities in the portfolio have the same value.

However, there are significant disadvantages in this method of the cumulative excess return assessment. The major failure is the unpredictable character of IPO shares portfolio. A potential investor in the IPO market cannot know in advance which of the purchased shares issue of IPO-companies will serve as a long-term investment. In a few years after the IPO placement, some companies suspend public sales of the shares, because the control stake of the issuer is acquired by a strategic investor (for example, shares of “Lebedyansky”, “Kalina”, “The Seventh Continent”), and the company is restructured within the holding (Polyus Gold, Polymetal) or gets into a difficult financial situation (RosBusinessConsulting IS). In addition, the IPO transactions of many issuers are usually rather time-consuming. Under such circumstances, the investor forms a portfolio gradually, so far as the IPO are arranged by the companies.

There is a need for the method of assessment of the cumulative excess return on IPO shares, that would provide comparable return on investments in issuing companies with regard to the fact that their portfolio is formed gradually and is either replenished with the assets of the regular IPO issuers, or reduced, when some shares IPO-companies withdraw from the public market trading. This can be achieved by comparing the estimated cumulative return on the shares of two Unit Investment Funds (UIF) formed in compliance with a certain framework. One of the Funds is a public UIF, formed of the companies’ shares in the progress of IPO placement. The other one is the index UIF, where the share prices of the respective issues are replaced with index values.

Rules for the model of UIF formation are as follows. Each time of the shares public offer it is expected that investments in the amount of Rb 100,000 is credited to UIF. The number of shares equal to the quotient of the amount contribution by the estimated price of share (ESP). The ESP is assessed by dividing the value of the UIF portfolio by the number of shares in circulation at the beginning of the day when contribution is made. If the shares of an IPO issuer are withdrawn from public trading, on the last day of those shares offer they are sold from the UIF model portfolio. Proceeds from the stock sales are withdrawn from UIF model portfolio, and the corresponding number of shares is redeemed.

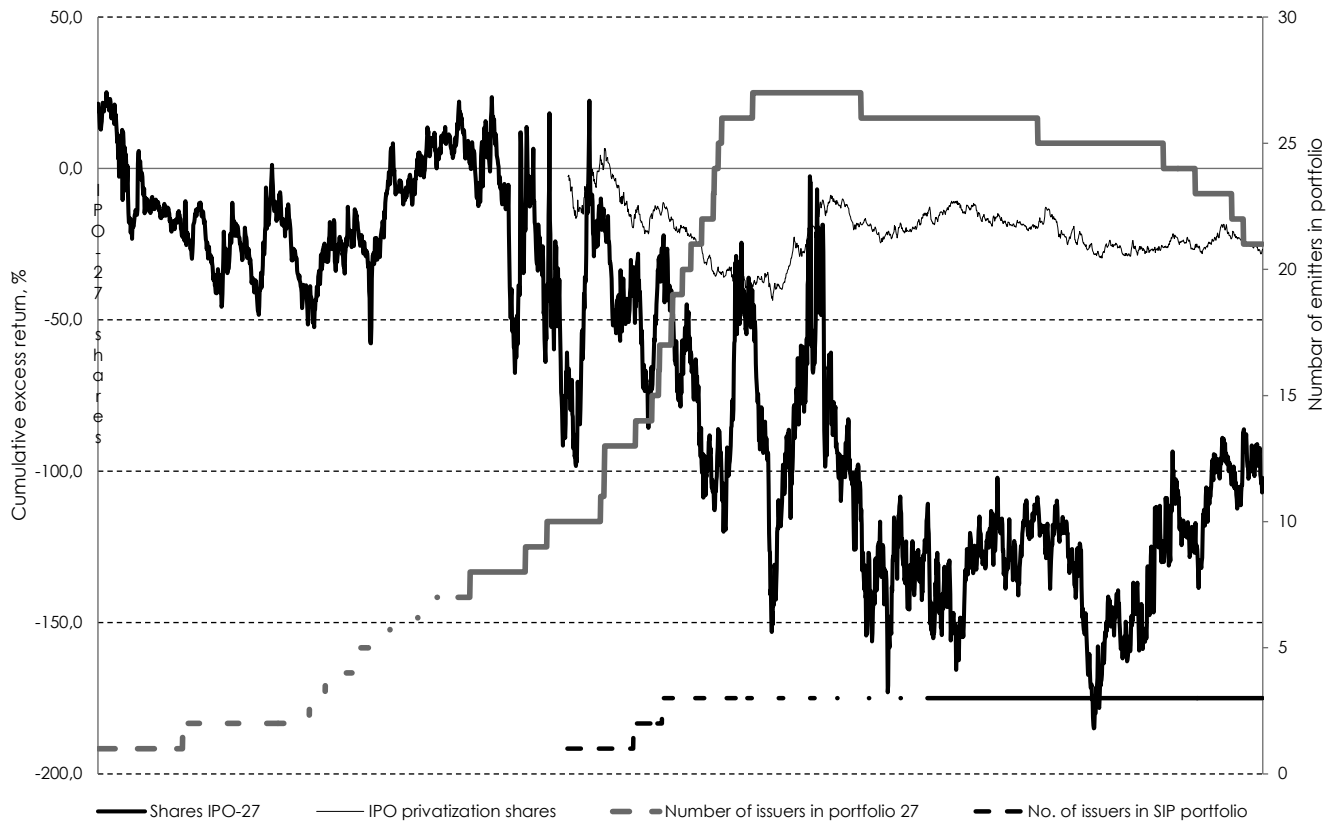
Based on ESP, the cumulative return of IPO-companies shares and relevant effective UIF index are calculated according to the UIF model portfolio shares. The difference between a daily excess

return of UIF shares and the excess return of the index UIF provides a cumulative excess return of IPO and ESP issuers by the new method.

Fig. 2 shows the results of calculation of the cumulative excess return of 27 IPO private companies stock portfolio (shares IPO-27) and the portfolio of 3 government EIP-companies (shares of privatization IPO). Herewith, In the portfolio of IPO-27 shares of the same companies are analyzed in the above calculation of the cumulative excess return. An alternative method of the excess return assessment gives the results different from the traditional method of its calculation. Cumulative excess return of IPO-27 private companies' UIFs over a decade was expressly negative, exceeding 100 p.p. The cumulative excess return of privatization IPO shares (of Rosneft, Sberbank of Russia and VTB), despite a 5-year period of its existence, is preferable against the stock returns of 27 private companies. However, the cumulative excess return of ESP-companies shares is also negative.

The reason for negative results of the cumulative excess return over a decade is a negative impact on the return of IPO-27 portfolio, provided by the IPO-companies shares, withdrawn from circulation. During this time the shares of 6 companies – RosBusinessConsulting IS, Kalina Group, Seventh Continent, Lebedyansky, Polymetal and Nutriinvestholding were withdrawn from circulation. There are two conditional reasons for withdrawal of those issuers: restructuring (especially acquisition by a global foreign company) and insolvency. As a rule, cumulative excess return of IPO-companies shares, for which public offering was only a step in the preparation for sale to a strategic investor is higher than cumulative return of companies, which became insolvent after the IPO underpricing. Withdrawal of the top successful companies from the market significantly reduces the market value of the portfolio and the estimated value of the model UIF shares. An unlucky company, remaining in the model UIF portfolio, also brings down the cost of its shares. As a result, the IPO-27 portfolio profitability is rapidly declining as well. UIF portfolio of privatization IPOs is still free from the impact of these factors due to the limited number of its member companies, which temporarily helps to achieve a higher cumulative excess returns.

Based on the analysis of long-term return of privatization and private IPOs of Russian companies, the following conclusions can be made. Unfortunately, placement of any privatization or private IPO-SPO does not ensure successful performance. Long-term cumulative excess return



Source: estimates based on Moscow Stock Exchange data.

Fig. 2. Cumulative excess return of two portfolios

of the companies' portfolios in both cases is negative. Herewith, different methods of assessment allow to estimate the long-term return on shares from different viewpoints. Traditional methods of assessment show that the cumulative excess return on shares of private companies, as a rule, exceeds the cumulative excess return of privatization IPO-companies. However, after 4.5–5 years those indicators are getting leveled. Meanwhile, for the 5-year period, it remains negative for the Russian companies.

Another method of assessment, based on the model UIF shares of IPO-companies allows to find out that in a decade, the fund formed of the shares of 27 IPO private companies, is facing serious difficulties. Withdrawal of the most profitable shares of IPO-companies in the process of their acquisition by a strategic investor, the depreciation of investments in the unsuccessful companies results in the expressly negative cumulative excess return of the IPO company portfolio indicators after 5 years. This problem can be expected in portfolios consisting of shares of privatized companies with the expansion of the range of such issuers and the accumulation of a longer history of their excess return. ●

MIGRATION PROCESSES (TEMPORARY LABOR MIGRATION)

L.Karachurina (NRU HSE)

The data published by the RF Federal Migration Service (FMS) – although these by no means should be seen as absolute truth because of the widespread practice of illegal employment of foreign workers – may, nevertheless, be taken as a kind of baseline information. These data testify to the fact that, since the same period of last year, no serious changes have occurred in regard of the scale migration, the geographical origin of foreign workers, the sectoral structure of their employment, and their distribution across Russia's regions.

According to the results of surveys conducted by the Levada-Center on 21–24 September 2012¹, 47% of Russians display a negative attitude to 'foreign guest workers', this being the record high hostility index for the entire period of surveys concerning this issue. More than half of the respondents are ready to support measures designed to restrict the entry into their region (in search of a new place of residence or employment) even of the residents of other subjects of the Federation. Two months earlier – in August 2012, when a joint survey was conducted by the Levada-Center and the Center for Social and Labor Rights, – 15% of the respondents stated that they constantly worked side-by-side with migrants; 42% believed that foreign workers bring down the level of the Russian citizens' earnings; and another one-third of the respondents said that they take jobs away from Russians². The role of migrants in the economy was then estimated as positive by 10% population, who thought that migrants help the domestic economy to develop, while 13% declared that without migrants Russia would be experiencing labor shortage. And 34% of the respondents are certain that migrants take only those jobs that are not wanted by Russians.

Data released by the RF FMS, which certainly must not be taken as ultimate truth because of the widespread practice of illegal employment of foreign workers, can nevertheless, be applied as a certain baseline. These data have revealed that, by comparison with the same period of last year, no serious changes have occurred in the scale of migration, the geographical origin of foreign workers, the sectoral structure of their employment, and their distribution across Russia's regions.

Over the period of January–September 2012, the RF FMS issued work permits to 1,072 thousand foreign workers, which is by 12% more than the number of work permits issued over last year. If the other categories of labor migrants are added (highly qualified specialists who obtained work permits; workers recruited by the RF FMS in an organized procedure for labor recruitment; "visa-waiver" foreign workers employed by Russian individuals on the basis of a patent), the total number of labor migrants legally employed in 2012 (January – September) will amount to 2,170 thousand.

If we look at expert's estimations of the ratio of legal to illegal labor migration inflow into Russia, the overall number of labor migrants will climb to 5–6m. Approximately similar estimations are presented in the Concept of State Migration Policy of the Russian Federation for the Period until 2025: "Every year, between 3 and 5 million foreign citizens are involved in labor activity in this country without a work permit". If we consider the opinions recorded in the surveys (see above – 15% testify that migrants constantly work side-by-side with them) and the basic parameters of employment in Russia (the average monthly number of employed in Q2 2012 amounts to 71.7m³), a conclusion can be made that the presence of foreigners in the Russian economy is much high-

1 The survey was based on a representative nationwide sample of 1,601 persons aged 18 years and older from both urban and rural areas; it was carried out in 130 settlements situated in 45 regions of Russia. The statistical error of this research does not exceed 3.4%. See the press-release of the Levada-Center of 16 October 2012. <http://www.levada.ru/16-10-2012/47-rossiyan-otritsatelno-otnosyatsya-k-gastarbaiteram>

2 The survey was based on a representative sample of 1601 persons. See Nikolaeva D. *Rossiane postavili negativnuiu otsenku trudovym migrantam* [Russians are highly displeased with labor migrants] // Kommersant. 2 October 2012.

3 *Sotsial'no-ekonomicheskoe polozhenie Rossii – 2012 g. Ianvar'-avgust*. [Russia's Social and Economic Situation. January–August 2012]. Rosstat, 2012.



*Based on information, submitted by employers, on labor and civil-law contracts concluded with foreign citizens arriving in the RF in search of employment in a visa-waiver procedure.

Source: data released by the RF FMS <http://www.fms.gov.ru/about/statistics/>

Fig. 1. Sectoral Employment Distribution in Russia of Foreign Workers from Visa-waiver Countries*, in %

of Ernest Gellner: “Paraphrasing Kant on ethics, we cannot overcome this tension, but we can understand why we must suffer it”¹. Or the statement made by Raimund Becker, Member of the Executive Board of Germany’s Federal Employment Agency (BA): “Today’s facts are such that we can save our prospective labor market and the social system linked to it only by allowing migration of skilled specialists”².

As it has been happening in every recent year, a vast majority of labor migrants – about 80% of those who obtained work permits – arrived from the visa-waiver countries of the CIS. According to prevailing legislation, only workers belonging to the visa-waiver category may work under a patent. The RF FMS’s statistics on the number of patents issued to individuals demonstrate that 83% of such persons have arrived from three Central Asian republics (predominantly from Uzbekistan, followed by Tajikistan and Kyrgyzstan)³. In reality, the Central Asian component indeed prevails in the stream of labor migration, but this prevalence is probably less marked because those who come from Central Asia have a stronger need for properly formalized documents (work permits or patents) than do those who arrive from the western republics of the former USSR. The data on the country of origin of foreign workers for 2011 demonstrate that approximately 70% of all work permits are issued to Central Asians⁴.

The statistics on the reported number of labor contracts concluded with foreign workers belonging to the visa-waiver category also point to the fact that their sectoral distribution changed only slightly by comparison with last year’s data (Fig. 1).

As before, more than third of the officially employed work in the construction industry. We do not mean here contracts for private apartment renovation – the migrants working under such

er – about 10–11m, which does not, however, appear to be very likely. The high level of hostility toward migrants revealed by the surveys reflects the population’s natural reaction to the existing political and socioeconomic problems in the country and the desire to find a scapegoat, which is further strengthened by the absence of any sustained government policy designed to explain the benefits associated with the attraction of migrants (a policy that has always been practiced by many recipient countries). In this connection, we may remind what the Archbishop of Valencia, Juan de Ribera, said when he learned that the Moriscos (who secretly practiced Islam, and therefore were persecuted by the Inquisition) were to be expelled from Spain: “Who will make our shoes for us now?” Or the words

1 Ernest Gellner, “Validation?” *Conditions of Liberty: Civil Society and its Rivals*. London: Penguin Books, 1996. P. 215. Quoted from: Mukomel V.I. *Migratsionnaia politika Rossii: postsovetskie konteksty*. [Russia’s Migration Policy: The Post-Soviet Contexts]. Moscow: Dipol, 2005. P. 7–8.

2 Gushchin V. *Bol’she migrantov, khoroshikh i nuzhnykh* [We need more good migrants] // *Russkaia Germaniia* [Russian Germany]. 2012. № 40. 5 October 2012. See http://www.rg-rb.de/index.php?option=com_rg&task=item&id=7935

3 Monthly data on the countries of origin of the migrants issued with work permits are not published.

4 *Itogi deiatel’nosti FMS Rossii v 2011 godu. Sbornik materialov rasshirennogo zasedaniia kollegii Federal’noi migratsionnoi sluzhby* [The Results of the FMS of Russia’s Activities in 2011. A collection of Materials Relating to an Expanded Session of the Federal Migration Service]. K.O. Romodanovsky, Gen. Ed. Moscow: FMS Rossii, 2012. P. 114.

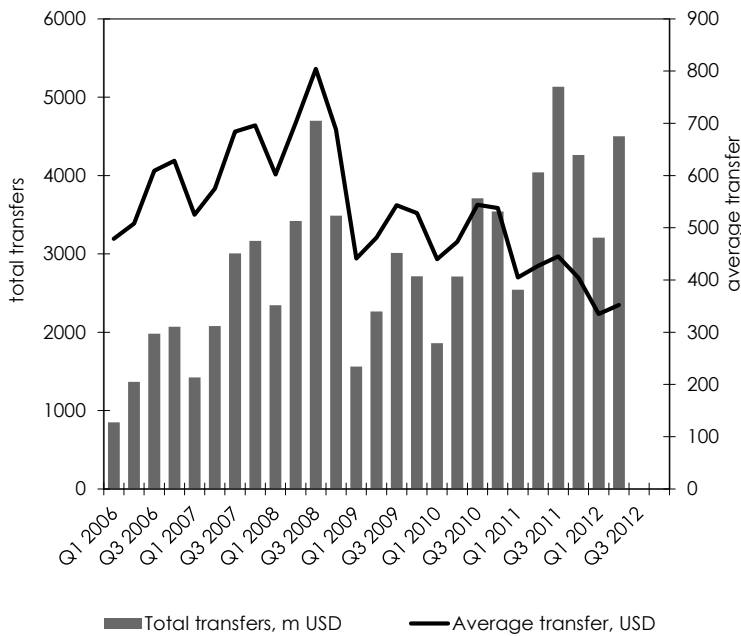
contracts, even if they are officially registered, hold patents for individual employment and so are entered in another statistical category. The downward trend displayed by the official number of employed in wholesale and retail trade is continuing. But it has been clear for a long time that migrants constitute a substantial proportion of those employed at retail outlets in big Russian cities. It should be reminded that after the incidents at Kondopoga in the summer of 2007 the RF Government introduced the so-called zero quota for the employment of foreign workers in the retail sector. The ban resulted in a dramatic decline in the number of officially employed in that sphere, but by no means eliminated the phenomenon itself – it only led to further evasion of the law. Now the retail food outlets, instead of their own records, officially enter their foreign employees in the records of outsourcing companies that provide them with loading and cleaning services¹. In October 2012, in order to make more normal the situation at supermarkets and other retail outlets, and to prevent growth of retail prices in response to increasing wages, the RF Ministry of Labor's commission on issues of competition and development of small and medium-sized businesses was assigned the task of preparing a draft government decree to the effect that the zero quota for foreign workers in the retail sector would be abolished and replaced, from the year 2013 onwards, by a 25 % quota.

From 1 July 2010, a new procedure is introduced in Russia for regulating the labor activity of some foreign worker categories²: those employed by individuals (under a patent) and highly qualified specialists (HQS). Essentially, the employment of foreigners on the basis of a patent, and in most cases – on the basis of a work permit, fits into the lower and broadest part of Russia's employment pyramid, where the concentration of available jobs is highest. On the contrary, the holders of work permits for highly qualified specialists are expected to fit into the employment pyramid's narrowest upper tier (the elite). The developed countries, when they had to deal with the issue of a declining rate of natural increase or natural able-bodied population loss, were forced to allow the immigration of low-qualified workforce. However, the migration of highly qualified specialists has also been paying a highly relevant role in those countries, in particular circular migration that implies, among other things, also some temporary forms of employment. In Russia, the desirability of this type of migration was for the first time recognized with the introduction of alterations in Federal Law of 25 July 2002, No 115-FZ "On Legal Status of Foreign Citizens in the Russian Federation", whereby highly qualified specialists were specified as a separate group. Now this group consists of three categories, which are identified by applying different quantitative criteria for determining their income: specialists employed as researchers or tutors, in the event of their being invited for that purpose (earning no less than Rb 1m per annum); other foreign workers (earning no less than Rb 2m per annum); and those without special requirements to the amount of their earnings – foreigners involved in the implementation of the Skolkovo Project. Although the definition of the category of highly qualified specialists was introduced in legislation in mid-2010, the actual issuance of work permits for that category of workers was started only in 2011. The situation in first nine months of 2012 has been nearly identical (the difference being only 1%) to that observed over the same period of 2011: work permits were issued to 8,059 persons, more than 90% of whom are citizens of non-visa-waiver countries. The actual number of received work permits is even less – 7,364. So, this channel has not yet begun properly functioning yet, it has some relevance only in the city of Moscow (which accounts for 59% of all work permits issued to highly qualified specialists in 2011³), the overwhelming majority of these specialists being managers employed in the real estate and retail sectors, and not researchers.

1 Representative of X5 Retail Group Mikhail Susov stated that "at present, about one quarter of shop personnel – mostly cleaners, loaders and packers – are employees of companies providing outsourced staff. Retail trade in big cities is hit by a colossal shortage of workforce". See Krenkina A., Gribtsova Yu., Malykhin M. *Gastarbaiteram razreshat rabotat' v magazinakh ofitsial'no* [Gastarbeiterers will be permitted to officially work in shops]. *Vedomosti*. 17 October 2012.

2 Federal Law of 19 May 2010, No 86-FZ "On Introducing Alterations in the Federal Law 'On Legal Status of Foreign Citizens in the Russian Federation' and Some Legislative Acts of the Russian Federation".

3 *Itogi deiatel'nosti FMS Rossii v 2011 godu. Sbornik materialov rasshirenogo zasedaniia kollegii Federal'noi migratsionnoi sluzhby* [The Results of the FMS of Russia's Activities in 2011. A collection of Materials Relating to an Expanded Session of the Federal Migration Service]. K. O. Romodanovsky, Gen. Ed. Moscow: FMS Rossii, 2012. P. 116–117.



Source: data released by the RF Central Bank; see <http://www.cbr.ru/statistics/?Prtid=svs>

Fig. 2. Money Transfers from Russia to CIS Countries, Based on Statistics of Cross-border Operations by Physical Persons, Q1 2006 – Q2 2012

Data released by the RF Central Bank on the transfers of money by individuals from Russia to foreign countries in Q1 and Q2 2012 demonstrate that the amount of transfers to the far abroad is still more twice as high as the total volume of money transfers to CIS countries. However, the balances of cross-border operations are relatively the same, because the transfers to individuals in Russia from CIS countries are negligible. The total volume of money transfers to CIS countries over the year's first two quarters rose by 17% on the same period of last year, this hitting a historic high of the entire period of observation; at the same time, the average sum per operation is lowest (Fig. 2). The reasons for this phenomenon may be the increasing opportunities for migrants to transfer their money from Russia to CIS countries (easy availability of the relevant infrastructure, lower transfer fees) coupled with the absence of any necessity for migrants to poor their resources in order

to effectuate a money transfer, as well as the disappearing margin between the size of migrants' earnings and that of their necessary expenditures in Russia (rent, food, transport costs). ●

THE ROLE OF THE FOREIGN ECONOMIC FACTOR IN THE COUNTRY'S INNOVATION DEVELOPMENT

A.Makarov, A.Pakhomov

At the present stage, the policy of a majority of developed states and dynamically developing countries is aimed at implementation of the innovation scenario of development through efficient utilization of the foreign economic factor. It is to be noted that the "quality" of foreign economic ties is a direct indicator of the general level of social and economic development of the state whose material base is R&D outputs and advanced technologies developed on their basis.

In autumn 2009, a modernization concept was formulated in Russia. It provides for development of intellectual and scientific potential of the country by means of both import of leading-edge technologies required for the economy and the export of competitive domestic innovation products to the global market¹.

Also, five strategic lines of economic modernization were determined. At the present stage, implementation of the above lines suggests active engagement in that work of Russia's foreign economic complex:

- Energy-efficiency and energy-saving;
- Nuclear technologies;
- Computer technologies and software;
- Space technologies and telecommunications;
- Medical technologies and pharmaceuticals .

At present, a transfer to the innovation way of development of the Russian economy is carried out within the frameworks of the catching-up modernization concept. In that context, the official approach suggests an interchangeable option of a switch over to innovations by means of combining the "catching-up" way of development (where foreign finished R&D products are actively utilized) with Russia's leading positions in some segments of the global innovation process.

Within a short period of time, the issue of economic modernization became popular and largely predetermined the lines of activities of the Government of the Russian Federation, including the Ministry of Economic Development of the Russian Federation which is responsible for development and realization of the state policy in foreign economic relations. It is to be noted that in a broad sense the term *modernization* is not quite clear to Russia's foreign partners because its foreign analogue suggests a technological aspect only. Due to that, difficulties often arise both in trade and political negotiations and implementation of the achieved arrangements.

Despite the three-year period of implementation of the modernization concept, at the present stage a number of small and non-system transformations in development of the foreign economic component in compliance with objectives of the innovation development can be mentioned².

So, in particular, to carry out technical due-diligence of the foreign economic projects selected for support the Ministry of Economic Development of the Russian Federation concluded 43 agreements on cooperation with experts and research entities, as well as institutions of development, including the Russian Academy of Sciences, the Skolkovo Fund, GK Rostekhnologii and other. Under the auspices of the above ministry's working group on coordination of development of foreign economic activities in modernization of the country's economy, measures of target state support of international innovation projects, including "technical assignments" to Russia's commercial consulates abroad were developed³.

1 D. A. Medvedev. Russia, Forward! // Web-site of the President of the Russian Federation, September 10, 2009. <http://www.kremlin.gov.ru>

2 In practice, a project-oriented approach to an economic modernization based on the need to produce quick results without taking into account real problems requiring long-term solutions was carried out. It appears that the Government of the Russian Federation did not virtually deal on a system basis with issues of development of innovations in foreign economic activities.

3 The web-site of the Ministry of Economic Development of the RF <http://www.economy.gov.ru>

In development of the above lines, inter-government and inter-departmental agreements with foreign states, as well as plans of actions (lists of pilot projects) on cooperation in modernization, including *Partnership for Modernization: Russia – the EU*, a multiparty initiative were signed¹.

For objective analysis, it is necessary to point out development of the information component of the foreign economic factor of modernization. In 2010 and 2012, the web-site of foreign economic activities, as well as the site of Partnership for Modernization: Russia – the EU² started to operate. In addition to the above, in accordance with international experience the practice of business-missions of public officers with a group of Russian businessmen within the frameworks of large international events became more and more required.

Positive examples in the above area are not numerous. They include a successful expansion abroad of domestic innovation nuclear technologies and services. So, in 2012 GK Rosatom's portfolio of orders from abroad amounted to \$69bn (for reference, Rosvooruzhenie – a traditional exporter of high-tech products – has got \$40bn worth of potential contracts)³.

Also, at present the government program on promotion of Russian navigation technologies and GLONASS equipment in six foreign countries is being developed. Target purchases of high-tech assets abroad were carried out by Rosnano and a number of private investment funds.

Late in 2011, an important innovation was the approval of the Strategy for Innovation Development of the Russian Federation till 2020 which included, among other things, a foreign economic component (*Table 1*).

Table 1

TARGET INDICATORS OF FULFILLMENT OF OBJECTIVES AS REGARDS THE LINE: PARTICIPATION IN THE GLOBAL INNOVATION SYSTEM

Indicator name	2010	2013	2016	2020
Unit weight of the export of Russian high-tech products in the aggregate global export volume of high-tech products, %	0.35 (2008)	0.4	1.1	2
Number of triad patent families (patents registered on an annual basis by Russian individuals and legal entities at patent offices of EPO, USPTO and JPO)	66 (2008)	over 300	over 1000	over 2500
Unit weight of researchers at the age below 39 years delegated to work (take a trainee job) at foreign research institutions, %	23	37	48.5	50
Balance of export-import of technologies, billion \$	-1 (2009)	-0.9	-0.6	over 0.3

Source: The Strategy for Innovation Development of the Russian Federation in the Period till 2020; October 2011 p. 110, the Web-site of the Ministry of Economic Development of the Russian Federation: <http://www.economy.gov.ru>

In October 2012, a draft state program – *The Economic Development and Innovation Economy* – was published. It is expected that the above program's implementation estimated at Rb 356bn will permit Russia by means of development of international cooperation to move from the 64th place (in 2010) in INSEAD, a global innovation index to the 40th place by the year 2015⁴.

It is to be noted that in the 2012 WEF Global Competitiveness Rating Russia moved down to the 67th place (out of 144 places) from the 66th place in 2011. In addition to that, as regards the extent of innovation which is a base component of the rating Russia moved 11 positions down to the 108th place.

1 The main mechanism of implementation of the initiative – *Partnership for Modernization: Russia – the EU* – signed at the Russia-EU summit on June 1, 2010 in Rostov-on-Don was sectorial dialogues which deal with profile technical assignments and innovation projects within the frameworks of the specific sector. On October 11–12, 2012, a Conference on Partnership was held at the Ministry of Economic Development of the RF where the outputs of such dialogues were summed up and topical issues of cooperation and prospects of future networking discussed. <http://www.formodernization.com>

2 <http://www.ved.gov.ru>, <http://www.formodernization.com>

3 So, for instance, at present the sphere of interests of GK Rosatom in Eastern Europe includes supplies of fuel, modernization and building of new projects on the basis of capacities of the nuclear power plants in the Check Republic (Temelin Nuclear Power Plant), Slovakia (Mokhovitse NPP and Bogunitse NPP) and Hungary (Paksh NPP).

4 In 2011, Russia was rated the 56th (between Serbia and Oman) in the INSEAD rating. The Web-site of the Ministry of Economic Development of the Russian Federation – <http://www.economy.gov.ru>

As stated by experts, foreign investments in general do not bring to Russia new technologies and know-how¹. Despite the orientation to attract the so-called high-tech investments, as regards the extent of the impact of direct foreign investments (DFI) on technological process Russia is rated 135th in the WEF rating (the 129th place in 2011)². Notably, in the WEF ratings as regards the level of protection of ownership rights, independence of the judicial system and efficiency of state governance Russia is rated the 133rd, the 122nd and the 130th, respectively.

The fact that the above positions in the ratings are not far from one another is evidence of interrelation between the state of the institutional environment and the extent of development of innovations in the country. It is for that reason that foreign capital investments in Russia are regarded less and less as a source of technologies and it is becoming clear that strategic foreign investors do not take any large-scale interest in Russian assets due to the existing business climate and institutional environment.

Due to the above, the concept of “attraction of technologies in return for the market” is of interest. The main objective of that approach consists in opening up of some segments of the domestic market for attraction of DFI in order to acquire modern equipment and technologies. As they are introduced and adopted, in the receiving country independent competence in the sphere of development of technological support is to be formed and, thus, the level of development of national innovations will be upgraded.

The National Entrepreneurial Initiative to Improve the Investment Climate in the Russian Federation is worth mentioning; it is a priority program of the Russian Government which includes 22 projects (road maps) aimed at making the existing business procedures simpler and less expensive and lengthy³.

As it appears, successful fulfillment of tasks set in “road maps” may have an effect both on development of innovations in case of a qualitative change in the investment climate and upgrading of the institutional environment in the country. It means that a high-tech product from the start-up date till commercialization and promotion onto foreign markets should be in a favorable environment, that is, ownership rights are protected, researchers supported, patenting procedures made simpler, corrupt practices fought against and effective measures of support of innovation export taken.

However, successful implementation of the objectives set in the above documents should be treated with cautious optimism. For instance, the export support road map⁴ was approved in general in May 2012, however, in the past six months nothing substantial, except for the implementation plan, has been done.

At the same time, at the current stage it would be expedient to pay higher attention to a major factor of innovation development, that is, rendering of support to purchases of foreign high-tech assets⁵. However, at present in Russia (unlike China and the USA⁶) there are no effective state agencies which assist purchasing of high-tech assets. Established late in 2011, the Russian Agency for Export Credit and Investments Insurance (EKSAR) has failed to produce any tangible outputs so far.

Another factor which may determine in the mid-term prospect the innovation development is Russia's membership in the WTO⁷. In that connection, in the short-term prospect Russia's foreign

1 S. Pukhov., Direct Investments: the Quantity does not Always Turn into Quality, “Comments on the State and Business” (KGB), Development Center of NRU HSE, No. 7, October 2011, p. 12.

2 The Global Competitiveness Report 2012–2013, World Economic Forum, Geneva, 2012, 545 p.

3 The strategic objective of that initiative consists in quality improvement of the investment climate in the Russian Federation and upgrading of the country's position in the World Bank's rating of accessibility and simplicity of business procedures from the 120th place to the 20th place by 2020.

4 The implementation plan of the road map on Support of Access to Foreign Markets and Support of Export was approved by Resolution No. 1128-r of July 29, 2012 of the Government of the Russian Federation.

5 For more detail refer to: A. Pakhomov. Purchasing of High-Tech Assets Abroad as a Factor Behind Innovation Development / Strategy of Innovation Transformations of Russian Economy in the Post-Crisis Period // edited by A.N. Folo-miev, Moscow, RAGS, pp. 159–169.

6 China's State Investment Corporation, the US Ex-Im Bank and the US Corporation of Foreign Private Investments.

7 On August 22, 2012, the Russian Federation became the 156th member-state of the World Trade Organization in accordance with the adopted procedures.

economic complex will face the following three groups of objectives with Russia's rights and obligations in the WTO¹ taken into account:

- Utilization of foreign technologies, equipment, leading edge know-how and competence and attraction of not only foreign experts in the area of innovations and high technologies, but also managers and experts in commercialization of R&D outputs;
- Attraction of foreign investments, primarily, those related to a transfer of technological designs and R&D and introduction of leading international know-how and advanced experience into Russian practice;
- Expansion of the presence of the Russian innovation business and domestic products on the global market.

Due to the above, the most important advantage in terms of the foreign economic policy is a non-discriminatory regime for Russian participants in foreign economic activities on foreign markets and development of innovation branches of industry in a competitive international environment. As regards the system issues, the main instruments established by the WTO norms and rules should serve as catalysts of development of innovation branches of the national economy.

To facilitate a switch-over of the economy to the innovation way of development, it is crucially important to ensure protection of outputs of intellectual activities (intellectual property – IP) on the basis of the universally recognized international rules. As expected, the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)² which is based on the norms of the World Intellectual Property Organization (WIPO) and sets such minimum standards of protection of intellectual property as are applied in international trade has the main role to play in that context.

The TRIPS provisions ensure a non-discriminatory regime within the frameworks of systems and procedures for registration of intellectual property projects abroad, an access to the international and public mechanism of settlement of disputes and positioning of Russia as a state which created favorable conditions for development of joint forms of innovation, commercialization and export of innovation products.

Also, with flexible application of the General Agreement on Trade and Services (GATS) the innovation sector of innovation services may become more highly technological and will be able meet the OECD “middle-tech” and “high-tech” criteria. At present, sales of Russian science-intensive services are growing fast (including those of the military industrial complex).

It appears that due to both a tougher global competition for innovation assets in the post-crisis period and the historical specifics of Russia's sectorial economic structure in which low-innovation industries dominate³, technologies and services of the “middle-tech” category are more perspective and required for Russia at the current stage.

So, a professional utilization of provisions of the WTO agreements on TRIPS, GATS, TBT⁴ and other may produce a synergistic effect on the country's innovation development and domestic business as regards growth in technological effectiveness of goods and services provided in Russia in conditions of competition with leading foreign producers, as well as in the area of export deliveries by Russian companies to foreign markets.

In terms of development of the Russian foreign economic policy in the mid-term prospect, it is worth mentioning preparations for Russia's joining the OECD. High standards and recommendations developed by the above organization on various social and economic issues⁵ may become an additional factor behind motivation of innovations.

1 Strategy of Innovation Development of the Russian Federation till 2020, Web-site of the Ministry of Economic Development of the Russian Federation – <http://www.economy.gov.ru>

2 The Results of the Uruguay Round of Multilateral Trade Negotiations (The Legal Texts), Annex 1C, Agreement on Trade-Related Aspects of Intellectual Property Rights, WTO, Geneva, 1995, 492 p.

3 V. Kondratiev. Competitiveness of Russian Corporations on Global Markets, the Web-site of *Perspektivy*, <http://www.perspektivy.info>, 26.08.2008.

4 Norms of the Agreement on Technical Barriers in Trade (TBT) are meant to ensure a situation where regulations, standards, tests and certification procedures do not create unnecessary obstacles and, at the same time, grant WTO member-states the right to apply measures to achieve legitimate goals of regulation.

5 Including the main components of the investment climate: from intellectual property and taxation to corporate governance and foreign trade.

At the same time, it is important to pay attention to the fact that the foreign economic factor in general and in implementation of the Russian modernization strategy, in particular, was highly underestimated and utilized ineffectively which situation, by the way, reflects Russian realities. It is a trans-border exchange of goods, services, technologies and investments that predetermines to a large extent innovation development of any country in the long-term prospect.

According to the estimates of the Center for Macroeconomic Analysis and Short-Term Forecasting (CMASTF), by the year 2015 with the global financial and economic situation and stages of development of global technologies taken into account Russia will have to choose a scenario of foreign economic policy in the mid-term prospect: either remain in the “technological mainstream” and keep exporting energy resources and primary products or find a niche of its own in production of finished products¹.

The first option suggests that Russia will continue to be oriented at export of energy carriers and primary products, while the other one is aimed at development of domestic products that will be competitive on international markets. In such a case, efforts are to be concentrated on individual lines of development of highly technological products (primarily, transport engineering and energy industry), as well as broad modernization of mid-tech industries (heavy engineering, machine-tool building and chemical industry).

At present, the government’s objective should consist in creation of “points of growth” all over the country and not the ephemeral modernization for which there are no relevant conditions so far. So, according to the research – *Clusters and Innovations in Constituent Entities of the Russian Federation* – Russia is not yet the country where innovations and social and economic development directly depend on each other².

Technologies alone without a favorable investment climate and developed infrastructure cannot be effectively adopted and become catalysts of economic growth because technically backward industries cannot be consumers of innovation products, nor will they create large-scale demand on such a basis. At the same time, both borrowing of technologies and development by Russian companies of modern methods of management (which is crucially important for Russia at the current stage) will permit to upgrade efficiency of production and create prerequisites for formation of the demand in innovations and comprehension of technologies in general in Russia.

It is to be noted that for a specific domestic company introduction of technologies used in developed countries, gaining of an access to export markets and ensuring compliance of its products with international quality standards is already a serious breakthrough. Due to the above, in the specific Russian conditions expansion of the export of high-tech products (goods and services) – as a compensation of low demand in them on the domestic market and an additional factor of development – is becoming particularly important.

It appears that a skillful utilization of WTO and OCED instruments should bring higher stability both to the Russian investment climate and development of the adequate infrastructure and, thus, create a favorable environment for innovation development. However, there are well-known risks and limitations due to low competitive edge of the Russian business, the innovation sector and the country’s economy in general. ●

1 Web-site of CMASTF – <http://www.forecast.ru>

2 E. Kutsenko., D.Tyumentseva. Clusters and Innovations in Constituent Entities of the Russian Federation : Outputs of Empiric Research // Voprosy Ekonomiki, No. 9, 2011, p. 103.

SUPPORT OF FUNDAMENTAL SCIENCE: CHANGING TARGETS

I.Dezhina

The program of fundamental research which is to become a part of the State Program of the Russian Federation on Development of Science and Technologies in the 2013–2020 Period is under active development. After a change of the top management of the Ministry of Education and Science of the Russian Federation, a few versions of the state program's sub-section dedicated to development of fundamental science emerged. Those versions differ much from the one which was early approved by the Russian Academy of Sciences (RAS). Analysis of the versions developed by the Ministry of Education and Science points to the fact that one of the objectives consists in restructuring of the RAS. However, permanent and inconsistent changes may, on the contrary, postpone solution of that problem.

A new intrigue as regards the issue of formation and financing of fundamental research is unfolding around the science policy. In the past few months, a few versions of the sub-section – dedicated to support of fundamental research – of the State Program of the Russian Federation on Development of Science and Technologies in the 2013–2020 Period were prepared. However, the RAS and the Ministry of Education and Science have failed to reach a consensus so far.

A close attention paid to fundamental science is not incidental. Firstly, support of fundamental research is a responsibility of the government. Secondly, in Russia the bulk of fundamental research is carried out within the system of state academies of sciences (*Table 1*) and there has been much talk that due to inefficiency and low productivity of that work fundamental research should be gradually transferred to institutions of higher education (IHE).

Table 1

FEDERAL BUDGET ALLOCATIONS ON FUNDAMENTAL RESEARCH BY THE MAIN ADMINISTRATORS OF BUDGET FUNDS, %

Country	2011*	2012**
Russian Academy of Sciences and its regional branches	63.5	68.6
Russian Academy of Agricultural Sciences	9.1	8.5
Moscow State University	1.6	n.a.
St. Petersburg State University	0.6	n.a.

Source:

* Report on administration of the consolidated balance of the Russian Federation and budgets of state extra-budgetary funds in 2011 (on the basis of the Federal Treasury);

** – Federal Law No. 371-FZ of November 30, 2011 on The Federal Budget in 2012 and the 2013-2014 Planned Period (as Amended).

Though federal and research universities have been already established and IHE were granted substantial funds, including those on fundamental research, changes are proceeding rather slowly. Publication activity is still low and the extent of quoting of Russian researchers' work points to an ever more negative trend: as regards the number of references made to Russian authors' work the country gradually yields its positions. In addition to the above, it seems paradoxical that universities in general and research at IHE, in particular, are downgraded in international ratings despite the fact that the government has attached them growing attention. It is particularly evident in those ratings¹, where the main component of evaluations is scientific achievements made by IHE (Shanghai, Times HE).

¹ For more detailed information on positions of Russian IHE in different ratings and the specifics of compilation thereof, refer to: I. Baranov. At the Bottom of International Ratings http://russiancouncil.ru/inner/?id_4=321; Not Happy with the Hit-Parade? // Poisk, No. 38, 21.09.2012, p. 2.

However, a low publication activity is related to inefficient work of research entities which are a part of state academies of sciences. For that reason, the decision of the Ministry of Education and Science of the Russian Federation to change the existing system of organization and financing of fundamental research seems quite logical.

The initial idea of the new program of fundamental research consisted in the fact that the above program should be a “single” one and integrate the main fundamental research performers in the country so that overlapping was avoided. In addition to the above, the role of research financing on the tender basis was to be enhanced. So, procedures for establishment of a coordination structure, management, networking with different agencies and assessment of efficiency were developed. In the initial version, the program of fundamental research of state academies of sciences was an independent section of the Sub-Program on Fundamental Research and Development of the Academic Sector of Science of the draft State Program of the Russian Federation on Development of Science and Technologies in the 2013–2020 Period. The RAS secured approval of the above version by the Ministry of Education and Science when the former top management was at the helm (in March 2012), however, the new management of the above ministry placed on June 19, 2012 an updated version of the program on its Web-site and after getting acquainted with the above version the management of RAS withdrew its *visa*¹ from it. Comparison of the both versions of the program shows what stood behind that decision. In the new version, there is no mention of the leading role of the RAS in implementation of the single program, however, the role of the Ministry of Education and Science of the Russian Federation was attached greater importance to. The earlier approved version presented the aggregate of independent sub-programs which were to be implemented by the leading participants, that is, the RAS, leading IHE, the Russian Fundamental Research Fund, the Russian Humanitarian Research Fund and other. However, it was suggested that formation and fulfillment of fundamental research would be carried out on the basis of the single system of priorities which are both determined on the basis of proposals of participants in the program with the RAS Plan of Fundamental Research till 2025 taken into account and approved by the Program’s Coordination Council. It was an important condition that the President of the RAS was to be in charge of the Coordination Council. In the new version, the Coordination Council was called the Single Program Council, its functions, as well as subordination of participants were outlined rather vaguely and the RAS became an equal partner, rather than the leading one.

The system of evaluation of the program’s efficiency underwent serious changes, as well. The earlier approved version included a variety of indices ranging from financial, infrastructure (the number of large research units) and personnel indices to those of frequency of quotation. For instance, there were indices of evaluation of the extent of integration of different entities carrying out fundamental research – the number of new base departments, training and research centers and laboratories dealing with academic issues established at IHE – which factors were quite important to the single program. On the contrary, the new version includes only indices of publication activity and quotation frequency. It is not quite correct to use the bibliometric analysis data alone for current evaluation of efficiency of the research as such data is adequate for longer periods of time and should be supplemented with other indices.

It is evident that all the changes were aimed at diminishing of the role of the RAS, while other aspects were not paid much attention to. As a result, the draft of that sub-section of the State Program appears rather eclectic.

After strong criticism from the RAS, redevelopment of the draft began and at least two more versions which do not contribute to amicable resolution of the situation followed. The next version presented the apotheosis of a bureaucratic approach. So, the goal of the program consisted in establishment of unified rules and procedures for organization and fulfillment of fundamental and applied research (FAR) for all the entities of FAR which qualitatively upgrade the institutional environment of fundamental science and create effective motivation and conditions for ensuring Russia’s leading positions by a broad range of the research, as well as follow-up coordination of activities of FAR entities on the basis of the established rules and procedures. Thus, the actual goal was determined as development of instruments, rather than fundamental research.

1 *N. Volchkova. May It Go Without Surprises? // Poisk, No. 38, 21.09.2012, p. 3.*

In the above version, the description of the program was structured by the objectives and due to that one could not get any idea about the fact how implementation of the program is organized, what system of subordination of fundamental research entities proposed and how fundamental science financed and coordinated in a complex structure made up of many participants.

The principal idea consisted in division of functions of financing and carrying out of fundamental research in order to, probably, eliminate the system of RAS where those functions overlapped. However, the idea of that approach was presented as a requirement to distribute on a tender basis at least 15% of funds allocated for fundamental research. So, despite intentions of developers such a situation actually consolidated the existing system of financing within the RAS where depending on the sector 15% to 25% of the funds is distributed on a tender basis on fundamental research.

Finally, division of evaluation indices did not withstand criticism. So, it was suggested, in particular, that evaluation of the established institutional structure of fundamental science should be carried out on the basis of existence of respective schools of scientific research, that is, a group of prominent researchers of international caliber (10 to 15 persons) in a specific area of research specialization.

The Soviet science had plenty of such research schools with many of them being world-renowned. If that is the indicator of quality of an institutional environment, then, they should return as soon as possible to the Soviet system of organization of fundamental science.

It was expected that the quality of consortiums' work should be evaluated, in particular, on the basis of the ratio of the expenditures on the equipment to the efficiency of such an equipment calculated as a ratio between the number of publications and patents and the period of utilization of that equipment. However, the period of utilization of the equipment is indirectly related to the number of publications and patents.

Another version emerged early in October and actually presented a number of conceptual provisions of the future system of support of fundamental science. The objective of that version consists in securing of "a global leadership in strategic lines of fundamental science" which task in a situation of low and declining indices, including bibliometric ones looks like an utopia, at least, in the period till 2020. A number of conceptual aspects, including engagement of foreign experts in evaluation of projects, ensuring of higher transparency of tenders, promotion of integration between science and education and holding of joint tenders for representatives of research entities and IHE, as well as Russian and foreign researchers are quite reasonable. However, the above is formulated as a list of intentions. The version in question does not provide explanations as to which party is the manager and which one, a participant in the program. Evaluation indices are reduced to a small set of bibliometric indices.

At the latest meeting of the Expert Council of the Open Government¹, the interested parties (representatives of the RAS, state research centers and IHE) pointed out that their comments on the draft state program were not taken into account. In its turn, the Ministry of Education and Science of the Russian Federation insists that that document is a framework one and all the details will be revised more than once before being finalized. However, the analysis of different versions of that document shows that neither details, nor some principal aspects have been specified.

Different versions of the sub-section on development of fundamental research aggravate the standoff between the Ministry of Education and Science and the RAS which took place in the past few years. The current developments should be interpreted as an effort to draw up a program which will become an instrument of gradual reforming of the RAS. However, the disarray demonstrated in development of that document may result in such a drop in the quality standard as would create unexpected and serious problems when the actual implementation of the State Program begins. ●

1 N. Volchkova. Consensus in Time Trouble. What Do Disputes Over the New State Program End Up With and When? // Poisk, No42, 19.10.2012. <http://www.poisknews.ru/theme/science-politic/4325/>

CLARIFIED PLANS OF MILITARY DEVELOPMENT IN THE RUSSIAN FEDERATION

V.Tsymbal

Soon after his inauguration as President of Russia, Vladimir Putin signed a number of edicts where he specified the tasks, aims and methods of upgrading Russia's social and economic development in every sphere, including the planning of further military development in this country. Quite naturally, the edicts were addressed to officials and state bodies. Recently, Vladimir Putin has urged government ministers to timely and punctually implement these edicts. Civil society, for its part, must not stay aloof as a passive bystander. Therefore all these plans and their implementation should be subject to independent extra-departmental analysis.

No radical changes have been introduced to the structure of Russia's state bodies since Putin's inauguration as RF President. That structure has preserved its "bifurcation", so typical of the Russian Federation. As usual, the activities of some federal bodies of executive authority (FBEA) are supervised by the RF President, while those the other FBEAs are supervised by the RF Government.

The Federal Services (FS) subordinated to the RF President include the FS for Military-Technical Cooperation, the FS for Technical and Export Control (both services belong to the jurisdiction of the RF Ministry of Defense), the FS for Punishment Execution (Russia's penitentiary service), and the Federal Service of Court Bailiffs (both services belong to the jurisdiction of the RF Ministry of Justice), and the following independent services: the State Courier Service, the Federal Foreign Intelligence Service, the Federal Security Service, the Federal Protection Service, the Federal Drug Control Service, and the Federal Financial Monitoring Service. The assignment of the latter to the category of "power services" is a novelty, which clearly testifies to the President's special interest in the issues of fiscal control and supervision.

Especially noteworthy among the Federal Agencies (FA) supervised by the RF President, are the FA for the Procurement of Armaments, Military and Special Equipment and Materiel (AMSEM), and the FA for Special Construction (both agencies are subordinated to the RF Ministry of Defense). Apart from them, the category of 'power agencies' includes the Main Directorate of Special Programs (MDSP) and the Executive Office of the RF President (both institutions are vested with the same powers as federal agencies).

However, when analyzing the plans and projects of military development, one should pay attention not only to the 'power', presidential branch of executive authority, but also to its second branch, because this division of executive power into two branches does not mean that the 'power block' is socially and economically isolated from the economic block, because these two blocks have common resources (human, material, technological, financial, etc.), and all events happening within these structures have countrywide impacts.

In many respects, this specificity of Russia's current regime is determined by this country's previous history. First of all, it is determined by the preservation of a number of entities organizationally isolated from the rest of Russia's economy, such as the defense-industrial complex (DIC), the missile and space complex (FA *Roskosmos*), and the nuclear complex (State Corporation *Rosatom*). Among other things, their area of responsibility includes the task of providing Russia's armed forces with weapons and equipment. A considerable part of the RF Government's managerial functions is vested in the Military-Industrial Commission (MIC). So far, the numerous attempts at rearranging the state management system of the Russian DIC have produced unsatisfactory results. It should be noted, that as far as national security is concerned, the other FBEAs whose management and control are vested in the RF Government are also very important. These FBEAs are the FS for the State Defense Order (SDO), which exists alongside the State Armaments Program (SAP), and the FS for State Statistics (although unlike the custom adopted in many civilized states, military

statistics do not actually exist in Russia). Many other FSs and FAs, which formally are not assigned to the category of “power” structures, are also involved in national security issues.

Naturally, the question arises as to who is actually responsible for the quality of interaction between the two parts of Russia’s executive authority. The relevant functions have been vested in Deputy Prime Minister Dmitry Rogozhin. In accordance with the RF President’s edicts and the RF Government’s resolutions, he has been instructed to “coordinate the work of the FBEUs”, and even to “give them assignments concerning the following issues”:

- ensuring the Russian Federation’s national defense and mobilization readiness, and ensuring the proper management of state material reserves;
- government policy in the field of DIC development;
- execution of the SAP, the SDO and the programs of development of defense industry and the nuclear and aerospace industries;
- implementation of nuclear supervision;
- export control with regard to goods, information, work, services and the results of intellectual activities that can be used in the production of weapons of mass destruction, means of delivery of weapons of mass destruction and other types of armaments and military equipment;
- implementation of a coordinated military-technological policy within the framework of the Collective Security Treaty Organization (CSTO);
- government policy in the field of international military-technological cooperation;
- government policy in the field of civil defense and population and territories protection from emergency situations;
- development of R&D for the purposes of implementing the goals of strategic military-technological and defense planning;
- development of the Russian Federation’s state border infrastructure;
- elaboration of proposals concerning the creation of a system for young Russians’ preparation for military service in the armed forces of the Russian Federation.

It should be noted that the aforesaid coordination functions belong to the “administrative resource” category. Dmitry Rogozhin has not been vested with the right to dispose of financial resources, which naturally considerably limits both his and the MIC’s managerial capacities.

In his edicts on the issues of military development, the President did not condescend to give detailed instructions to individual FBEAs, confining himself instead to the formulation of his assignments to the RF Government, although the “power block” is not subordinated thereto. In *Tables 1* and *2*, some of the President’s assignments are followed item-by-item by our comments.

Table 1

RF PRESIDENT’S ASSIGNMENT CONCERNING PROGRESS IN MILITARY DEVELOPMENT

Items of Edict No 603 of 7 May 2012 “On the Implementation of Plans (Programs) for Building and Developing the Armed Forces of the RF and Other Troops, Military Units and Agencies, and Modernizing the Defense-Industrial Complex”. The Government ... must ensure:	
Item-by-item	Comments
1-a. Arming and equipping the RF Armed Forces and other troops with modern types of AMSEM, and raising their share to 70% by the year 2020.	Such a high proportion of modern AMSEM exceeds those achieved by the majority of the existing armies. It will be harmful for the economy and will, in due course, cause a collapse of AMSEM output in the DIC.
1-b. That first priority be given to primarily developing the traditional means of AMSEM (then follows the list of such means).	The new means actively developed abroad are omitted, including nonnuclear means of deterrence; means of cyber warfare, etc.
1-c. The development of the Navy, first of all, in the Arctic zone and the Far East.	It is not proved that the defense of Russia’s interests in the Arctic predominantly by the Navy is the best possible option, because the placement of land-based long-range weapons can turn out to be less costly and more efficient.
1-d. The implementation of a number of organizational and managerial measures ... in the interests of drafting the SAP and the SDO.	Planning measures are essential not only for the SAP and the SDO but also, and especially, for the production of dual-purpose products, which falls under the competence of the MIC.

Table 1, cont'd

Items of Edict No 603 of 7 May 2012 “On the Implementation of Plans (Programs) for Building and Developing the Armed Forces of the RF and Other Troops, Military Units and Agencies, and Modernizing the Defense-Industrial Complex”.	
The Government ... must ensure:	
Item-by-item	Comments
1-e. The elaboration, in 2012, of a number of organizational proposals (then follows the list of these proposals).	We believe that the most important proposals on this list are those suggesting the creation of a single database on dual-purpose products and personnel-training systems.

Table 2

THE RF PRESIDENT'S ASSIGNMENT CONCERNING THE RESOLUTION OF PROBLEMS RELATED TO MILITARY SERVICE

Items of Edict No 604 of 7 May 2012 “On Further Improvements to Military Service in the RF”. The Government ... must ensure:	
1-a. The full provision, in 2013, of housing to the military personnel of the RF Armed Forces, other troops, military units and agencies, in accordance with RF legislation. 1-b. The creation, by 2014, of a service housing fund.	These demands reflect the recognition that Vladimir Putin’s promises to provide solution to the housing problems of servicemen have failed to materialize. At the same time and most importantly, they dilute the responsibility for resolving these problems, because both the Federal Special Construction Agency (Spetstroy) and the Housing Provision Department are subordinated not to the Government but to the “power” FBEAs.
1-c. Setting the money allowances (MA) of military personnel at levels that are no lower than the levels of pay established for workers at enterprises in the leading branches of the economy.	It would be much more advisable if the minimum MA were tied not to some vague notions, as is done in the edict, but to the concrete countywide wage average (strictly and registered by Goskomstat), because the military organization of the State must be competitive in the open labor market.
1-d. An annual increase in the pensions allotted to citizens dismissed from military service, by no less than 2% after adjusting for inflation.	This demand simply reflects the previously adopted norms. It fails to ensure the provision of adequate military pensions to the lower tiers of the military hierarchy, i.e. to former contract soldiers.
1-e. An annual rise by no less than 50 thousand in the number of military personnel serving under a contract, over the next 5 years.	This sentence should be clarified because some officers also serve under a contract, which means that an increase in their number can create an illusion that the problems created by RF regular troops’ switchover from conscription to contract service have been solved.
The Government must ensure in the year 2012:	
2-a. The inventory auditing of the RF Armed Forces’ property and the subsequent transfer of social and community infrastructure objects (and the responsibility for financing their day-to-day maintenance) into the ownership of RF subjects.	An extremely important measure, although not fully substantiated from an economic point of view.
2-b. The introduction of changes to RF legislation, designed to increase the prestige and attractiveness of conscription military service, including through: – the allotment of additional benefits to former servicemen seeking to enroll in higher educational establishments; – the allotment of grants to graduates of higher educational establishments, who have completed their mandatory military service, that will finance their education in Russian and foreign business schools; – the provision of preferential treatment to former servicemen seeking for jobs in the civil service.	The high-priority measures listed in this item of the Edict can be approved, although they contradict the principle of voluntary military service in time of peace. Moreover, it should be taken into account when implementing this Decree that, in conditions of an innovative economy, education grants for former servicemen should be established not only in regard to business schools, but also, and maybe predominantly, in regard to the educational establishments preparing specialists for high-tech industries.

Table 2, cont'd

Items of Edict No 604 of 7 May 2012 “On Further Improvements to Military Service in the RF”. The Government ... must ensure:	
2-c. The creation of the RF Armed Forces’ national reserve.	This notion contradicts the principle that the Armed Forces’ reserve should be trained in the course of mandatory military service; its implementation will be irrationally costly, given the reputed lack of funds for the switchover to contract service.
2-d. Organization of work in the field of military-patriotic education and physical development of the students of secondary general educational establishments.	It should be noted that both the patriotic education of young people and their physical development are important by no means only in regard to the military sphere. They are equally important for the civil sphere and the economy as a whole.
2-e. The development of military-applied sports among citizens of conscription age, their mastering the basics of working with transport vehicles and acquiring the knowledge base required by contemporary military occupational specialties.	As has been emphasized above, it will be important for young people to acquire dual-use (military and civilian) knowledge and skills, and to master the cutting-edge information, computer and robotic technologies.

On the whole, the edicts under consideration are designed to make good on the promises (given by all Russian presidents since 1992) to resolve the major issues of improving Russia’s defense capabilities and to provide adequate care and all types of allowances for military personnel and persons dismissed from military service.

However, judging from our past experience, no decree can guarantee that it will be duly implemented. In principle, the recent decrees can share the fate of the decrees and resolutions related to various issues of military service, issued under President Boris Yeltsin, during President Putin’s first two terms in office, and under Dmitry Medvedev. It should be reminded that many aspects of military reform were doomed to failure by their inefficient managers in the FBEAs, who frequently “cooperated” with corrupt officials and shadowy personalities – while independent no-governmental organizations exercised absolutely no control over their activities.

Special emphasis should be placed on the planned annual increase in the number of privates and non-commissioned officers serving under a contract in the RF Armed Forces by 50 thousand, over the next five years. The failure of the Federal Target Program for the RF Armed forces’ switchover to contract service in 2003–2007 indicates that the success of the new plan depends on the responsibility for its implementation being vested in an empowered official, on the openness of the personnel policy, and on society’s control over the implementation of this plan. Otherwise the plan will certainly fail, given government officials’ (both in uniform and in mufti) influence on Putin and their capacity to manipulate his opinion.

In corroboration of our opinion, we should quote from the Concept of the New Federal Target Program signed by Putin in his capacity as Chairman of the RF Government: “...the switchover to mandatory military service for a term of one year means that military personnel, after their completion of training in junior specialist schools and their subsequent acquisition, in military units, of necessary practical skills in handling new-generation military equipment, will be dismissed from military service in connection with the expiry of their legislatively-established terms of mandatory military service, which means that the training of personnel will go on permanently, but there will be no fully-trained junior specialists”.

The conclusion he came to was as follows: “The switchover to contract service is the only real way out of the current situation”.

But it did not take long for the Federal Target Program to be purged of such conclusions, not included in its approved version. And it is not by chance that the recent decree focuses not on the abolition of conscription in the regular army, but on making mandatory military service more attractive.

As far as the “bifurcation” of Russia’s system of government is concerned, let us mention some aspects of responsibility for military development and organization of military service in the RF Armed Forces vested in the Government of the Russian Federation:

- 1) As the responsibility for developing the SAP is vested in the RF Ministry of Defense and its agencies and institutions, while that for developing the SDO – in the agencies subordinated to the RF Government (the MIC and the DIC) and their institutions, this situation is fraught with tensions. This problem is a perpetual stumbling block for Russia.
- 2) The responsibility for manning the RF Armed Forces with conscripts is vested in the Main Organization and Mobilization Administration (GOMU) of the General Staff, while that for manning the RF Armed Forces with contract personnel – in the Main Personnel Administration of the RF Ministry of Defense. This Administration is subordinated to the RF President, while the RF Government is vested with the responsibility for changes in military service.

As far as Russian society is concerned, the Decree's proposition that the time has come for Russia to immediately begin creating a national reserve for the RF Armed Forces and other troops seems very doubtful. It can happen that Russia, the only G8 country preserving conscription to military service, will not only ignore one of the greatest achievements of civilized nations, but will recklessly borrow from them the concept of establishing and maintaining a legalized reserve, effective when a nation abolishes conscription. As a result, the combat efficiency of Russia's Armed Forces will not increase. Moreover, the discontent of her citizens with the situation in the armed forces will persist. Budget funds will be spent irrationally, in spite of the reputed lack of money for the creation of a fully volunteer, professional army.

The Decrees have also failed to clarify the issue of the possibilities to reduce military expenditures. Thus, the Decrees do not specify what types of AMSEM can be considered modern, and the demand that their share must be increased to 70% can be interpreted simply as the upper limit of modernization. The rest of the propositions of Decree No 603 are completely devoid of numerical expression.

As regards Decree No 604, it can be said that, for the purpose of truly prudent budget spending any surpluses, if they emerge, should be spent on accelerating the switchover of the RF Armed Forces and other troops to the method of manning all permanent combat-readiness units exclusively with contract personnel. At the same time, the numerical strength of these units should be reduced without affecting their combat efficiency. If conscription is to be preserved, its purpose should be limited to preparing personnel for contract military service and for their inclusion in the adequately trained military reserve.

Maybe, Russia has some secret documents that contain answers to the questions posed by society and independent experts. However, judging by the adjustments being made to the projects published in 2008 by Chief of the RF General Staff Nikolai Makarov in the course of the RF Armed Forces "transition to a new image" masterminded by him, this "new image" was rather vague. That is why it was subject to many serious impromptu alterations.

Both society and the President have reasons for concern. The President's remarks at a cabinet meeting devoted to the draft federal budget for 2013–2015 is very typical in this respect¹: *"I would like to say a few words about those executive orders. We have said many times, and I warned from the very beginning that those executive orders must not remain on paper. They should be reflected in the practical efforts of the cabinet of ministers – the Government of the Russian Federation. I have talked about this many times with almost everyone present here, as well as with those who are absent today. After all, the majority of people in our country are closely monitoring the domestic political situation and the plans announced by the country's leadership, and they are waiting for us to implement the tasks set out in those executive orders. We cannot allow a situation when the executive orders and the major, fundamental goals they set are one thing, and the activities of the executive branch are another. We must not and will not allow this, I say this straight away"*.

At the same time, people see not only that the plans are clumsily implemented. They also see the continuation of officials' fighting for real powers and for having their say in the use of budget funds. Recently, the RF Minister of Defense has redistributed the functions of his deputies²: his first deputy, Alexander Sukhorukov (a tank man by education, better known as lieutenant colonel of

1 Kremlin.ru/news/6493.

2 Kommersant. No 193. 13 October 2012.

the FSB), who had supervised the implementation of the SDE, has handed over that responsibility to another deputy minister, Dmitry Chushkin, who is also known not as a specialist in AMSEM issues. According to available information, he is more competent in information and financial issues. The questions as to why authentic armament specialists are still deprived of any real influence on the development of AMSEM, and how the recent redistribution of managerial functions will help properly rearm the RF Armed Forces, have so far remained unanswered. ●

**REVIEW OF MEETINGS OF THE GOVERNMENT OF THE RF
IN OCTOBER 2012**

M. Goldin

In October 2012, at the meetings of the Presidium of the Government of the Russian Federation the following issues were discussed: organization of a step-by-step provision of state and municipal services on the basis of a “single window” principle; draft Federal Law on Amendment of the Federal Law of the Russian Federation on the Customs Tariff; fulfillment of the forecast plan (program) of privatization of federal property in the 2011–2013 period and measures on limitation of purchasing of shares and interests of business entities by companies with state participation.

Rendering of state and municipal services on the basis of a “single window” principle was discussed by the Government of the Russian Federation on **October 11**. The idea of the “single window” principle which is being implemented in Russia consists in the fact that provision of a state or municipal service is carried out upon single application with the required documents to a general-duty officer of a multi-functional center for provision of state and municipal services (MFC), while networking with authorities providing state and municipal services is carried out MFC officers without the applicant’s involvement.

Development of MFC has been actively carried out at the level of constituent entities of the Russian Federation since 2007. At the federal level, the turning point in implementation of the “single window” principle became the approval of Federal Law No. 133-FZ of July 28, 2012 on Amendment of Individual Statutory Acts of the Russian Federation for the Purpose of Elimination of Limitations as Regards Provision of State and Municipal Services on the Basis of the “Single Window” Principle. Development of the federal law in question was envisaged by the Concept of Reduction of Administrative Barriers and Raising of Accessibility of State and Municipal Services in the 2011–2013 Period and the Plan of Measures on Implementation of the Above Concept Approved by Instructions No. 1021-r of June 10, 2011 of the Government of the Russian Federation. Approval of Law No. 133-FZ is aimed at elimination of such provisions in individual federal laws as limit rendering of state and municipal services at MFC.

On the basis of the results of the meeting of the Government of the Russian Federation on October 11, 2012, federal executive authorities and bodies of state extra-budgetary funds are instructed in the short period of time, not later than December 1, 2012, to develop and submit to the government commission on administrative reform draft plans and schedules of organization of provision of state services on the basis of the “single window” principle.

Also, in the period till January 1, 2013 the above authorities are ordered to bring their regulatory statutory acts, including administrative regulations in compliance with the requirements of Law No. 133-FZ.

In addition to the above, supreme executive authorities of constituent entities of the Russian Federation were advised to approve within a period until March 1, 2013 plans and schedules of organization of provision of state and municipal services on the basis of the “single window” principle, as well as the scheme of location of MFC.

The Ministry of Economic Development of the Russian Federation together with the Ministry of Finance were instructed to prepare in the period until April 1, 2013 proposals aimed at compensating to budgets of constituent entities of the Russian Federation of expenditures related to organization of provision of state services by federal executive authorities and bodies of state extra-budgetary funds on the basis of the “single window” principle at MFC.

Also, at the meeting of the Government of the Russian Federation on October 11, 2012 draft Federal Law on Amendment of the RF Law on the Customs Tariff was discussed. The above draft law is aimed at upgrading the mechanism of rates of export customs duties on crude oil and some categories of oil products.

Also, the draft law provides for establishment of a new mechanism of special export duties on some types of crude oil.

On October 25, at the meeting of the Government the issue of fulfillment of the forecast plan (program) of privatization of federal property in the 2011–2013 period and measures on limitation of purchasing of shares and interests of business entities by companies with state participation was discussed. In particular, a need was considered to introduce such amendments to regulatory statutory acts as were aimed at limitation of purchasing of shares and interests of business entities by companies with state participation in which the Russian Federation owns over 50% of the equities, state unitary enterprises and entities controlled by such companies and enterprises.

It is to be reminded that on December 9, 2011 President D. Medvedev instructed the Government of the Russian Federation to submit until March 1, 2012 proposals on “limitation of abilities of companies with a controlling state interest to buy shares in charter capitals of companies operating in competitive sectors of the Russian economy”. The instructions were issued on the basis of the results of the meeting of the International Advisory Council on Establishment of the International Financial Center which was held late in October 2011.

Mr. Medvedev’s initiative was supported by President V. Putin who by Order No. 596 of May 7, 2012 of the President of the Russian Federation on the Long-Term State Economic Policy instructed the Government of the Russian Federation to see to it that until November 1, 2012 such amendments were made to regulatory statutory acts as were aimed at limitation of purchasing of shares and interests of business entities by companies with state participation in which the Russian Federation owned over 50% of the equities, state unitary enterprises, as well as entities controlled by such companies and enterprises.

The mechanism of determination of the status of the shareholder-the Russian Federation is applied only to those joint-stock companies in which the Russian Federation participates directly; the above mechanism was established in accordance with Resolution No. 738 of December 3, 2004 of the Government of the Russian Federation on Management of Joint-Stock Companies’ Shares which are in Federal Ownership and Utilization of the Special Right of the Russian Federation to Participation in Management of Joint-Stock Companies (“Golden Share”). At present, the list of such companies is approved by Resolution No.91-r of January 23, 2003 of the Government of the Russian Federation on the List of Open-End Joint-Stock Companies in Respect of Which the Status of the Shareholder-the Russian Federation is Determined by the Government of the Russian Federation. However, so far at the federal level there is no mechanism of approval of deals made by subsidiaries of companies included in the above list with the shareholder-the Russian Federation.

The draft Resolution of the Government of the Russian Federation on Amendment of Some Resolutions of the Government of the Russian Federation which eliminates the above problems has already been developed by the Ministry of Economic Development of the Russian Federation.

The draft resolution provides for guidelines on participation of subsidiaries in other business entities to be issued to representatives of the interests of the Russian Federation, that is, members of the board of directors (supervisory council) of an open-end joint-stock company whose shares are in federal ownership.

In addition to the above, the draft resolution includes instructions to federal executive authorities to see to it that amendments were made to articles of incorporation of open-end joint-stock companies whose shares are in federal ownership, those of their subsidiaries to the effect that decisions on participation by the subsidiary in other business entities are taken by the board of directors (supervisory council) of the open-end joint-stock company whose shares are in federal ownership, as well as those of subsidiaries of federal state unitary companies to the effect that decisions on participation by the subsidiary in other business entities are taken by the board of directors (supervisory council) of the above company. ●

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

L.Anisimova

In October 2012, the RF State Duma approved in the first reading the draft federal budget for 2013 and the planning period 2014–2015. We believe it to be necessary that, in the situation of an ongoing financial crisis, the issue of mandatory payments as a non-refundable renewable source of budget revenue proper should be dealt with in connection with government borrowings as one of the sources for covering budget deficit, because the budget has been prepared with due regard for the increased expenditure allocated to the social obligations declared in course of the electoral campaign and later on confirmed by the edicts issued by the new RF President.

According to the generally applied rule, any alterations to the RF Tax Code may be entered no later than one month prior to the moment of the draft federal budget being submitted to the RF State Duma. However, this year alterations can be adopted throughout the entire period determined for the discussion of the draft federal law on the federal budget for 2013 and the planning period 2014–2015¹. In this connection, we believe that innovations introduced in the tax sphere will be applied as one of the available methods for balancing budget revenue against budget expenditure and for attracting the votes of certain groups of deputies (in support of decisions lobbied by the RF Government in exchange for a tax exemption). No doubt that such an approach has nothing at all to do with market; however, it is a reflection of the real situation in the national economy.

The organizational work aimed at implementing the RF President's decisions formalized as presidential edicts issued after the inauguration has been continuing through the period of the draft budget being considered by the RF State Duma. This process also involved consideration of the issue of introducing a special tax regime for the Far East and the Baikal region, which represented, so to speak, the final evolution of the task designated by the RF President as the provision of funding for the development of Siberia and the Far East². One gets the impression that the 'roadmap' (the term that has become very fashionable) for coordinating the planned measures with the allocated volumes of financing has not been properly elaborated in every detail³. Given the difficulties with earmarking direct budget allocations, it can be concluded that the federal authorities have evidently attempted to replace them with tax exemptions (based on the idea that, instead of allocating "live" money from the budget, it is worthwhile to leave part of the resources in a region, thus also making it easier for the regional officials who may fail to collect taxes for their own budget, while money will come from the federal budget to cover the shortage of revenues).

Such a policy is essentially destructive for the Federation and the regions alike. Federal officials have totally disregarded the possibility that a region may actually fail to raise a sufficient amount of revenue after having been granted the relevant tax exemptions, while no regulations exist in regard of these 'released' resources. As, until recently, heads of regions were appointed and not elected, local authorities voiced no objections to the replacement of the loss of tax resources in regional and local budgets that had been produced by the newly introduced tax exemptions, by 'live' money from the RF budget. And they did not object to the resulting shrinkage of the regional revenue base coupled with the increased dependence of the regions on the federal center. Following this general trend, Senator for Amur Oblast Pavel Maslovsky suggested, on behalf of his region, that manufacturers should be made exempt from practically all the federal, regional and local taxes that form that region's revenue base, including personal income tax (PIT) (for a period of three years – in

1 Federal Law of 16 October 2012, No 175-FZ.

2 D. Kaz'min, *Minfin vystupil protiv shchedrykh nalogovykh preferentsii na Dal'nem Vostoke* [The RF Ministry of Finance Spoke Against Liberal Tax Preferences in the Far East]; see www.vedomosti.ru of 19 October 2012.

3 Plan of Measures Designed to Implement the Strategy of the Socioeconomic Development of Siberia until 2020, approved by Regulation of the Government of the Russian Federation of 5 July 2010, No 1120-r; further specified by Regulation of the RF Government of 11 October 2012, No 1898-r.

order to attract workforce), the regional profit tax, mineral resources extraction tax (MRET), as well as VAT and the payments to state off-budget social welfare funds (“as they do it at Skolkovo”).

Why does a region ask to be made exempt from profit tax? In fact, Item 2 of Article 283 of the RF Tax Code already contains stipulations whereby manufacturers are allowed to carry forward their losses (expenditures in excess of the amount of proceeds from sale are either included in the value of newly created depreciable fixed assets, or recorded as losses – the amount of which is then written off against finished products over the next ten years). The conclusion is inevitable: when a regular tax scheme is applied, expenditures need to be backed by properly formalized documentation; thus, a tax exemption is needed – so that neither incomes nor expenditures could be properly calculated and recorded. Why do they ask for an exemption from VAT? VAT on exports is already levied at a zero rate, and when the products exempt from VAT are sold, the amount of ‘incoming VAT’ increases the manufacturer’s (or supplier’s) production costs. In other words, as a result of this alteration, the products exempt from VAT will become much more expensive for the buyer, because no ‘incoming VAT’ will be charged to such costs, and no deductions will be made from the amount of VAT levied on that buyer’s own products. The outcome will be an unjustified growth of prices for the processing industries’ products. Another inevitable conclusion will be that the exemptions from VAT are needed only in order to make in unnecessary to properly enter in the tax records the information as to what and how much of it is actually manufactured, and which products are delivered and where these are delivered¹.

Former RF Minister of Finance Alexei Kudrin remarked that, in fact, no tax exemptions are needed in the Far East: ‘Whether an enterprise is a new or an old one – this provides strong grounds for falsifications’. Instead, he believed, what that region really needs is proper incentives for promoting production of mineral resources, which can generate revenues capable of covering the cost of the upkeep of its welfare system and infrastructure².

The RF Ministry of Finance allows for the possibility to apply the regime of a special economic zone (SEZ) of the same type as applied at Kaliningrad. Some types of tax exemptions can also be allowed, but on condition that the decision concerning their implementation be adopted directly at a relevant region’s level (in other words, the federal budget will not be covering the amount of lost regional revenue³). It is suggested that full exemption should be granted in regard of property tax and land tax; as for tax on profit, its federal component (2%) should be levied at a zero rate for a period of 20 years, while its regional component (18%) should be completely eliminated during the first 10 years and reduced in part (no less than 10%) over the next 10 years. In this connection, the RF Ministry of Finance believed that the exemptions must only be granted to newly adopted projects, launched strictly in the period between 2013 and 2022. The aforesaid exemption should not be applied to any oil and gas projects, the manufacturers of alcohol and tobacco products, or in the fields of trade, financial services, or utilities and other similar services rendered to the population, or to the participants of consolidated taxpayer groups. Besides, the companies applying for such exemptions will be required to make investments in amounts of no less than Rb 400m, and also to keep separate accounting records for their tax-exempt transactions.

The extent to which the policy of replacing a region’s own tax-generated revenue by subsidies coming from the upper-tier budgets is harmful for the relevant territories has been revealed by an analysis of changes in the revenue structure of local budgets conducted by Standard & Poor’s (S&P)⁴. In the case of regions, similar problems arise in their relationships with the federal budget.

1 We have already emphasized more than once that VAT is the only tax based on a conflict of the economic interests of contracting parties, where each successive participant in a production chain is willing to declare to a tax agency the amount of VAT refunds that is due to them in regard of the goods (or work, or services) purchased by them, and so the tax agencies automatically receive information on the amounts of sales and the types of the goods (or work, or services) being sold by each producer (or seller) of goods (or work, or services) throughout the entire territory of the Russian Federation. But this is not a tax that is levied on producers – its amount is ultimately paid by end consumers, so it is a classical example of tax on consumption.

2 www.finmarket.ru/z/nws/news.asp?id=3090415. 16 October.

3 Hereinafter we are offering a number of graphic examples of how Russia has already been faced with the necessity to adopt some fundamental adjustments to the basic parameters taken into account in the process of drawing up a budget; it is feasible to formalize these adjustments as alterations to the RF Budget Code.

4 V. Visloguzov. Rossiiskie goroda bedny i nesvobodny. S&P otsenilo problem munitsipalitetov Rossii [Russian towns are poor and constrained. S&P has estimated the problems faced by Russia’s municipalities]. See kommersant.ru No 193/II (4978), of 15 October 2012.

According to S&P, the low degree of revenue autonomy displayed by territories represents an issue of fundamental importance. Thus, after the centralization of many of the existing taxes (which formerly had been transferred to the local budgets) carried out in 2004–2005, the share of municipalities in Russia’s national budget shrank from more than 30% in 2004–2008 to less than 18% in 2011. Simultaneously, they became much more dependent on interbudgetary transfers. Since 2000, the share of such transfers in local budget revenue has doubled, while targeted transfers have been playing an increasingly important role. In 2012, according to the rating agency’s estimates, the share of taxes in local budget revenue is 30%; that of non-tax sources – 9%; that of non-targeted transfers – 19%; and that of targeted transfers – 42%, which means that transfers constitute more than 60% of the size of local budgets. The share of transfers to other budgets in federal budget expenditure is 37.6%¹.

The replacement of taxes by subsidies granted to regions increases the burden imposed on the federal budget, which manifests itself in a shift of the sources of funding for budget expenditure towards growth of the size of tariffs set by natural monopolies, thus artificially increasing the need for government borrowings.

International experts, at their meeting with Chairman of the RF Government Dmitry Medvedev, raised the question as to the causes of the continual growth of natural monopolies’ tariffs in the Russian Federation². They noted that the constantly increasing tariffs trigger price inflation which, in its turn, is a manifestation of the government’s inability to ensure macroeconomic stability in this country. It should be reminded that RF President Vladimir Putin set macroeconomic stability as one of priorities of the RF Government’s economic policy. The rising tariffs of natural monopolies may be regarded as a hidden form of capturing some additional amount of budget revenue (hidden taxes) – unauthorized by the RF Tax Code, – or an authorized form of mandatory payments (pseudo-taxes) collected for the benefit of those same monopolies. In any event, growth of tariffs is an evidence of a certain failure of the measures being implemented in order to ensure this country’s economic development.

The experts disagree with the statement that a systematic growth of tariffs at a rate of 13–15% per annum (which is twice as high as the inflation rate) is a necessary source for investment. According to the explanation offered by *Business Russia’s* Executive Director Nikolai Ostarkov, an investment component must not be included in the tariffs for electric energy or natural gas. Instead, the monopolists could have taken bank loans for the implementation of each of their projects. Given that they are regarded as “super-reliable” borrowers, the terms for such loans can be very tempting.

The situation can be explained in more detail. If an organization makes investments funded by its own profit, its costs are first charged to the value of its newly created fixed assets, and then by means of depreciation are written off as current costs. In this case, the periods and volumes of investments are determined by the state monopoly itself, and all its ineffective expenditures are automatically “swallowed” by its tariffs and covered from its customers’ pockets. If a loan is attracted for the purpose of creating a new fixed asset, the timelines for loan repayment are stipulated in the loan agreement, while the cost of its servicing (interest on the loan) can immediately be charged to current costs. In this case, the size of tariffs can be set at once for a long period, without their annual adjustment by 13–15%. In other words, experts are pointing it out that the introduction of market mechanisms (bank loans) in the sphere of tariff regulation can improve the efficiency of operation and transparency of expenditures of the existing natural monopolies, as well as stabilize the level of prices.

But evidently, the State needs some supplementary money for subsidizing the regions. This is the reason why the tariffs are rising. Tax payments can be introduced, altered or abolished only by law, and so, when they are actually eliminated (by way of introducing tax exemptions), the result is the increasing prices for the services rendered by state monopolies (that is, their tariffs). Con-

1 Federal Law of 2 October 2012, No 151-FZ “On the Execution of the 2011 Federal Budget”.

2 I, Naumov. *Zapadnym investoram potrebovalsia VIP-perevodchik. Dmitrii Medvedev ob”iasnit inostrantsam, pochemu pravitel’stvo ne ogranichilo appetity monopolii* [Western investors felt that they needed a VIP-level interpreter. Dmitry Medvedev will explain to the foreigners why the government had not restrained the appetites of monopolies]. See ng.ru, of 1 October 2012.

sequently, the introduction of tax exemptions undermines social stability in the country because, at present, the accelerated growth of the value of utilities (by comparison with the rate of market inflation) coupled with their inadequate quality represents one of the most painful social issues.

Experts' opinions differ also with regard to the issue of government borrowings.

Troika Dialog's head economist Evgeny Gavrilentov has noted the growing volume of government borrowings on the domestic market at 8% per annum, with later placement of that monies in the Reserve Fund at 1–2% per annum even in a situation of budget surplus. He explains that this policy reflects the government's lack of certainty in its ability to ensure stable growth of the ruble's exchange rate. If money is being withdrawn from the national economy by means of such a method, this effectively means capital outflow, according to Evgeny Gavrilentov. By giving preference to the USD, the government shows a bad example to the other market participants; besides, it disorients foreign investors, for whom the situation in Russia appears tricky and uncertain¹. We also believe that the government's current policy is compatible with financial logic – while ordinary logic, regrettably, cannot be applied in the field of finance.

By way of comparison, it is worthwhile to consider some other viewpoints. Chairman of the Management Board of the Institute of Contemporary Development Igor Yurgens, in contrast to Evgeny Gavrilentov's opinion, does not see any threats in the RF Ministry of Finance's preparedness to make debts in order to increase the size of the Reserve Fund². "The volume of Russia's foreign debt is negligible. It is profitable to borrow, given that money today is cheap on the world financial markets" – this is the opinion of Igor Nikolaev, Director of FBK's Strategic Analysis Department. He believes that the RF Ministry of Finance's position with regard to government guarantees is too harsh, noting that these guarantees can serve as an efficient instrument in the support of enterprises – without direct spending of budget resources. All these opinions share sound common sense: money must be taken while it is cheap. This tactic would have been correct if the government could also effectively invest it. But is there really any sense in borrowing money 'for storing' if capital is flowing out of Russia? In other words, there is no desire to invest market capital in those companies which, according to Igor Nikolaev, can be granted government guarantees for their development at the expense of cheap loans. Besides, we do not really understand the standpoint shared by some officials at the RF Ministry of Finance, who now interpret the fact of current capital outflow from Russia as a beneficial opportunity³ – where is the benefit? Is it really beneficial that the period of reevaluating Russian assets in the international market prices is over, and there are no businesses in this country in which the available capital could have been invested with a yield that can be estimated as good according to world standards?

The existing situation has been interpreted more frankly and honestly by RF Minister of Finance Anton Siluanov. A total of Rb 1.145 trillion was allocated in the 2013–2015 budget to the implementation of the presidential edicts issued last May. To cover this expenditure, the RF Ministry of Finance had, in addition to optimizing (i.e., cutting or delaying) its current expenditures, also to apply the so-called credit schemes, when the contractors fulfilling government orders receive, in lieu of direct budget funding, credits with guarantees of subsidies to cover the interest on those credits, and the actual payment from the budget under the contracts takes place at the moment of a contract's fulfillment, or with a delay. The payments are thus carried forward beyond the current three-year budget period – to the budget for 2016. 'We are adding to the liabilities of the next years', Siluanov remarked⁴.

So, the opinions concerning the suggested policy of borrowing vary greatly.

It seems altogether that at present Russia must not aggressively increase the scale of government borrowings. Our own viewpoint is as follows. The USA follows a policy of quantitative easing

1 Ibid.

2 I. Naumov. *Minfin meniaet starye dolgi na novye. Rossiya gotovit rynek goszaimstvovaniia dlia inostrannykh investirov* [The RF Ministry of Finance trades old debts for new ones. Russia is preparing a government borrowing market for foreign investors]. See ng.ru, 8 October 2012.

3 A. Bashkatova. *Samoopravdatel'noe nou-hau Minfina. Chinovniki nazvali stremitel'nyi ottok kapitala blagom dlia Rossii* [The RF Ministry of Finance's self-justifying know-how. Officials called the rapid capital outflow a benefaction for Russia]. See ng.ru, 15 October 2012.

4 O. Kuvshinova. *Dlia vypolneniia ukazov Putina Minfin "zalez v karman" budushchikh let* [In order to implement Putin's edicts, the RF Ministry of Finance has borrowed from the future]. See vedomosti.ru, 19 September 2012.

(the government provides funding for the buyout and withdrawal from the market of the “toxic assets” that arose as a result of large-scale housing mortgage loans issued by banks). In technical terms, this means buying up “bad” liabilities from market participants and paying with liquidity; but there is no implication that after the national economy’s revival these liabilities are not going to be presented to the debtors in order to capture the liquidity issued specifically for the purchase of those liabilities. The European Union, acting in this respect in unison with the USA, is also issuing currency for buying up bad debts (this, for example, is the method applied in order to provide Greece with liquidity – in exchange for Greece’s government bonds). This does not mean, however, that later on, when the crisis is finally over, these liabilities will not be presented to the debtors (to be bought back by Greece). We distinctly see that Western countries are pursuing a policy of easing in exchange for liabilities (suspension, temporary withdrawal from the market of bad debts, to be replaced by current liquidity). China will, most likely, also react in a certain way to the unconstrained quantitative easing of the world’s major currencies. China’s accumulated assets will be depreciating in US dollar and euro terms, while the yuan will be strengthening – which is unprofitable for an exporter. Under such conditions, surplus (and consequently, cheapness) of other countries’ is by no means the reason for the Russian government to urgently make debts only because it will be cheap to do so. On the contrary, it is not advisable for Russia to actively create convenient and profitable refuges for currency speculators across the globe by issuing her government bonds at 8% per annum (with the possibility to subsequently place them on the market at only 1–2% per annum), in addition issuing unlimited guarantees against the liabilities of state-owned corporations. It is probably not feasible, either, to raise competition on the market for domestic manufacturers by artificially boosting the price of foreign cheap liquidity at the government level and in the spheres related to the government. The existence of foreign cheap liquidity is indeed a real chance for speeding up the development of the domestic market economy in RF territory. It becomes especially relevant in such a situation to create comfortable conditions in Russia for doing business, and so the main goal for the government must be to avoid tying up the existing capital by investing in government liabilities at an effectively loss-making interest rate, thus pushing money away to the zones of intense business activity (which will be springing up around the world in the event of continuing quantitative easing of major currencies); instead, capital must be attracted into Russian territory. This can be achieved only through increasing this country’s investment attractiveness. It should be noted in this connection that no competitive production entities can be created by introducing tax exemption, because then businesses will be oriented towards distorted profitability parameters.

To borrow money in order to store it, or to support and thus maintain inefficient state-owned companies (including by means of granting government guarantees to them) will be a sure way to tumble into a ‘debt pit’. If the government really must keep one or other type of production, the only proper source for its funding will be taxes – the government’s own, non-refundable and annually replenished resources. But a tax base needs to be properly grown, and the only source for its formation are competitive production entities.

Another special note: we are strongly for Russia’s incorporation into the civilized financial and stock market, and that is why we are saying that a clear distinction must be made between simple human logic (that something should always be taken while it is offered or is cheap) and the logic of financial relations. It is contrary to the logic of financial relations to borrow money at an interest (even if the interest rate is very low), if its investment cannot yield an acceptable rate of return.

For several years already, draft budgets have been approved with a continually increasing debt. In 2011, the cost of government debt servicing markedly increased (by 27.0% on 2010), which can be explained by the increasing volume of domestic government borrowing over the period of economic crisis in 2009–2010¹.

In the resolutions of the RF Audit Chamber on the 2011 and 2012 draft budgets, the following data concerning the Russian Federation’s aggregate debt and the amount of debt outstanding can be found. The volume of aggregate foreign debt of the RF as of 1 July 2011 was \$ 538.6bn (28.3% of GDP), being by \$ 14.1bn (or by 2.7%) greater than that of RF international reserves (\$ 524.5bn);

1 Federal Law of 2 October 2012, No 151-FZ “On Execution of the 2011 Federal Budget”.

and when taken less the volumes of the Reserve Fund and National Welfare Fund – by \$ 133.3bn, or by 32.9%.

The value of the indicator of foreign debt stability – “ratio of payments against aggregate foreign debt to the volume of exports of goods and services” in Q1 2011 amounted, according to data released by the Bank of Russia, to 28%, which is by 3 pp. above the ceiling determined by the IMF for analytical purposes (25%).

Although the size of RF government debt is relatively small and does not exceed the IMF’s analytical parameters, it is increasing at an accelerated rate. The volume of RF government debt has increased from 11.8% of GDP in 2010 to 18% of GDP in 2013. Government debt will further increase mostly due to the growth of government domestic debt, whose share amounts to 79%. Budget allocations to cover the servicing of government domestic debt in 2013 will increase 2.5 times on 2010, to about 1% of GDP. The ceiling established for the budget liquidity index (10%) has been exceeded. This index describes the ratio of the cost of debt servicing and redemption to the size of federal budget revenue, which in 2013 will go above the level of 12%. An analysis of the structure of the sources of borrowing that formed government debt has revealed that about one-third of the monies attracted predominantly on the domestic financial market is earmarked for debt redemption, and the share of such allocations is also increasing: in 2011 – 22% of the total volume of borrowing money; in 2012 – 25.6%; and in 2013 – 29.3%.

Given that RF government debt displays an upward trend and that Russia’s aggregate debt exceeds her international reserves, the RF Audit Chamber has raised the question of introducing a number of alterations to the RF Budget Code, thus making it possible for the text of the Federal Law on the Federal Budget’s articles to reflect operations involving the sources of financing the federal budget deficit, the volumes of monies attracted to (or received by) the federal budget, the redemption of debt (the size of payments) from the federal budget, and the amounts by which federal budget residuals will be increased (or reduced)¹. We believe this issue to be worthy of consideration. It would be highly advisable to provide legislative substantiation for the dependence between budget revenue and the established ceiling for the size of government borrowing, for example by applying for this purpose the budget liquidity index².

It should be reminded that part of government debt represented as guarantees against loans has already been carried forward beyond the timelines of the 2013 budget and the planning period 2014–2015, as has been explained by Anton Siluanov. This means that the amount of the government’s own, non-refundable, renewable revenue (generated only by taxes) needed for implementing its current financial policy will be continually declining every year – in view of the accelerated growth of government debt and the debts of state-owned corporations (represented by government guarantees granted to them), because that revenue is already “bound” against the government’s future liabilities. The ceiling on government debt is established by the federal law on the federal budget for a corresponding planning period, but its parameters are sufficiently flexible.

In our opinion, any further obligations relating to government debt can only be assumed with due regard for the budget liquidity ceiling (the level recommended by the IMF is 10%), which must be established by the RF Budget Code. Besides, it must be legislatively established that the size of expenditure allocated to annual government debt servicing in the periods beyond the 3-year budget period (including the 2-year planning period), must not exceed, say, one-third of the cost of government debt servicing entered in the budget for a current financial year.

Among the normative documents and explanatory notes issued over the period under consideration, we should like to note the following ones.

1. By Federal Law of 2 October 2012, No 161-FZ “On Introducing Alterations in Part Two of the Tax Code of the Russian Federation, and Recognizing As Null and Void Some Provisions of the Legislative Acts of the Russian Federation”, alterations are introduced to the RF Tax Code concerning tax exemptions for agricultural producers. In particular, a VAT rate of 10% is established for the proceeds from sale of purebred. Grants and subsidies from budgets allotted to heads of peasant (or farmer) households are exempt from personal income tax. A zero rate of profits tax

1 The RF Audit Chamber’s resolutions on the 2012–2014 draft budget, Point 12.5, Paragraph 11.

2 It describes the ratio of the cost of debt servicing and redemption to the size of federal budget revenue.

is established for an indefinite period of time for agricultural producers (including fisheries), to be levied on operations relating to sale of their own agricultural products or to processing of their own agricultural products. Consumer cooperative organizations whose personnel number exceeds 100 are granted the right to apply the single agricultural tax (SAT).

2. Federal Law of 2 October 2012, No 162-FZ “On Introducing Alterations to Articles 251 and 294 of Part Two of the Tax Code of the Russian Federation” granted exemption from profits tax to insurer associations in regard of their monies accumulated in their compensation funds created under agricultural insurance agreements that are subject to government support in accordance with Federal Law of 25 July 2011, No 260-FZ ‘On Government Support in the Sphere of Agricultural Insurance, and on the Introduction of Alterations to the Federal Law “On the Development of Agriculture”’. The mechanism for supporting the insurers providing insurance to agricultural producers is, to a certain extent, based on the same principles as the system for insuring bank deposits, and so this tax exemption cannot be considered a typical tax benefit. The losses of organizations – agricultural producers are covered by a joint insurer fund which, by accumulating the contributions of insurers, consolidates the relevant profits and losses within the limits of the amounts transferred to the fund by each insurer. It is somewhat similar to the system for insuring bank deposits in that the fund pays for the losses incurred by an agricultural producer as a result of the destruction or damage to crops, perennial plantations or livestock in the event when the insurance compensation cannot be paid by the insurer with whom a relevant insurance agreement has been made – for example, if the latter goes bankrupt. Given the existence of a compensation mechanism for agricultural producers established by this Federal Law, the granting of direct tax exemptions to agricultural producers, in accordance with Federal Law of 2 October 2012, No 161-FZ, appears to be superfluous. ●

REVIEW OF THE ECONOMIC LEGISLATION

I.Tolmacheva

In October, the following amendments were introduced into the legislation: amendments were made to protect people's rights to privatization of housing in which they do not live, but have the right to use it; norms permitting to increase wages and salaries of managers of federal government and budget entities have been adopted; in 2013 people in Russia will have 10-day long New Year holidays, 5-day long Spring and Labor celebrations and 4-day long Victory Day celebrations.

I. Federal Laws of the Russian Federation

1. Federal law No. 170-FZ of October 16, 2012 ON AMENDMENT OF ARTICLE 2 AND ARTICLE 11 OF THE LAW OF THE RUSSIAN FEDERATION ON PRIVATIZATION OF THE HOUSING FUND IN THE RUSSIAN FEDERATION

The above amendments are aimed at protection of people's rights to privatization of housing in which they do not live but have the right to use it. In particular, the wording of Article 2 (1) of the Law of the Russian Federation on Privatization of the Housing Fund in the Russian Federation was changed. It was established that citizens of the Russian Federation "who have the right to use the specified housing" and do not "occupy" it as it was envisaged earlier are now entitled to acquire in ownership housing of the state or municipal housing fund. It is to be noted that a consent to privatization must be given by all the adults "who have the right to privatization of that housing", as well as minors at the age of 14–18 years old.

II. Resolutions of the Government of the Russian Federation

1. Resolution No. 975 of September 26, 2012 on AMENDMENT OF RESOLUTION NO.583 OF AUGUST 5, 2008 OF THE GOVERNMENT OF THE RUSSIAN FEDERATION

From January 1, 2013, new legal norms permitting to increase wages and salaries of managers of federal government and budget entities will come into effect.

In accordance with amendments introduced into the Statute on Establishment of the System of Labor Remuneration of Workers of Federal Budget and Government Entities approved by Resolution No. 583 of August 5, 2008 of the Government of the Russian Federation, the ultimate level of the ratio between the average pay of managers of entities and that of their workers will be set at 1 to 8 by a federal state authority which carries out functions and powers of the founder of the respective entities (at present that ratio is set at 1 to 5). It is to be noted that the ultimate level of the ratio between the average pay of the manager and that of workers of that entity can be increased within the specified frameworks by decision of a federal state authority which is the main administrator of the federal budget funds and is in charge of the entity. As regards entities whose functions and authorities are exercised by the Government of the Russian Federation, the ultimate level of the ratio between the average pay of the manager of the entity and that of workers is set by the Government of the Russian Federation or a federal executive body authorized by the Government of the Russian Federation.

As an indicator of efficiency of the work of the manager of the entity, by decision of the main administrator of federal budget funds an increase in the average pay of the entity's workers can be set in the reporting year on the previous year without taking into account a pay increase in accordance with decisions of the Government of the Russian Federation. It is specified that federal government and budget entities should develop indicators and criteria of evaluation of efficiency of work of their employees and the above indicators and criteria are to be taken into account in making of motivation payments.

2. Resolution No. 1048 of October 15, 2012 on TRANSFER OF HOLIDAYS IN 2013 In accordance with Article 112 of the Labor Code of the Russian Federation, the Government of the Russian

Federation has the right to transfer holidays onto other days for the purpose of rational use by workers of holidays and non-working days. The following holidays will be transferred:

- From Saturday (January 5) to Thursday (May 2);
- From Sunday (January 6) to Friday (May 3);
- From Monday (February 25) to Friday (May 10).

Thus, winter holidays will last for 10 days from December 30, 2012 till January 8, 2013 (with taking into account the transfer of holidays in 2012). In May 2013, there will be five-day holidays falling in the Spring and Labor celebrations and four-day holidays falling in the Victory Day celebrations. ●

CHANGES IN THE REGULATORY BASE OF THE BUDGETARY PROCESS

M. Goldin

In October 2012, the following changes were introduced in the regulatory base of the budgetary process: some provisions of the Budget Code of the Russian Federation have been suspended as regards limitation of the period of introduction of amendments to the legislation on taxes and duties and the legislation which regulates budget legal relations which results in changes in revenues of budgets of the budgetary system of the Russian Federation; veterans of combat operations are made entitled to receive a lump-sum cash payment for building or buying of housing; amendments which make housing privatization rules simpler for certain categories of people have been approved.

Federal Law No. 175-FZ of October 16, 2012 on Suspension of Individual Provisions of the Budget Code of the Russian Federation suspends till January 1, 2013 individual provisions of the Budget Code of the Russian Federation as regards limitation of the period within which amendments can be introduced to the legislation on taxes and duties and the legislation which regulates budget legal relations which results in changes in revenues of budgets of the budgetary system of the Russian Federation.

It is to be reminded that according to Article 53 (2) of the Budget Code of the Russian Federation federal laws on amendment of the legislation of the Russian Federation and federal laws regulating budget legal relations which result in changes in revenues of budgets of the budgetary system of the Russian Federation and coming into effect in the next financial year and the planned period are to be approved within a month from the date a draft federal law on the federal budget in the next financial year and the planned period is submitted to the State Duma. Similar rules are envisaged for lower levels of the budgetary system of the Russian Federation.

In addition to the above, according to Article 174 (2)¹ of the Budget Code of the Russian Federation it is required that such federal laws providing for amendment of the RF legislation on taxes and duties as were approved after the date the draft federal law on the federal budget in the next financial year and the planned period was submitted to the State Duma and resulting in changes in revenues (expenditures) of budgets of the budgetary system of the RF should include provisions specifying that the above federal laws come into effect not earlier than January 1 of the year following the latest financial year.

The above provisions of the Budget Code of the Russian Federation are aimed at upgrading predictability of the budget policy and stability of the budget system. However, in practice both before and after submission of a draft federal law on the budget to the State Duma a large number of federal laws is approved with effective dates set before January 1 following the latest financial year. So, for securing the principles of stability and predictability of the budgetary process it is vitally important to take decisions quickly in allocation of budgetary funds and it was for those reasons the above amendments were developed and approved.

By **Federal Law No. 169-FZ of October 16, 2012** on Amendment of Article 23.2 of the Federal Law on Veterans, veterans of combat operations are made entitled to receive a lump-sum cash payment for building or buying of housing.

Federal Law No. 169-FZ was approved for the purpose of implementation of Cl.6 of Instructions No. VP-P12-595 of January 31, 2011 of V.V. Putin, Premier of the Government of the Russian Federation. The above instructions were issued on the basis of the results of the meeting with representatives of veteran public organizations held on January 19, 2011.

So, in accordance with Article 23.2 (3.2) of the Federal Law on Veterans from October 27, 2012 veterans of combat operations and persons made equal to them who are in need of better housing conditions and were registered prior to January 1, 2005 are entitled to receive a lump-sum cash payment for building or buying housing whose size is determined on the basis of the total floor area of 18 sq. meters and average market price of a sq. meter of housing (prevailing in the respective

constituent entity of the Russian Federation) set by monthly Orders of the Ministry of Regional Development of the Russian Federation.

By **Federal Law No. 170-FZ of October 16, 2012** on Amendment of Article 2 and Article 11 of the Law of the Russian Federation on Privatization of the Housing Fund of the Russian Federation, amendments which make privatization of housing simpler for persons who are entitled to it have been approved.

According to Article 2 (1) of RF Law No. 1541-1 of July 4, 1991 on Privatization of the Housing Fund of the Russian Federation, in a wording which was in effect before Federal Law No.170-FZ of October 16, 2012 was approved persons who occupied housing on the basis of a social hiring agreement had to secure consent to privatization of that housing from all the adult-members of their family and minors at the age of 14–18 years old living together with them in order to privatize that housing. According to the RF Law on Privatization of the Housing Fund in the Russian Federation as amended, persons who have the right to use housing but are not entitled to privatize it are excluded from the number of persons whose consent to privatization is to be secured from.

In addition to the above, the former wording of Article 2 (1) of the RF Law on Privatization of the Housing Fund in the Russian Federation unreasonably excluded absent hires from the number of persons who were entitled to privatization.

Though according to Article 7 of the RF Law on Privatization of the Housing Fund in the Russian Federation, a similar situation was resolved in a different way. The above article established long ago the right to privatization of housing by minors who did not lose the right to use that housing though they lived separately from persons whom that housing was assigned to in joint ownership with minors.

In addition to the above, indirect equal right of adults and minors to privatization of housing is envisaged by Article 71 of the Housing Code of the Russian Federation: temporary absence of the hirer of the housing under the social hiring agreement, his/her family members living together with him/her or all the above people together does not involve a change in their rights and obligations under the social hiring agreement. ●